STATE BANK OF PAKISTAN

ANNUAL PERFORMANCE REVIEW

2003 - 2004

Our Vision	Our Mission
To transform SBP into a modern and dynamic central bank, highly professional and efficient, fully equipped to play a meaningful role, on sustainable basis, in the economic and social development of Pakistan.	To promote monetary and financial stability and foster a sound and dynamic financial system, so as to achieve sustained and equitable economic growth and prosperity in Pakistan.

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Governor's Message

In the fiscal year under review, the State Bank of Pakistan (SBP) continued to pursue the strategic direction it set for itself in the year 2000. The major thrust of our strategic direction is the promotion of competition and deepening of the financial sector while broadening its coverage to include the middle and lower income groups of the population. The impact of this broad based access to institutional credit on the economy will be both direct as well as indirect. By diversifying the client base from a narrow focus on government, corporate and foreign trade financing to a larger spectrum of financial services extending to consumer finance, small and medium enterprises (SMEs), agriculture, housing, construction and microfinance, the banking system will be able to manage its risks more prudently. The stimulus to aggregate demand through private sector credit expansion in a large number of economic sectors and activities will result in higher production, employment and growth. Indirectly the income distribution, which has worsened in the last decade, will also improve. The financial system will be more stable and resilient to weather adverse shocks.

Although a beginning has been made, the process of broadening the base will be evolutionary and gradual. As banks develop systems, procedures and controls, up-grade their technology and train their staff, a more aggressive foray into this new business area is likely to remain fraught with serious consequences for both the lenders and the borrowers. Pursuing a steady path through which the banks gain experience and build upon those experiences will minimize risks.

Volume II of SBP's Annual Performance Review revisits the central bank's strategic priorities, which include:

a) Ensuring soundness of the financial sector.
b) Maintaining price stability with growth.
c) Prudent management of the exchange rate.
d) Strengthening of the payment system.

I would like to highlight some of the new developments that have taken place in each of the four areas of strategic importance during the year under review. Our first and foremost responsibility is ensuring the soundness of the banking sector, whose assets account for an overwhelming majority of assets in the financial sector of the country. There was an improvement in the performance of the banking sector during the year under review, and most banks recorded an increase in their profitability. After tax profits for the half-year ending June 2004 came to Rs12.8 billion with a return on assets of 1.0 percent and return on equity of 18.3 percent. This has been possible as intermediation cost came down to 2.7 percent in June 2004. All commercial banks, with the exception of three, have met their minimum capital requirements of Rs1 billion. Risk-weighted capital adequacy ratio (CAR) of commercial banks was 10.9 percent and banks accounting for 45 percent of assets had a CAR exceeding 10 percent.

New Prudential Regulations for corporate, consumer and SME sectors were issued this year, which have been favorably received by the stakeholders. Banks have been asked to train their staff in consumer and SME credit appraisal and their follow-up techniques. The stock of gross Non-Performing Loans (NPLs) of banks has been brought down to Rs208 billion by June 2004 compared to Rs232 billion in December 2002. Net NPLs to Net Loans ratio of all banks has come down to 5.3 percent and that of commercial banks to just 3.8 percent.

As part of raising awareness of Corporate Governance among interested parties, members of the boards and senior management of commercial banks were invited to attend the Conference on Corporate Governance so that they are familiarized with their responsibilities and roles. A handbook on Corporate Governance was also widely circulated. Furthermore, risk management guidelines have been issued to the banks to prepare them for Basel II Accord and training of bankers in Risk Management has been initiated. To supplement these efforts "Guidelines on Internal Controls" have been issued, which will help the banks in structuring, running and reporting on their internal control systems.

Islamic banking has made further strides this year. A Shariah Board, consisting of eminent persons in the field, was established to advise the SBP on its Islamic banking functions. So far, five commercial banks have established ten stand-alone branches for Islamic banking in addition to eleven branches of one full-fledged Islamic Bank.

Microfinance Institutions (MFIs) have expanded their outreach to more than 134,000 borrowers and their network has increased to 60 branches distributed all over the country.

Derivatives have been introduced in the financial market to manage risk and for providing hedging solutions. The issuance of 15 and 20 year Pakistan Investment Bonds (PIBs) by the Government of Pakistan has elongated the maturity spectrum to establish a benchmark for corporate yield curves. These issuances are mainly aimed at mobilizing long-term funding to match mortgage loans and infrastructure financing.

Maintaining price stability with growth is another area of strategic importance for the SBP. This objective is achieved through the conduct of monetary policy to keep inflation at the minimum level possible without adversely affecting the growth potential of the economy. During the year under review, the continued drop in lending rates caused by an easy monetary policy and improvements in macroeconomic fundamentals accelerated capacity utilization in the manufacturing sector, which led to the higher aggregate growth rate achieved this year. Unlike the previous year, when large foreign exchange inflows put pressure on the money supply as well as the exchange rate, this year an exceptional expansion in private sector credit was the source of the above target increase in broad money. To keep the public-at-large and markets in particular informed about its monetary policy stance during the year, the SBP issued its third and fourth Monetary Policy Statements.

The lending rate was brought down further from 7.58 percent in June 2003 to 5.05 percent by June 2004 – a drop of more than 250 basis points over and above the 500 basis points drop in the fiscal year 2003 (FY03). The spread between deposit and lending rates has also been narrowed from 568 basis points to 384 basis points this year, showing a marked improvement in the intermediation efficiency of banks.

Consequently, credit to the private sector has expanded by Rs325 billion up to end June 2004 compared to the expansion of Rs167.7 billion in the corresponding period last year. However, net disbursements from July 2003 to end June 2004 shot up by 93.9 percent compared to the same period in FY03. SBP's efforts to bring agriculture lending into the mainstream of the portfolio of commercial banks have met with success. Commercial banks have overtaken the Zarai Taraqiati Bank Limited (ZTBL) in disbursement of agriculture credit this year and have surpassed their targets by a wide margin. The agriculture credit disbursement this year reached Rs73.5 billion - up 25 percent from Rs58.9 billion last year.

Prudent management of the exchange rate and foreign exchange reserves management is our third area of responsibility. During the year under review, the Balance of Payments (BoP) continued to show modest surplus but the magnitude is much smaller as compared to the previous year. A fall in the current account has resulted due to moderation in remittances, acceleration in imports and the termination of the Saudi Oil Facility besides higher oil prices. Fortunately, import growth was driven principally by the increase in inflow of machinery, transport equipment and industrial raw materials. Capital account deficit was much higher this year due to pre-payment of expensive debt (partially offset by the Eurobond issuance) and lower inflows of external official assistance.

The exchange rate during the period under review has depreciated by 0.6 percent from Rs57.81/US$ at the end of June 2003 to Rs58.16/US$ at end June 2004. This is a direct consequence of the demand for foreign exchange outstripping supply in the last quarter of this fiscal year but in a certain way it is beneficial for our exporters who are able to retain their competitiveness against other countries. However, SBP's fight against inflation will receive a setback if the trend of the depreciating rupee continues unabated.

The pace of reserve accumulation this year was slower as compared to the previous year; total reserves stood at US$12.3 billion at the end of June 2004 compared to US$10.7 billion last year. SBP's net reserves for the year stood at US$10.5 billion. The SBP has allocated US$3.2 billion out of its reserves to nine international investment fund managers and agreed on a benchmark rate of return, which is higher than what we are getting through placement with banks. The remaining amount will be managed in-house but risk parameters have been laid down for placing the funds.

An efficient and well functioning payment system is necessary for reducing systemic and operational risks, lowering transaction costs and promoting stability in the financial system. To make the payments system more efficient and robust, the SBP has been working on the design and implementation of the Real Time Gross Settlement (RTGS) system. This system will automate the current manual inter-bank settlement process of large value payments at the SBP.

Another development in the payment system this year has been the achievement of interconnectivity between the two Automated Teller Machine (ATM) Switches (1-Link and M-net). ATM users now have the convenience of operating their accounts from a countrywide network.

To make the achievement of its strategic priorities and objectives sustainable, SBP's management strategy continued to focus on:

a) Information technology and infrastructure development
b) Human resource development
c) Improved accountability

In recent years, the SBP has enhanced its focus on operational efficiency and its information management capabilities. Realizing the gains to be made through streamlined procedures and the analysis of the knowledge base available to it, the SBP made further strides in the implementation of the project to leverage Information Technology (IT). This technology up-gradation project initiated in December 2000 with the assistance of the World Bank's Financial Sector Deepening and Intermediation Project and continued under the Technical Assistance for Banking Sector (TABS) program, again sponsored by the World Bank, is expected to be completed by September 2005.

Human resources are without any doubt, the most important asset of any organization. The SBP is well aware of the importance of human capital for its development and has been pursuing a policy to attract and retain qualified and experienced professionals. The SBP recruited 175 new staff members this year including 68 Officers under the State Bank Officials Training Scheme (SBOTS) and 20 Officers as Research Analysts. To promote diversity within the organization and to encourage greater participation of educated females in economic activity, a special recruitment process was conducted for SBOTS, in which 97 female candidates passed the tests and interviews. Of these, 24 were recruited by the SBP, 24 by the SBP Banking Services Corporation (SBP BSC) and 30 by the First Women Bank.

The greater level of autonomy attained by the SBP in recent years has been accompanied by greater accountability for results. The SBP is fully aware of its responsibilities in this regard and considers accountability and transparency as essential components of its mandate. The SBP is accountable to the general public through their elected representatives in parliament and has made considerable efforts to increase disclosure of information on its activities in the form of various reports and publications. This will help in keeping all stakeholders well informed on key policy decisions and actions. The SBP is also striving to achieve high standards of accountability within the organization. The system of internal checks and balances within the SBP has been improved and made more comprehensive.

Most of the reform initiatives undertaken since 2000 under the Capacity Building Program are due for completion in December 2004. These change initiatives include a consolidation of the SBP functions, delegation of authority, human resource development, technological up-gradation, business process re-engineering and improvement in the physical environment. The most immediate task is, therefore, to formulate a "successor" program to the last initiative and ensure that the strategic planning process becomes embedded into the regular planning cycle at the SBP. To facilitate this, a Strategic Planning Unit (SPU) has been set up in the SBP earlier this year. The purpose of the SPU is to develop a strategic planning framework for the SBP and formulate the five-year plans in coordination with various departments of the SBP.

The SBP has come a long way since the Change Management and Capacity Building Programs were initiated in 2000. However, the process of transformation is an ongoing one and the SBP has yet to cross many milestones on its journey towards a more proactive, dynamic and responsive central bank. The Board and senior management of the SBP is firmly committed to the change process and is striving for excellence in all areas of strategic importance.

In the end, I wish to thank all our staff members whose hard work, commitment and devotion have made the change process a success. I also look forward to their continued support for meeting the challenges that lie ahead for us.

Ishrat Husain
Governor

Strategic Objectives of the SBP

1. **Ensuring Soundness of the Financial Sector**
2. **Maintaining Price Stability with Growth**
3. **Prudent Management of the Exchange Rate**
4. **Strengthening of the Payment System**

1 Ensuring Soundness of the Financial Sector

1.1 Overview

One of the fundamental responsibilities of the State Bank Pakistan (SBP) is regulation and supervision of the financial system to ensure its soundness and stability as well as to protect the interest of depositors. The financial sector in Pakistan comprises Banks, Development Finance Institutions (DFIs), Microfinance Institutions (MFIs), Non-Bank Finance Companies (NBFCs) and Insurance Companies. Under the prevalent legislative structure, commercial banks, Islamic banks, DFIs, and MFIs fall within the ambit of the SBP while the rest of the financial institutions are monitored by the Securities and Exchange Commission of Pakistan (SECP). At present 40 scheduled banks (including 2 Islamic banks), 6 DFIs, and 2 MFIs are operating in Pakistan.

The overall health of the banking sector during Fiscal Year 2004 (FY04) has improved further and except for a few banks, all other banks have performed well and increased their profitability. The enhanced minimum capital requirements have helped in weeding out weak institutions leading to mergers, acquisitions and consolidation. Stringent enforcement of the good governance code has forced changes in ownership and management of banks operated by individuals and groups who did not fulfill the 'Fit and Proper' criterion. Adoption of technology platforms for banking services has improved the service provided to customers. All these reforms have resulted in fierce but healthy competition in the financial sector.

After-tax profits have risen to Rs25.1 billion with a return on assets of 1.1 percent in 2003. This has been possible as intermediation costs came down to 2.7 percent in 2003. The trend has continued this year as well, as after-tax profits of Rs12.8 billion have been reported from January till June 2004, showing a return on assets of 1 percent. There have been several mergers and acquisitions, which have reduced the number of financial institutions in the country. All the commercial banks, except three, have met their minimum capital requirements of Rs1 billion. Risk-weighted Capital Adequacy Ratio (CAR) of commercial banks was 10.9 percent and banks accounting for 45 percent of assets had a CAR exceeding 10 percent. The total equity of all commercial banks has increased from Rs141 billion in June 2003 to Rs153 billion as of June 2004. There is some concern about the banks that have large exposure to equity markets or to Pakistan Investment Bonds (PIBs) and the SBP is taking both regulatory actions as well as using moral suasion to get the banks to realign their portfolios.

The SBP has not only increased its interaction with banks and DFIs but has also strengthened its coordination with other regulators. The SBP officials now meet more frequently with the board of directors and the senior management of banks and DFIs to apprise them of the regulatory concerns that the SBP has about the condition of their bank. To achieve the objective of consolidated supervision, the SBP has also increased coordination with other regulators on a more formal basis. A Memorandum of Understanding (MoU) has been signed between the SECP and the SBP for increased cooperation in respect of information and skill sharing. Similar MoUs are also being signed with supervisors from central banks of other countries. The SBP is working closely with different professional bodies like the Institute of Chartered Accountants of Pakistan (ICAP) regarding implementation issues of International Accounting Standards (IAS) 39 and 40, and the Basel Capital Accord II.

All the Chief Executives of banks and DFIs have been asked to exercise prudence and caution in the new areas of lending. They have been advised to embark upon consumer financing only when they are fully equipped with technology, internal controls and the required skilled manpower. The SBP is keeping a vigilant eye on this product class and has directed the banks to create a general reserve on their consumer portfolio, to protect them from risks associated with this business.

1.2 Banking Supervision Structure of the SBP

The health of an economy depends on the degree of safety and stability of its financial system. A sound, stable and robust financial system is a pre-requisite for economic well being of a country and its populace. In Pakistan, ensuring the stability and soundness of the banking system is a statutory responsibility of the SBP. The banking supervision departments which include Banking Policy Department (BPD), Banking Supervision Department (BSD), Banking Inspection Department (BID) and Islamic Banking Department (IBD) work jointly to ensure the soundness of individual banks and of the overall banking industry.

The BPD formulates policies and regulatory framework. The BID conducts on-site inspection of banks and DFIs to assess their financial health, risks assumed and compliance with policies and regulatory framework. The BSD ensures effective enforcement of regulatory and supervisory policies, monitors risk profiles and evaluates financial soundness of individual banks and DFIs as well as the banking industry as a whole, while issuing guidelines for managing various types of risks. It also ensures that banks and DFIs are adequately capitalized and have policies and systems in place to assess various risks. The department is also responsible for regulation and supervision of MFIs to ensure their soundness and stability and also to promote growth in these financial institutions. The IBD is working for regulation and promotion of Islamic banking.

1.3 Privatization of Banks

The SBP has been actively involved in the restructuring of the banking sector. The main focus of the restructuring efforts has been to privatize Nationalized Commercial Banks (NCBs) besides enhancing their competitive efficiency. During the current year (July 2003 - June 2004), the privatization of 51 percent shares of Habib Bank Limited (HBL) was completed on February 26, 2004 with the signing of the share purchase agreement between the successful bidder, Aga Khan Fund for Economic Development (AKFED), the Privatization Commission and the SBP. AKFED offered the highest bid of Rs22.41 billion for 51 percent shares of HBL. The SBP, being the regulator of the banking sector in Pakistan, rendered its professional advice to the Privatization Commission in the whole process of privatization.

The SBP also initiated the process of reconstruction of Allied Bank Limited (ABL) and transfer of its management to a strategic investor under Section 47 of the Banking Companies Ordinance, 1962. Expressions of Interest (EoIs) were invited from banks and financial institutions. Twelve parties expressed their interest in acquiring the additional shares of ABL. Subsequently, the seven parties which were allowed to carry out due diligence, submitted their Statement of Qualifications (SoQs). Of these, five parties took part in the bidding process on July 23, 2004. As a result of a competitive open bidding, the consortium of Ibrahim Leasing Limited and Ibrahim Group gave the highest bid of Rs14.20 billion. This amount has raised the capital of ABL as well as increased the CAR of the bank to around 20 percent, as against the minimum requirement of 8 percent of risk weighted assets. The management of ABL was transferred to the successful bidder on August 20, 2004.

Keeping in view the larger interest of passing the benefits of privatization to the general public and broadening domestic capital markets, 3.2 percent shares of National Bank of Pakistan (NBP) owned by the Government of Pakistan (GoP) were offered to the general public on best effort basis on October 6, 2003. Pursuant to the above decisions, the GoP has already successfully offloaded 23.2 percent shares of NBP through local stock exchanges.

Box 1.1: Mergers and Acquisitions

The SBP has repeatedly emphasized the need for well-capitalized Financial Institutions to increase their capability to cope with the challenges of the changing scenario and to enhance competitive efficiency of the domestic banks. To achieve this objective, the SBP has been actively involved in processing the cases of mergers/acquisitions of financial institutions. During the period under review six cases of mergers/acquisitions were processed including the following:

a) Merger of Mashreqbank psc and Crescent Investment Bank into Mashreq Bank Pakistan Limited (later renamed as Crescent Commercial Bank Limited).
b) Merger of National Development Leasing Corporation (NDLC) and International Finance Investment and Commerce (IFIC) Bank with and into NDLC-IFIC Bank Limited (NIB).
c) Merger of KASB Leasing with KASB Bank Limited.
d) Merger of Bank of Ceylon-Pakistan Operations with and into Dawood Bank Limited.
e) Merger of Credit Agricole Indosuez (Pakistan operations) with NDLC-IFIC Bank Limited (NIB).
f) Merger of Trust Investment Bank Limited, Fidelity Investment Bank Limited, and Doha Bank with and into Trust Commercial Bank Limited.

Source: Banking Policy Department, SBP

1.4 Developments in Banking Sector Regulations and Supervision

The focus of the supervisory efforts by the SBP is on the health and stability of the banking system in Pakistan. The noteworthy developments that took place during the year in the banking sector regulations and supervision were:

1.4.1 Prudential Regulations

The Prudential Regulations have been in place for quite sometime now, providing prudential guidelines to banks regarding matters relating to credit extension, money laundering, corporate governance and various operational issues. This fiscal year the Prudential Regulations have been thoroughly reviewed and issued for banks/DFIs. The new Prudential Regulations now cover three broad areas viz. Corporate and Commercial Banking, SME Financing and Consumer Financing, so that the banks and DFIs are provided specific guidelines on the respective areas while undertaking business activities in corporate and commercial banking, consumer financing, and Small and Medium Enterprise (SME) financing. The regulations on consumer financing cover financial instruments on offer in auto finance, personal loans, housing finance and credit cards. Banks have been asked to train their staff in consumer and SME credit appraisal and follow-up techniques. Further, Urdu language versions of Prudential Regulations for Corporate/ Commercial Banks, Consumer Finance and SME Financing have been issued for the convenience of the general public. Moreover, Prudential Regulations for Microfinance were issued during the last fiscal year.

This fiscal year, the SBP issued guidelines and regulations for banks and DFIs governing the establishment of subsidiaries including Brokerage Houses, dealing in commercial paper and extending margin financing to brokers.

Box 1.2: Branch Licensing and Automated Teller Machines (ATMs)

In order to further liberalize the Branch Licensing Policy, the SBP issued a comprehensive circular providing banks greater independence regarding opening/shifting and closing of their branches. Further, banks have been allowed to install ATMs within branch (on-site) premises as well as at off-site places for deposit of cash/cheque(s) and withdrawal of cash.

Source: Banking Policy Department, SBP

1.4.2 Improving Quality of Banking Assets

The rapid transformation of a predominantly nationalized state-owned banking system into a private sector owned and managed system has brought about a fundamental change in the ground rules governing the allocation of credit. The approval and disbursement of loans based purely on political considerations has given way to rigorous credit and risk appraisal and improved the quality of new loans. Market based determination of lending and deposit rates, in place of the arbitrarily administered rates, has spurred prudent risk management by banks. Due to the proactive supervision by the SBP, the quality of new loans has improved considerably. Nearly 5.3 percent of net loans in the banking system are now classified as non-performing.

Table 1.1: Net NPLs to Net Loans of the Banking System

Percent

Global Operations	CY01	CY02	CY03	Jun-04
Public Sector Commercial Banks	13.1	12.8	8.1	5.7
Local Private Banks	10.4	7.0	4.5	3.9
Foreign Banks	1.1	1.1	0.7	0.0
Commercial Banks	**10.3**	**8.3**	**5.3**	**3.8**
Specialized Banks	31.5	28.5	33.0	33.4
All	**12.1**	**9.9**	**6.9**	**5.3**

CY: Calendar Year
Source: Banking Supervision Department, SBP

Box 1.3: SBP Guidelines on Write-Off of Irrecoverable Loans and Advances

To clean up the large volume of old stuck-up loans from the books of banks/DFIs while providing an opportunity to defaulters to settle their long outstanding liabilities on flexible terms, SBP issued new guidelines on write-off of irrecoverable loans and advances vide BPD Circular No. 29 of 2002. In order to encourage the borrowers/ defaulters to come forward and clear their liabilities at the earliest, in December 2003 the SBP allowed the banks/DFIs to provide incentive to the eligible borrowers who were willing to immediately repay the full settlement amount in lump sum, keeping in mind the net present value of future repayments.

By end September 2004, the banks/DFIs had received a total of 51,337 applications representing an outstanding amount of Rs99.81 billion. The banks/DFIs have also settled 49,669 cases involving outstanding amount of Rs52.56 billion. The banks/DFIs have recovered cash amount of Rs6.12 billion in terms of down payments/quarterly installments. In addition, the SBP Committee has also settled/resolved 467 cases/disputes under the scheme.

Source: Banking Policy Department, SBP

1.4.3 Strengthening of Microfinance Supervisory Capacity

The SBP has entered into a partnership with the Swiss Agency for Development and Cooperation (SDC) whereby it is receiving technical assistance for building and enhancing its capacity to effectively regulate and supervise licensed MFIs. The partnership was initiated in August 2003 and has three major components:

SBP Skill Enhancement and Enrichment in Microfinance

The primary objective of this project component is to build and enrich skill level and capacity of the SBP to effectively play its role as a regulator and supervisor of MFIs. A Microfinance Resource Pool comprising of 25 officers of banking departments has been created and is imparted training under this project.

Development of an On-Site Inspection Manual

The SBP conducts periodic on-site examination of licensed MFIs to assess the systems and controls in place, the risks taken and coverage thereof by the MFIs. In order to bring standardization and objectivity in the on-site inspection process and to facilitate the inspecting officers, a comprehensive on-site examination manual containing detailed guidelines for reviewing all areas of activities of MFIs will be developed.

Development of Off-Site Monitoring System

The basic objective of off-site surveillance is to continuously monitor the operating and financial health of MFIs, identify early warning signals for taking timely corrective actions to safeguard the interest of the MFIs depositors. An effective off-site monitoring system for MFIs will therefore be developed under the proposed technical assistance.

1.4.4 Institutional Risk Assessment Framework

The rapid advancement in Information Technology, together with growing complexities of modern banking operations, has made the supervisory role more difficult and challenging. The institutional complexity is increasing, technical sophistication is improving and technical base of banking activities is expanding. Accordingly, the SBP has adopted new inspection and surveillance techniques for better supervision of the financial institutions. Banking activities are now being monitored through a system of 'off-site' surveillance and 'on-site' inspection. During recent years, the SBP has shifted from 'compliance oriented' system of supervision to more 'risk focused' approach through the adoption of the CAMELS-S framework (gauges the Capital adequacy, Asset quality, Management soundness, Earnings and profitability, Liquidity, Sensitivity to market risk and System and controls) in its on-site reviews of banks and DFIs. This is supplemented by the recently introduced Institutional Risk Assessment Framework (IRAF) and CAELS framework (gauges the Capital adequacy, Asset quality, Earnings and profitability, Liquidity and Sensitivity to market risk) for off-site surveillance, and further augmented by "stress-testing and scenario analysis".

The off-site surveillance system and the on-site inspection functions work closely to portray a legitimate and true financial condition of a bank. As a result of this close coordination, bank ratings reflect more accurately the true financial condition of a bank and the banking system as a whole. The new institutional risk assessment framework provides continuous monitoring and enhances the capacity of the SBP to take timely remedial action. The framework is likely to bring together crucial off-site surveillance, on-site inspection information, and policy guidelines through an automated system for proactive supervision of banks by the SBP. The automated system is expected to maintain a comprehensive and up-to-date database of information on four key areas relating to each and every bank. The database will then rate banks based on these four key areas: the banks own self-assessment reports on compliance of various statutory regulations, the data gathered by the SBP through on-site inspections, the data collected from audited financial statements and lastly the credit rating done by independent agencies. The software application package is under development and it is expected that IRAF will go live by December 2004.

Box 1.4: IRAF Rating

Based on the aggregate weightage of the four inputs, each bank/DFI on a quarterly basis, would be assigned but not advised, a rating on a scale of 1 to 5, having similar connotations as in the case of CAMELS-S approach being presently used by the SBP. The four inputs and their weights in the final rating are:

Compliance with Standards, Codes and Guidelines
Bank's compliance with the standards, codes as adopted in Pakistan laws and regulations, the SBP's guidelines like regulatory and statutory requirements, code of corporate governance and risk management guidelines and instructions for sound business and financial practices. This input would be in form of a self-assessment exercise carried out by the banks duly endorsed by their Board of Directors. This self-assessment would be validated during the on-site inspections by BID. This component would carry an aggregate weightage of 20 percent.

Supervisory and Regulatory Information
Supervisory and regulatory information gathered from the findings of on-site inspection on capital adequacy, management, profitability, asset quality, liquidity etc., off-site surveillance reports as well as enforcement/compliance status from BSD and policy related issues from BPD would form the second component of this framework. This component would carry an aggregate weightage of 25 percent.

Financial Performance and Conditions
Financial performance and condition compiled from audited annual statements, inspection reports, off-site surveillance reports/data and quarterly published accounts would form the major core of this assessment. This component would carry an aggregate weightage of 40 percent.

Market Information and Intelligence
Basic input for this component would be drawn from credit rating agencies, research reports and where applicable international supervisory reports. This component would carry an aggregate weightage of 15 percent.

Source: Banking Inspection Department, SBP

1.4.5 Comprehensive Circulars

This year the SBP continued to issue comprehensive circulars on various regulatory requirements, to provide up-to-date information to bankers. The circulars covered branch licensing policies, financial disclosure requirements and statutory liquidity requirements. In addition, the Urdu and Sindhi language versions of comprehensive circulars on agricultural loans and credit schemes were circulated among the chambers of agricultures, farmer associations and directly to farmers. The Punjabi, Balochi and Pushto language versions will be published in the next fiscal year.

1.4.6 Transparency and Disclosure

To promote transparency and greater disclosure, the banks have been asked to publish financial statements every quarter. New formats for reporting of financial information have also been circulated and enforced. The formats are based on IAS to avoid miscommunication and bring standardization. A reporting chart of accounts covering all the periodic data reporting needs of various departments of the SBP is currently under development.

The SBP has also started publishing Quarterly and Annual Performance reviews of the banking system highlighting overall performance of the banking system in areas like asset quality, solvency, liquidity and risk management, etc. Mandatory credit rating for the banks by independent credit rating agencies has also been extended to MFIs now.

1.4.7 Risk Management

Risk Management guidelines have been issued to the banks to prepare them for Basel Capital Accord II and training of bankers in risk management has been initiated. All banks/DFIs have been asked to put in place a compliance programme to minimize the legal and regulatory risks. To supplement these efforts "Guidelines on Internal Controls" have been issued which would help the banks in structuring, running and reporting on their internal control systems. Guidelines on managing cross border exposures (country risk) have also been disseminated this year and the banks have been asked to draw up their own policies for effective country risk management.

1.4.8 Corporate Governance

To provide bankers access to the international best practices, a detailed handbook on Corporate Governance was published and widely circulated for the benefit of the corporate participants, management and shareholders of businesses. The handbook provides guidelines on how to ensure that decision-making powers are not misused. This awareness is necessary with the advent of new business models where there is a potential for conflict of interest, such as banks entering into brokerage businesses through subsidiaries.

As part of raising awareness of Corporate Governance among interested parties, members of the Boards and Senior Management of the commercial banks were invited to attend the Conference on Corporate Governance so that they are familiarized with their responsibilities and roles. Fit and Proper Test (FPT) for members of Board, Chief Executive Officers and Senior Executives is also being effectively implemented. The Corporate Governance Rules are in line with international standards.

Box 1.5: Reconstitution of the Board of Directors

The Board of Directors of private sector commercial banks has been reconstituted and the number of family members allowed on their boards has been reduced from four to two. Apart from this, a case has also been processed for changing the definition of family members as it exists in Section 5 (ff) of the Banking Companies Ordinance 1962. Under the existing criteria of FPT as well as *the handbook on Corporate Governance*, there exists no restriction with regard to the presence of two or more family members on the Board of a bank.

Source: Banking Policy Department, SBP

1.4.9 Derivatives

The SBP has also approved a number of transactions involving the use of financial derivatives and is encouraging the banks to educate their customers in the benefits and risks of these instruments. Derivatives have been introduced in the financial market to manage risk and provide hedging solutions. But it is still in the early stages and each proposed transaction has to be approved by the SBP. At the present nascent stage of the derivatives markets, contracts of Forward Rate Agreements (FRAs), interest rate swaps and currency options have taken place and the total volume approved at the end of June 2004 was around Rs10 billion, which is quite small compared to the size of financial sector as a whole.

Box 1.6: Derivatives Market in Pakistan – Growth Potential

Financial Derivatives are a relatively new area of development in Pakistan and represent opportunities as well as challenges for the banking sector. From the perspective of the regulator, the SBP needs to ensure that development efforts in this regard are accompanied by appropriate measures to reduce systemic risk.

The first major drive in this respect was a seminar held by the Pakistan Banks Association (PBA) in March 2003 in which the SBP Governor laid down the following three prerequisites for development of the derivatives market i.e.

a) Banks have to have systems, procedures, expertise and internal controls in place.
b) Corporate clients who fully understand the upside and downside risks of the derivatives instruments.
c) Regulators should be able to provide an enabling environment in which there is a balance between promoting market innovation and safeguarding the safety and soundness of the system.

In the initial stages of the development, since August 2003, banks have been allowed to deal in derivatives on a transaction by transaction basis to hedge customer exposures, albeit with the approval of the SBP. Since then, in a joint effort with the PBA and Financial Markets Association of Pakistan (FMAP), guidelines have been developed to allow Banks to deal in vanilla derivatives to hedge customer exposures without the approval of the SBP. Such guidelines - when implemented - will initially allow approved market makers and sellers to quote FRAs, Interest Rate Swaps, and Currency Options to their customers.

The Banks have introduced financial derivatives in the financial market primarily to provide hedging solutions to their customers for their interest rate and currency risks. The risks typically hedged arise from interest rate financial instruments, either as an investor or from short and long-term borrowings, and from foreign currency trade related transactions.

Source: Risk Management Cell, SBP

1.4.10 Extending the Yield Curve

For the purpose of establishing a benchmark for long-term credit and extending the yield curve to 20 years, the Government of Pakistan has issued 15 and 20-year PIBs for the first time. The issuance of these bonds is aimed at providing an avenue for institutional funds to be invested in long-term government securities on one side, and will provide a benchmark to the newly emerging mortgage loans and infrastructure financing market on the other side.

1.4.11 Foreign Bank Penetration

The number of foreign banks operating in Pakistan has declined from 20 to 11 due to acquisitions, and policy changes of their head offices. The SBP has an open door policy and welcomes the presence of quality foreign financial institutions that have strong capital base and wide international network; can bring about product innovation; improve the financial infrastructure in the form of accounting, disclosure and transparency; help transfer skills and technology to Pakistanis; facilitate international trade and capital flows and raise the financial sector threshold of competitive efficiency in the system.

1.4.12 Information Systems Inspections

The SBP has started conducting Information Systems (IS) inspections of the banks to gauge their IS reliability and effectiveness under the CobiT (Control Objectives for Information and related Technology) standards. The CobiT provides a framework for management, users, and IS auditors, and its standards are internationally accepted as good practice for control over information, Information Technology (IT) and related risks.

Box 1.7: CIB Online

The Credit Information Bureau (CIB) Online project was successfully completed with the collaboration of Information Systems Department (ISD) of the SBP and the PBA. It provides online Credit report of borrowers with outstanding loans of 0.5 million or greater. Based on state of the art technology, this system has reduced the response time for getting the required information from 48 hours to 5 minutes.

Source: Information Systems Department, SBP

1.4.13 Credit Information Bureau

The CIB has gone online for real time information retrieval and access by banks. It is being expanded to accommodate information on all borrowers above a limit of Rs1,000 as consumer financiers need this data for making decisions. Further, the SBP is currently working on suggesting regulatory changes to facilitate and encourage establishment of private sector Credit Bureaus in line with international practices.

1.4.14 Deposit Insurance

This year the proportion of total commercial banking deposits under private sector management increased to around 80 percent. This means that the government guarantee enacted through the Banks Nationalization Act 1974 no longer exists. With the local private banks competing in an open market atmosphere the small depositor that constitutes a major chunk of these deposits stands exposed. Thus to create a safety net, the SBP has initiated efforts to develop a Deposit Insurance Scheme (DIS) for Pakistan. A study on the subject was completed this year and draft of the SBP's proposal on creating an effective deposit insurance scheme is underway.

In this regard, a working group, headed by Director BPD, has studied nine countries where DIS is playing an effective role. The Group has gathered information from various relevant institutions, and also considered the socioeconomic and geopolitical conditions prevailing in that country. The Group has made recommendations on the design of the proposed DIS in Pakistan covering the following aspects:

a) Coverage limits.
b) Scope (i.e. what deposits should be included).
c) Premium structure (i.e. flat or risk based).
d) Premium base.
e) Ownership, administration and corporate structure.
f) Legal framework.

The study is now under review. Input from various stakeholders such as commercial banks and Ministry of Finance will be taken and the existing draft will be amended accordingly.

1.5 Legal Framework

There are still some lacunae in the legal framework that does not allow the SBP to fully exercise and enforce its regulatory writ on the financial institutions. The Banking Law Reforms Commission prepared a new draft of the SBP Act that was thoroughly discussed by the senior management of the SBP and a revised draft is being sent to the Government for its consideration. A new Corporate Bankruptcy Law has also been drafted that allows an orderly resolution of the defaulted or non-performing bank loans when a firm declares bankruptcy.

Box 1.8: Banking Companies Ordinance

In order to capture the effects of the changed scenario and new developments taking place in the banking sector, the SBP has proposed certain amendments in the Banking Companies Ordinance, 1962 that include:

a) Changes in the definition of banking company and inclusion of branches and subsidiaries functioning outside Pakistan, of banking companies incorporated in Pakistan.
b) Making it mandatory for banks/DFIs to meet minimum capital requirement and CAR for effecting payment of dividend out of profits. It will bring in more financial discipline in banks/DFIs as well as encourage them to strengthen their capital base and make prudent lending decisions.
c) Enhance powers of the SBP for appointment and classification of auditors of banks and revoke, downgrade or remove auditors from the panel of auditors if their performance is not satisfactory. It will ensure more accountability of the banks' external auditors. In addition, the banks' balance sheets will become more transparent and a true reflector of its business affairs.
d) Conferring more powers to the SBP to curb money-laundering activities etc.

Source: Banking Policy Department, SBP

1.6 Anti Money Laundering (AML)

The SBP has been taking concrete steps to prevent the use of banking channels for the purpose of money laundering. The measures include establishment of AML Unit, issuance of prudential regulations, circular for appointment of compliance officer, restriction on issuance of Rupee traveler cheques of denomination above Rs10,000; phasing out Bearer Instruments, establishment of Exchange Companies, drafting of AML law, coordination with other agencies/bodies like SECP and the National Accountability Bureau (NAB), liaison and cooperation with regional/global bodies, and creating awareness through seminars and training of concerned staff.

1.6.1 Establishment of AML Unit

With the growing sensitivity and importance of the money laundering issue, the need was felt for an exclusive unit to combat money laundering and financing of terrorism in relation to banks. The unit has since been created which has taken up the work to bring the rules/regulations in line with international best practices. The unit is cognizant of Pakistan's international obligations and responsibilities and fully determined in its efforts towards evolving an effective regulatory system that minimizes the possibility of money laundering and financing of terrorism. Additionally the unit has been issuing instructions for freezing of assets of individuals/organizations, which have been declared involved in terrorism under various United Nations (UN) Security Council Resolutions. Therefore, the SBP is compliant with the relevant provision of the UN Security Council Resolutions.

Issuance of Prudential Regulations

The global standards as well as UN Security Council Resolution 1373 requires financial institutions to put in place measures for Know Your Customer (KYC), Record Keeping and Reporting of Suspicious Transactions. State Bank of Pakistan has accordingly reinforced its regulatory guidelines by issuing three more prudential regulations on record keeping, correspondent banking relationship and suspicious transactions reporting along with detailed examples of suspicious transactions.

1.6.2 Bearer Instruments

Various kinds of bearer instruments were previously available in the market which have been gradually phased out in collaboration with the Federal Government. Presently no bearer instruments except Prize Bonds are available in the market.

1.6.3 Exchange Companies

Through an amendment in Foreign Exchange Regulation Act, 1947, setting up of Exchange Companies has been permitted. The companies shall maintain proper record of transactions and also submit returns to the SBP. This will help in regulating the foreign exchange transactions in Pakistan. With the powers to conduct on-site inspection of such companies, SBP can keep an eye on their activities. The step will help in curbing the trend of "*Hawala* System".

1.6.4 Draft Anti-Money Laundering Law

A comprehensive law on the subject is under consideration of the Federal Government. The SBP has provided comments on the draft, since the law will have substantial impact on the banking sector in the country.

1.6.5 Liaison and Cooperation with Regional/Global Bodies

Pakistan is a member of Asia Pacific Group on Money Laundering (APGML), a regional organization engaged in combating money laundering. Officials of the SBP have participated in APGML's conferences and workshop. The objective is to keep abreast with the global developments as well as to provide an opportunity to interact with the regional partners with regard to AML areas.

1.6.6 Coordination with other Agencies/Bodies like the SECP and NAB

Meetings between various agencies are part of the AML program. Occasional meetings between the SBP, SECP and NAB have been arranged to discuss and chalk out strategies for future course of action. Such meetings form part of the networking and liaison activities of the SBP.

1.7 Enhanced International Cooperation

Due to increase in financial liberalization, banking has become global in nature and its complexity has increased. Banks often have overseas or cross-border branches in different countries and due to this they are often under the supervisory jurisdiction of more than one supervisory authority. On one hand, they are supervised by the supervisor of the country, in which they are incorporated (home country supervisor) and on the other hand, they are also accountable to the supervisor of the country of their overseas branches (host country supervisor). Cross border banking necessitates enhanced cooperation and consolidated supervision between the banking supervisors. Exchange of information between the home and host country supervisor is an important element in implementing effective consolidated supervision.

Signing of MoUs is an important step in establishing contact and information exchange with various other supervisors as it formalizes and regulates exchange of information between the supervisory bodies. Even when there is no cross border presence of banks, MoUs can still facilitate a host of financial activities, promote exchange of banking know-how and also improve bilateral relationships between the countries. Realizing the importance of such arrangements the SBP has taken the initiative and contacted supervisory authorities of various countries particularly those which have cross border relationships with Pakistan, are major trading partners or enjoy friendly relationships with Pakistan. During the last year eight MoUs have been signed with regulatory/supervisory bodies of the following:

1.	Bahrain	2.	Kazakhstan	3.	Turkey	4.	Bangladesh
5.	Mauritius	6.	Vietnam	7.	Qatar	8.	Sri Lanka

Apart from the above, MoUs with Egypt, China and Indonesia are in the pipeline and will be executed soon.

Box 1.9: BIS Core Principles for Effective Supervision

Bank of International Settlement (BIS) Core Principles for Effective Supervision have also stressed the importance of cooperation between the Banking supervisors for the purpose of consolidated supervision. BIS Core Principle No. 23, emphasizes that the Banking supervisors must practice global consolidated supervision over their internationally active banking organizations. BIS Core Principle No. 24, states that the key component of consolidated supervision, is establishing contact and information exchange with the various other supervisors involved. Signing of MoU is an important step in fulfillment of these principles as it formalizes and regulates exchange of information between the supervisory bodies.

Source: Banking Supervision Department, SBP

1.8 Islamic Banking

SBP's Islamic banking strategy allows the people to manage their financial relationships in line with their Islamic beliefs. At the same time, it provides choice to the banks to choose the structure that suits them the most in terms of their current structure, business prospects, and the cost structure in the competitive environment. In view of the demand for Islamic financial products, licenses are being issued for Islamic commercial banks, subsidiaries and stand alone branches.

A full-fledged IBD in the SBP became functional on September 15, 2003 with the objective to serve as a facilitator and a focal point for all matters relating to Islamic banking in the country. The Department is staffed with personnel who have rich experience in regulating the banking industry, with in-depth knowledge of all aspects of Islamic banking, both conceptual as well as business and its mission is to make Islamic banking the banking of first choice for the providers and users of financial services. This year, a comprehensive awareness campaign to clarify the myths and realities of Islamic banking was conducted by the IBD.

1.8.1 Formation of the Shariah Board

A Shariah Board comprising of two Shariah scholars and three experts in the areas of banking, accounting and legal framework was established in the SBP on December 3, 2003. The Board advises the SBP on modes, procedures, laws and regulation for Islamic banking to ensure that the Islamic banks function in line with the Shariah principles. So far, the Board has approved the Essentials and the Model Agreements of all major modes of Islamic banking, and a Fit and Proper Criteria for appointment of Shariah Adviser in Islamic Banking Institutions (IBIs) operating in the country.

1.8.2 Development of Prudential Framework

Guidelines on Islamic banking in the form of Shariah Essentials and Model Agreements of various Islamic modes of financing have been placed on the SBP website for seeking comments from the bankers, Shariah scholars, economists, educational institutions, business community and the public at large. On finalization, these guidelines will serve as the basis for the regulatory framework of Islamic banking in the country. So far, Model Agreements for nine Islamic modes have been introduced to facilitate the existing IBIs and the potential market players to develop Islamic banking products in particular and to create awareness about Islamic banking products in general.

1.8.3 Development of In-House Shariah Audit Expertise

Shariah compliance audit for IBIs, arrangements of which have been finalized by the SBP, is very important for promotion and supervision of Islamic banking and finance as it would enhance credibility of the system. The draft Manual for Shariah audit has been prepared in consultation with a consultant firm of repute. For capacity building, the first Shariah audit of an Islamic bank has been outsourced to the same firm to develop Shariah audit skills and provide hands-on training to the SBP's inspection staff. As it would be the first Shariah audit to be conducted by a central bank as a part of supervisory framework, the Manual will be finalized keeping in view the experience gained during the audit and the observations made by the auditors. Based on rulings of the Shariah Board, SBP shall continue to review the Manual as and when needed.

1.8.4 Islamic Export Refinance Scheme

A Musharakah-based Export Refinance Scheme was designed by the SBP in order to provide refinance to Islamic banking institutions against their export financing operations to eligible exporters on the basis of Islamic modes of financing under both parts of the SBP's Export Refinance Scheme. The scheme has been successfully running for over a year now.

1.8.5 Development of Shariah Compliant Capital Market Instruments

Currently, IBIs have been given a different statutory reserve requirement regime till the time Shariah compliant approved securities are available. Presently they are required to maintain 11 percent of their time and demand liabilities in the form of cash with the SBP. Efforts are underway to develop Islamic money and capital market products that may be used to maintain statutory liquidity requirement and to facilitate management of liquidity by Islamic banking institutions. For this purpose, the SBP has completed its work for developing Islamic Sukuk based on leasing of fixed assets. The Shariah Board of the SBP has already approved structure of the Sukuk. Currently, the issue is under consideration of the Ministry of Finance, which will finalize the structure and documentation of the instrument as well as identify the underlying assets in consultation with the SBP. The SBP is also working for developing a Mudarabah based Islamic inter-bank market that could work once there is sufficient number of players in the Islamic banking industry in the country.

1.8.6 Taxation Issues

SBP took up the issue of double taxation on Murabaha transactions with the Central Board of Revenue (CBR) and proposed amendments in the taxation laws in consultation with market players for providing a level playing field to the IBIs. Consequently, in the budget for the year 2004-2005, an amendment has been made (Statutory Regulatory Order 445(1) / 2004) in the Sales Tax Act, in terms of which goods delivered under a Murabaha financing arrangement to or by a bank or a financial institution approved by the SBP or the SECP, as the case may be, shall not be treated as Supply.

1.8.7 Industry Status

As regards the present status of Islamic banking industry in the country, Meezan Bank is operating with 11 branches in 5 cities as a full-fledged Islamic bank. In addition to it, 5 banks (MCB, Bank of Khyber, Bank Alfalah, Habib Bank AG Zurich and Standard Chartered Bank) have been issued licenses for 12 dedicated Islamic Banking Branches (IBBs) of which 10 branches are operating in Karachi, Islamabad, Peshawar, Lahore, Faisalabad and Multan. These banks are planning to offer Islamic banking products in Quetta, Hyderabad, Gujranwala and other major cities during 2004. The SBP has also given in principle approval for opening 10 more IBBs during 2004 by MCB and Bank Alfalah and conversion of 3 branches by Bank of Khyber.

Table 1.2: Break up of Islamic banking

End June	2002	2003	2004
Islamic banks	**1**	**1**	**1**
Branches	5	8	11
Conventional Banks with Islamic Banking Branches	**0**	**1**	**5**
Islamic Banking Branches	0	1	10

Source: Islamic Banking Department, SBP

HBL and Bank Al Habib Limited have been granted in principle approval to open two IBBs. They are expected to start these branches during the calendar year 2004. At least five more banks are expected to open IBBs till December 2004. Applications for two new full-fledged Islamic banks are also under scrutiny while the license of a foreign Islamic bank is being converted to Islamic banking. Some of the banks that are operating Islamic banking branches are planning to offer Islamic banking products through their existing conventional branches by using hub and spoke arrangement, which will increase the outreach of Islamic banking products in other cities as well.

1.8.8 International Collaboration

At the global level, the SBP is actively participating in the efforts being made to develop an Islamic financial system as an intermediation process contributing to overall wealth creation, growth and development and a greater shared prosperity. With a view to learn from the experience of other countries and also sharing its experiences for the benefit of Islamic banking industry, Pakistan is represented on the Bahrain based Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), International Islamic Financial Market (IIFM), Liquidity Management Centre (LMC) and Islamic International Rating Agency (IIRA), and the Malaysia based Islamic Financial Services Board (IFSB). The SBP has been actively participating in the meetings of Board of Directors, Working Groups, and other organs of institutions like IIFM, IFSB, and AAOIFI. The SBP has also been actively collaborating with central banks of other countries like Malaysia, Bahrain and Indonesia for the promotion of Islamic banking and finance.

1.9 Broadening of Access to Credit of Middle and Lower Income Groups

Financial sector development can lead to broad based growth and improved income distribution only when the less privileged segments of society are able to get access to credit. Rural sector and SMEs account for 85 to 90 percent of employment in this country. Providing access to credit to these sectors, by commercial banks, will naturally generate economic activity and employment for lower and middle classes, which they were previously denied.

The growth of financing to sectors that mainly cater to middle and lower income classes were handicapped as the mode of their financing was restricted to specialized institutions with limited outreach. Until 1999-2000, although the commercial banks were given mandatory targets for agriculture credit, they were quite happy in paying penalties to the SBP for not fulfilling the targets. Only Zarai Taraqiati Bank Limited (ZTBL) and provincial cooperative banks were the main conduits for credit to the 60 percent of the population that was dependent on agriculture. In 2000, the agricultural credit scheme was completely revamped to provide incentives to the commercial banks and the results have been spectacular. Similarly, only SME Bank was assigned the responsibility for providing credit to small and medium entrepreneurs. As the forces of competition have squeezed margins on lending to large borrowers, the commercial banks have started shifting their attention to SME sector. The new prudential regulations will also help in expansion of credit to this sector.

The major regulatory restrictions in provision of large volumes of credit to these classes were the various instructions imposed by the SBP on financing e.g. uniform prudential regulations were equally applicable to the Corporate, SMEs, Agriculture and Consumer financing, without taking into account the different characteristics of these sectors and there was absence of a proper framework for MFIs.

During the last three years most of these constraints have been removed. Banks and financial institutions are encouraged and enabled to move into mortgage and consumer financing. A separate set of prudential regulations was formulated for SME finance, consumer finance and put in place since January 1, 2004. Due to the peculiar nature of agriculture production cycle, a new set of regulations is under consideration for agriculture as well. Licensing and prudential norms for MFIs have been designed with particular emphasis on facilitating growth of these institutions and expanding their outreach to the poor and vulnerable segments of the population.

1.9.1 Agricultural Credit

Commodity financing which was so far the exclusive domain of the public sector has been opened up to the private sector. The private sector can finance commodity operations at a market-based rate, benchmarked with the 6 months Market Treasury Bill (T-Bill) Rate. Agricultural credit exhibited an increasing trend as it increased from Rs39.7 billion in 1999-2000 to Rs73.5 billion in 2003-2004 – an average annual increase of 16.7 percent over the past 4 years.

SBP's efforts to mainstream agriculture lending in the commercial banks' portfolio have started bearing fruits now. Commercial banks have overtaken the ZTBL in disbursement of agriculture credit this year and have surpassed their targets by a wide margin. The SBP has now mainstreamed agriculture credit among the commercial banks and expanded outreach of borrowers to 0.85 million. The agriculture credit disbursement this fiscal year reached Rs73.5 billion - up 24.8 percent from Rs58.9 billion of last fiscal year.

Table 1.3: Credit to Agriculture Sector, disbursements

Billion Rupee	FY 00	FY 01	FY 02	FY 03	FY 04	Annual growth rate (FY 03-04)
ZTBL	24.4	27.6	29.1	29.3	29.9	2.0
Commercial Banks [1]	9.3	12.1	17.5	22.7	33.2	46.3
New private Commercial Banks	-	-	0.6	1.4	2.7	92.9
Cooperatives	6	5.1	5.3	5.5	7.7	40.0
Total	**39.7**	**44.8**	**52.5**	**58.9**	**73.5**	**24.8**

Source: Agriculture Credit Department, SBP

Smaller private banks have also started participating in the disbursement of agricultural credit as they have realized that recovery is good and profitability in this sector is relatively higher. However as they have started from almost scratch their share in total credit is so far very small although growing rapidly. This shows that incentives and regulations can be combined in an ingenious manner to channel credit to the under-served sectors.

The increase in agricultural credit has been accompanied by a greater outreach of the farming community to agricultural credit. The number of borrowers served by commercial banks and ZTBL has risen by almost one quarter in the last 4 years. But even after including the cooperative bank borrowers the number is hardly 1.1 million. As the number of farms in Pakistan is 6.62 million, bank credit covers only 16.6 percent of the farming community. The challenge for the commercial banks is, therefore, to extend the coverage to 50 percent or more than 3 million borrow ers in the next 5 years.

Table 1.4: Total No. of Borrowers of Agricultural Credit (Excluding Cooperatives)

	FY 00	FY 01	FY 02	FY 03	FY 04	Percent Increase (FY 00-04)
ZTBL	374,243	427,124	462,639	458,238	464,799	24.2
Commercial Banks [2]	290,572	309,022	353,610	335,229	367,759	26.6
New private Commercial Banks	-	-	4,751	10,765	13,203	177.9[a]
Total	**664,815**	**736,146**	**821,000**	**804,232**	**845,761**	**27.2**

a: FY 02-04

Source: Agriculture Credit Department, SBP

1.9.2 Microfinance Institutions

The SBP is also making serious efforts to expand the outreach of micro finance services to the poor segments of the population. Currently, the SBP is responsible for regulating 2-microfinance banks working in the country, the Khushali Bank and the First Microfinance Bank. These Institutions have expanded their outreach to more than 134,000 borrowers and their branch network has increased to 60. The total outstanding advances of MFIs as of June 2004 amounted to Rs1.2 billion. Both Khushali Bank and First Microfinance Bank have plans to double their customer base.

The SBP is also engaged in collaborative effort with civil society institutions, especially involving large Non-Government Organizations (NGOs) in providing complementary services, such as social intermediation and capacity building. The regulatory regime adopted by the SBP for microfinance

[1] NBP, MCB, HBL, ABL and United Bank Limited (UBL).
[2] Ibid

sector is that of a facilitator, guide and problem solver. The SBP has a light regulatory oversight and is in the process of learning, together with the practitioners. The SBP has a consultative group drawn from the representatives of stakeholders who guide the SBP in the development of regulations and prudential norms for the sector.

A peculiar feature of the microfinance sector development is that as the poor segments of the population are much more prone and vulnerable to shocks, they need to be protected. Thus a bad harvest or drought or strikes in the cities or violence completely wipe out the earning capacity of the poor and disable them from repaying their credit obligations on time. As labor is their only asset and the returns on labor are disrupted for no fault of theirs a risk mitigation mechanism had to be created to insulate the poor borrowers from these unforeseen hazards. The SBP, under its Microfinance Sector Development Programme (MSDP) recognized the need to enhance social capital and risk mitigation as a necessary safety net for the poor. A Risk Mitigation and Deposit Protection Fund has been created to provide protection to the MFIs borrowers and depositors. The stakeholders can seek recourse to this fund under adverse circumstances beyond their control.

1.9.3 SME Financing

There exists strong evidence that SME expansion boosts employment more than large firm growth because SMEs are more labor intensive. In Pakistan, it is estimated that the SME sector contributes around 40 percent to the GDP and 25 to 30 percent of employment. A sensibly designed SME support programme is likely to create more jobs in the economy and generate income. From this perspective, providing credit to SMEs is an attractive tool for small and middle classes. SBP's efforts to bring about the same results in the SME sector have not been that successful so far. However the SBP is beginning to monitor this sector to ensure that prudent lending to SMEs also becomes the mainstream activity of the commercial banks.

Since there is risk aversion by banks towards extending credit to SMEs, credit constraints had limited the expansion of these businesses in Pakistan. Realizing the large potential for growth and employment opportunities offered by the SME sector, SME Bank was established in the public sector in January 2002. This bank, just like Khushali Bank for the microfinance sector, is intended to act as a prototype for other SME banks in the private sector. Just one bank cannot simply cover the whole vista of SME financing within the country. The SBP envisages SME Bank as taking the lead in developing a portfolio approach or program lending tools where standardized credit scoring methodology is used for each sub-sector rather than the current method of scrutiny and appraisal of each individual proposal. The present methods and documentation are onerous for small entrepreneurs and relatively costly for the banks. SME Bank has to experiment and come up with the standardized set of easy to fill out fully informational documentation, specification of risk parameters, credit appraisal and delivery techniques and new and innovative products and services which are in heavy demand by the SMEs. These business models, products, services, techniques developed by SME Bank can then be applied and replicated by other banks planning to enter this particular market segment. The externalities in form of the spill over effect from a public good i.e. SME Bank will thus benefit the private providers of credit.

The SBP has enforced a new set of prudential regulations specific to the SME sector, which will be widely disseminated. The CIB with the assistance of the World Bank has been upgraded to assemble the data and current status of small borrowers. The information flows to the banks based on this source have improved their credit risk appraisal capacity and ultimately reduced the NPLs in their portfolio. Information available on SME financing indicates a stagnant level of credit to the SME sector even though there is significant increase recorded for the last quarter. While the outstanding loans in the previous quarters have not recorded any change probably due to short-term working capital requirements of the SME borrowers, the number of borrowers has significantly risen during last one year, i.e. by almost 50 percent. This trend shows that the banks and DFIs are beginning to penetrate this particular sector. It is envisaged that the commercial banks will play an important role in providing credit to the SME sector in the coming years.

The SBP is working with Small and Medium Enterprise Development Agency (SMEDA), SME Bank and commercial banks on dissemination of new prudential regulations and technique of credit appraisal, delivery and documentation for SMEs. This will result in larger flows of credit to SMEs while minimizing the risks of non-recovery.

Establishment of SME Unit

In order to develop capacity building and implement training initiatives at the willing banks under the Asian Development Bank's (ADB's) SME Sector Development Program (SDP), the SBP has established an SME unit which will be responsible to hire consultancy for capacity building support to the banks and to provide training to bankers in implementing SME finance business lines. It will lead to the development of SME Finance policy, institutional support infrastructure for credit enhancements for SMEs, and analysis of banks' response to the policies. It is actively engaged in promoting awareness among commercial bankers for commercial approaches to SME finance and investment of banks into building dedicated SME units through workshops/seminars.

SME unit is also overseeing the restructuring of SME Bank under the ADB's SME SDP, as well as the implementation of key result areas and conditionalities of the project for timely release of different loan tranches by the ADB.

1.9.4 Consumer Financing

The commercial banks started consumer financing on an appreciable scale only during the last year. The beneficiaries of this sector are mostly the middle-income group borrowers and the most common types of financing have been auto financing and credit cards. Lately, mortgage financing and consumer durables have begun to attract increased attention and the demand is picking up.

The total amount outstanding against consumer financing reached Rs102.6 billion by the end of June 2004 from Rs22.6 billion recorded toward the end of December 2004. Auto loans and credit cards together account for over 43 percent of total consumer financing. The recent tax and fiscal incentives given by the GoP and the regulatory changes introduced by the SBP should provide an impetus to mortgage financing.

Table 1.5: Financing to SMEs and Consumer Sector by the Banking System

Domestic Operations

Billion Rupee	Dec-02	Dec-03	Jun-04
SME Financing	170.0	215.0	250.6
Consumer Financing	22.6	65.5	102.6
Credit Cards	*6.1*	*8.9*	*11.2*
Auto Loans	*8.3*	*22.2*	*33.1*
Housing Loans	*1.9*	*4.1*	*8.3*
Other (Durables and personal loans)	*6.3*	*30.3*	*50*

Banking Supervision Department, SBP

1.9.5 Housing Finance

The Advisory Group on Housing Finance, under the aegis of the SBP, continued its work programme to remove the constraints and irritants in the way of expanding housing finance. PIBs of 15 and 20-year tenure were introduced to serve as benchmark for the long term corporate and mortgage bonds. Several fiscal incentives were introduced to facilitate the spread of mortgage finance in the country.

Box 1.10: Housing Finance

At the policy level, lack of direction has been one of the major impediments in institution of a market based housing finance system. Therefore, the role of the SBP is to facilitate and provide a level playing field (from banking viewpoint) to stakeholders for the development of housing finance sector. The SBP has taken various steps to promote housing finance in Pakistan, which includes: -

Liberalization of Credit Regime

a) Banks' exposure to housing finance has been enhanced from 5 percent to 10 percent of their net advances.
b) The maximum per party limit has been increased from Rs5 million to Rs10 million .
c) The maximum debt-equity for housing loans has been increased from 70:30 to 85:15.
d) The maximum loan tenure for housing finance has been increased from 15 years to 20 years.

Deepening/Broadening the Scope of Housing/Consumer Finance
Presently banks are adhering to a "skimming" strategy for marketing their consumer/housing loans and most of them are essentially targeting the same population due to lack of an extensive consumer credit information system. However, for enabling banking system to "penetrate" the consumer/housing finance market, the SBP is considering to reduce the minimum threshold of its CIB, besides adding a number of desired features to CIB that would enable banks to ascertain debt-burden and credit worthiness of the borrowers.

Housing Loans to the Federal Government Employees
Finance Division has instituted a procedure, wherein the Auditor General Pakistan Revenue/Accounts Office has been assigned the task of recovering a portion of monthly salary of the Officer/Employee for payment to the concerned lending financial institution, besides the loan recovery procedure requires a government employee to pledge his General Provident Fund balance and commutation value in favor of the financial institution. Banks/DFIs may formulate their housing policies for Federal Government employees keeping in view the procedure devised by DFIs as also Prudential Regulations/instructions on the subject issued by the SBP from time to time.

Progress of Housing Sector
As a result of a better enabling environment created for housing finance in the country due to regulatory and fiscal incentives, the number of active banks in housing finance during July 2003-June 2004 has increased and the housing finance portfolio of banks has increased to Rs8.205 billion. Banks now reckon that housing is a good sector for business and momentum of housing loans has certainly increased. At the same time, favorable tax treatment of housing loans and prevailing environment of low interest rates are further making mortgage loans affordable.

Source: Banking Policy Department, SBP

2 Maintaining Price Stability with Growth

2.1 Overview

Unlike the previous year when large foreign exchange inflows put pressure on the money supply as well as the exchange rate, this year an exceptional expansion in private sector credit was the source of the above target increase in broad money. The lending rate was brought down further from 7.58 percent in June 2003 to 5.05 percent by June 2004 – a drop of more than 250 basis points over and above 500 basis points drop in FY03. The spread between deposit and lending rate has also been narrowed from 568 basis points to 384 basis points this year showing a marked improvement in the intermediation efficiency of the banks. Although deposit rates have declined from 1.90 percent to 1.21 percent, the proportionate change is much lower than expected. Rates on savings and fixed term deposits were relatively higher than this average rate. Continued drop in lending rates caused by easy monetary policy and improvements in the macroeconomic fundamentals accelerated capacity utilization in manufacturing sector and thus led to higher aggregate growth rate in the current fiscal year. In this process though, the depositors failed to receive positive real rates of return on their savings and suffered as a result.

2.2 Monetary and Credit Policy Operations

In the last three years, the SBP has amply supported the growth momentum in the economy by reducing the cost of capital besides ensuring easy availability of credit to the private sector. The success of monetary policy could be gauged from the fact that interest rates declined to historic low levels (a cumulative decline of more the 1000 basis points during July 2001 to August 2003 in the benchmark 6-month T-Bill yields). Consequently, the credit to private sector swelled to a historic figure of Rs325.2 billion in FY04; exceeding the target by more than 280 percent. This phenomenal surge in credit helped achieve higher growth in the manufacturing sector that eventually led to an overall growth of 6.4 percent (highest growth since FY96). Meanwhile, the Monetary and Fiscal Policies Coordination Board (MFPCB) played an important role in harmonizing and coordinating fiscal and monetary policies[3].

The discount rate (repo rate) being the basic signaling tool, declined from 14 percent to 7.5 percent during July 2001 to November 2002, to make monetary policy accommodative and spur growth in the economy. The discount rate did not see any decline during FY04 despite a phenomenal fall in T-bill rates; losing its importance as a signaling tool, nevertheless its usefulness as a penal rate increased and resulted in better cash management by commercial banks (resort to the SBP discount window declined considerably besides improvement in banks' bidding behavior in auctions of government securities).

The continual reduction in T-Bill primary market yields played a significant role in transmission of the easy monetary policy stance during FY01-FY04. In fact, due to high differential between T-bill yields and the discount rate, the importance of T-bills auction cut-off as a signaling tool increased. The recent (post April 2004) tightening of monetary policy was primarily signaled through T-bill auctions.

[3] For details see section 2.3 of chapter 7.

2.2.1 Open Market Operations

The purpose of intervention by the SBP in money market was to stabilize the overnight rate besides keeping monetary expansion within the targeted limits. Therefore, the SBP not only absorbed excess liquidity from the system but also injected money as and when the market conditions warranted. The money market remained liquid throughout FY04 (due to foreign exchange purchase) and the SBP mopped up Rs410.7 billion against a smaller absorption of Rs66.9 billion during the corresponding period of last year. Moreover, the SBP mopped up liquidity below the targeted amount to moderate the rising interest rate expectations.

The SBP injected liquidity amounting to Rs76.7 billion from October 2003 to December 2003 due to acute liquidity shortages faced by the money market. These injections by the SBP were made to curb expectations for increase in interest rates stemming from sharp jump in net credit off-take by the private sector, lesser foreign exchange purchases by the SBP, the liquidity drain due to launching of PIBs Jumbo issue etc. As a consequence of the liquidity injections by the SBP, the market interest rates remained stable at the desired level. Since January 2004 the SBP has only absorbed liquidity, thus effectively complementing the tightening monetary policy stance.

Table 2.1: Open Market Operations

Billion Rupees

	Injections		Absorptions	
	FY03	**FY04**	**FY03**	**FY04**
July	51.7		12	41.5
August				8
September			16.9	76
October		3.5		13
November		56.7	13	
December		16.5		29.5
January				54.5
February				22
March				16.6
April				24
May	3.1			4.9
June			25	120.9
Total	**54.8**	**76.7**	**66.9**	**410.7**

Source: Economic Policy Department, SBP

2.2.2 SLR and CRR Requirements

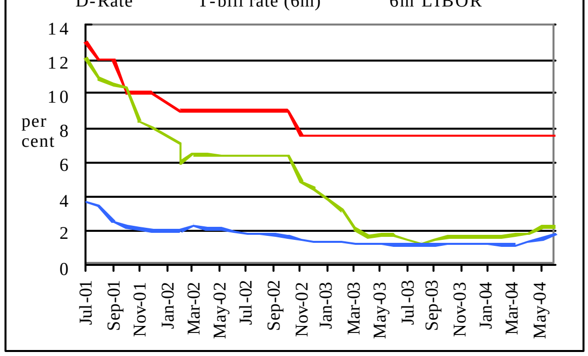
Changes in the Cash Reserve Requirement (CRR) and Statutory Liquidity Requirement (SLR) not only affect the capacity of commercial banks to expand credit but also have financial implications for the banking system. Further, the usage of SLR has also lost its importance after the financial sector reforms and the objective of maintaining or ensuring desired liquidity levels in the financial sector is achieved by the conduct of Open Market Operations (OMOs). Therefore, the SBP did not make changes in the CRR or SLR requirements during FY04. In fact, CRR and SLR have remained fixed during the last three fiscal years. However, the commercial banks have kept excess reserves with the SBP due to low market interest rates during FY04.

2.2.3 Discount Rate

The SBP discount rate not only regulates commercial banks' borrowing from the central bank but also indicates the pursuance of easy, tight or unchanged monetary policy stance as circumstances warranted. Any change in the discount rate (the penalizing rate in case commercial banks resort to the SBP discount window) reflects the cost of SBP's lending to scheduled banks besides transmitting a signal of changes in policy stance of the central bank. To transmit the signals of easy monetary policy stance, besides taking other measures, the SBP started reducing the discount rate gradually from 14 percent in June 2001 to 7.5 percent in November 2002. Since then, the SBP has kept the discount rate stagnant at 7.5 percent, which reflects the commitment of SBP towards keeping a low interest rate environment.

However, the 6-month T-Bills rate, which is also, a benchmark rate, started edging up after reaching at its lowest in August 2003. As the benchmark T-Bills rate is more sensitive to money market conditions and other economic indicators, the T-Bills rate started inching up in the later half of September 2003 on account of increase in foreign interest rates, increase in domestic inflation particularly in the non-food component, depreciation of Rupee *vis-à-vis* US Dollar and higher demand for bank credit due to seasonal factors. The rates on T-Bills with different maturities also increased during the period. Similarly, the export refinance rate, which was linked with the 6-months T-Bills rate, also increased from 1.5 percent as in June 2003 to 2 percent as in June 2004.

Figure2.1: Interest Rates



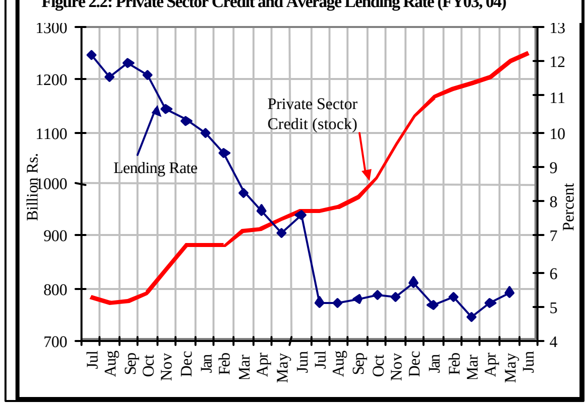
2.3 Monetary Policy Statement

The SBP during FY04 issued the third and fourth Monetary Policy Statements to inform the public-at-large and markets in particular about its stance during the first and second half of the fiscal year. The first statement of the fiscal year came out in July 2003, which provided the justification for easy monetary policy stance and its continuation. It also explained the major developments and their potential linkage with the conduct of monetary policy. The second statement was issued in January 2004, it discussed the rising inflationary trend and its impact on interest rate trends and the potential impact on economic recovery and growth. However, the policy stance during the year, as pointed out earlier, remained easy and accommodative. The perspective of the SBP was that inflation was still within tolerable limits and that gradually rising interest rates at their current levels were not likely to considerably disturb the investment plans of the private sector.

2.4 Low Interest Rates Environment

Lower lending rates caused by easy monetary policy coupled with improvement in the macroeconomic fundamentals resulted in accelerated economic activity. The cost of bank credit came down significantly due to high bank liquidity and downward trend of lending rates triggered by the lower discount rate. In view of the excess liquidity and low inflation, the lending rates came down further. The private sector was much better placed as the overall weighted average lending rate of all banks dipped to 4.69 percent in March 2004 from 12.17 percent in July 2002 and 14.49 percent in July 2001. The private sector community availed Rs325.2 billion during FY04 against the credit plan target of Rs85 billion and Rs167.7 billion in the corresponding period of last year. Low interest rate environment not only dampened the inflationary expectations but also scaled up investment activities necessary to achieve the GDP growth target set for 2003-04.

Figure 2.2: Private Sector Credit and Average Lending Rate (FY03, 04)



The distribution of credit utilization by the private sector during FY04 was broad-based as all the important segments of the economy showed increased utilization of bank credit. Manufacturing sector continued to show a larger credit share (46 percent or Rs150 billion) followed by Personal loans (20.6 percent or Rs67.1 billion), Services (12.0 percent or Rs39 billion), Agriculture (6.5 percent or Rs21.3 billion) and Commerce (3.1 percent or Rs9.9 billion).

The government also benefited from the low interest rate environment, as it was able to reduce its cost of funding substantially from both the bank and non-bank sources. The reduction in cost of borrowings helped reduce future debt servicing cost and created a fiscal space for the initiation of development programs. The Government was even able to make pre-payments of expensive external debt amounting to US$1.17 billion during FY04. The low cost funds available to the corporate sector enabled many companies to strengthen their balance sheets, improved profitability and invest retained earnings along with bank borrowing for expansion, modernization or enhancing capacity utilization.

The banks moved into new areas of business such as housing, SMEs, consumer durables and agriculture. Thus, higher demand for funds by the private sector and increased public sector development spending helped meet the postulated targets for the domestic economy.

Despite a massive monetary expansion of 19.6 percent during FY04, the Consumer Price Index (CPI) inflation remained low at 4.6 percent. The sterilization of capital inflows, strong rupee together with sufficient supply of food contained inflationary pressures, made it possible to keep the inflation rate close to its target. However, the inflationary expectations did not exert any upward pressure due to pro-active monetary management, fiscal discipline, adequate supply situation and stable exchange rate. Summing up, the monetary and fiscal policies continued to provide the enabling environment essential for economic take-off.

2.5 Karachi Inter-Bank Offered Rate (KIBOR)

For the purpose of establishing a uniform benchmark for corporate lending, the SBP has directed all banks to benchmark their corporate lending to KIBOR from January 31, 2004. For this purpose, the previously existing tenures of KIBOR upto 6 months have been extended to include 9-month and 1-year tenure, and will be extended to include tenures upto 3-years by the end of 2004.

Money Market Computerized Reporting System

The money market monitoring system of the SBP has been automated in 2004. All the information pertaining to primary and secondary market activities is now being captured in the database regularly. Using this database, SBP will be able to forecast the future inflows and outflows of the market through a liquidity-forecasting model, which is in testing phase at present.

Certificate of Deposit

The SBP has designed a new instrument, the SBP Certificate of Deposit (COD), for liquidity management in the money market. Unlike T-Bills, which are issued by the Government, the SBP will issue this instrument. This instrument will be of short-term nature, with maturity of 28 days, and will be used in case stock of government securities with SBP depletes. With this instrument in its arsenal, any change in government borrowings level will not affect the capability of the SBP to manage liquidity in the money market.

Brokers' Accreditation Criteria

The SBP, in collaboration with FMAP has finalized the criteria for inter-bank brokers' accreditation. All the new and existing brokerage houses will need to fulfill the criteria laid down in order to get accredited by FMAP, which will bring uniformity and transparency among brokerage businesses operating in inter-bank market.

3 Prudent Management of the Exchange Rate

3.1 Overview

The balance of payments continued to show modest surplus but the magnitude was much smaller in relation to FY03. A fall in the current account has resulted due to moderation in remittances, acceleration in imports and the termination of Saudi Oil Facility and higher oil prices. Fortunately, the import growth was driven principally by the increase in machinery, transport equipment and industrial raw materials. Capital account deficit was much higher this year due to pre-payment of expensive debt (partially offset by the Eurobond issuance) and lower inflows of external official assistance. Consequently, the pace of reserve accumulation was slower in FY04 and the total reserves stood at US$12.3 billion at the end of June 2004 compared to US$10.7 billion last year. SBP's net reserves were US$10.5 billion.

Exchange rate during this period has consequently depreciated by 0.6 percent from Rs57.81 per US Dollar at the end of June 2003 to Rs58.16 per US Dollar at end June 2004. This is a direct consequence of the demand for foreign exchange outstripping the supply in the last quarter of this fiscal year but in a certain way it is beneficial for our exporters who are able to retain their competitiveness against other countries. However, SBP's fight against inflation will receive a setback if the trend of depreciating rupee continues unabated. At the same time, it should be recognized that foreign reserves are accumulated during good times and used up, to some extent, during bad times.

3.2 Exchange Rate Volatility

Table 3.1: SBP's Intervention in Foreign Exchange Market (Inter-bank)

Million US Dollars

	FY03		FY04	
	Sale	**Purchases**	**Sale**	**Purchases**
Jul-Dec	0	2,541.0	0	884.5
Jan-Jun	0	2,005.0	461.8	474.1
Total	**0**	**4,546.0**	**461.8**	**1,358.6**

Source: Economic Policy Department, SBP

The high and low levels for the exchange rate (Rupee per US Dollar) during FY04 were 57.18 and 58.17 respectively. The Rupee remained very stable during the first three quarters of the fiscal year. It was only in the last month of June that the green back strengthened as a result of large import demand, prepayment of debt and decelerating inflows. The SBP remained vigilant in the foreign currency market and intervened from time to time to contain the excessive exchange rate volatility. Here the large foreign currency reserves, accumulated in the past, proved to be a bedrock. The SBP intervention in the inter-bank foreign currency market was aimed at smoothing volatility, curbing speculation and maintaining a stable exchange rate in consonance with the competitiveness of Pakistan's export. To achieve these objectives, the SBP purchased US$1,358.6 million from the foreign exchange market while injected only US$461.8 million during FY04.

3.3 Trade Deficit

During FY04 there was growth in Pakistan's economy as is evident from the shrinking Balance of Payment (BoP) surplus and rising trade deficit, mainly on account of surging imports and debt prepayments in the public and as well as private sector. The large imports of machinery by the manufacturing sector during the last quarter were around US$1.5 billion while the overall import figure for FY04 was approximately, US$15 billion against export figure of US$12 billion. The trade deficit in the current fiscal year as compared to last fiscal year has increased by three times from

US$1,030 million to US$3,200 million. The increase in import demand has also increased the foreign exchange demand putting further downward pressure on the US Dollar / Rupee parity. Sensing stability in the exchange rate during the last quarters, the exporters are also deferring the realization of their exports proceeds. The increasing oil prices have also increased the import bill of the country along with the price of imported food items.

3.4 Reserve Management

The country's reserves have continued to rise albeit at a slower pace. The overall reserves have increased by US$1,609 million during the current fiscal year. The slower accumulation of reserves can be attributed to the slowdown in home remittances with the overall depletion of US$350 million or 8.6 percent. The prepayment of expensive ADB loan to the tune of US$1.17 billion was also made along with corporate debts ahead of schedule. The peaking of the oil prices in the last quarter and the withdrawal of the Saudi Oil facility of around US$750 million has also contributed to considerable foreign exchange demand. The payments of multilateral and bilateral debt obligations would not only result in public sector debt going down, but private sector debt is also expected to go down.

3.4.1 Reserves Management Strategy

This year the SBP moved into an active reserve management strategy for its foreign currency reserves. It has currently categorized the reserves into three kinds of portfolios based on liquidity; cash, short-term and long-term. The cash portfolio will be denominated in the prime currencies (US Dollar, Euro etc.), while the short-term and long-term portfolios will consist of at least investment grade instruments.

A part of the short-term and long-term portfolio has been outsourced to nine international fund managers according to their expertise, on an agreed benchmark rate of return. The rest of the reserves are managed in-house under parameters laid down by the SBP investment committee. The SBP has already revamped its short-term placement activities for getting higher returns and has made its first long-term investment in bonds. The categorization of reserves into three separate portfolios will ensure availability of reserves while the outsourcing to foreign fund mangers will ensure competitive returns. Return earned from the short and long term investments will be transferred to the cash category of reserves.

A Risk Management Cell has been established in 2003 along with a Back Office and a Front Office dealing room, under the supervision of an Investment Committee. The objective is to obtain optimal returns on the foreign exchange reserves with the desired level of risk, and at the same time maintain enough flexibility for a successful execution of monetary policy. The Treasury Back Office at Accounts Department is currently involved in settlements, generating Management Information System (MIS) reports and monitoring deal execution process to ensure internal control.

3.5 Exchange Companies

Another milestone achieved this year was the phasing out of money changers and the formation of exchange companies. To gradually formalize the foreign exchange business the SBP decided to facilitate Authorized Money Changer's (AMC) move into the Exchange Company business. In order to provide continuity to the money changers' business, the SBP encouraged the AMCs to either incorporate Exchange Companies or set up a franchise agreement with any existing Exchange Company. In the second phase, the SBP facilitated AMCs with small financial means by allowing establishment of Exchange Companies of 'B' category, with a reduced paid-up capital requirement of Rs20 million and reserve requirement of only 10 percent of the paid-up capital.

A minimum of five AMCs was required to form an Exchange Company of 'B' category. Unlike the regular exchange companies which can sale or purchase, import or export and remit foreign currencies, the new exchange companies 'B' category or namely 'Exchange Company –B' would undertake only sale and purchase of foreign currencies. Their formation would allow the consolidation of the many money changers, their expertise and resources, into fewer and stronger exchange companies with corporate cultures. The exchange companies are regulated together by the SECP and the SBP. The inspection of the established Exchange Companies also started this year.

The transition from 375 money changers to fewer Exchange Companies has taken place smoothly and 33 'B' category Exchange Companies have been issued licences in addition to 20 existing full-fledged Exchange Companies. About 83 money changers have opted to become franchisee of these companies. The newly formed Exchange Companies of 'B' category have commenced their business with a branch network, comprising of the constituent AMCs, with countrywide reach. Registered Head Offices of 15 companies are located in Karachi, 7 in Lahore, 6 in Islamabad/Rawalpindi, 2 in Quetta and 1 each in Gujranwala, Hyderabad and Kharian and the total number of branches are around 250 at this initial stage.

The process was successful because it was planned well ahead of time, consultations took place with the stakeholders and their genuine grievances were redressed and there was better coordination between Exchange Policy Department (EPD) of the SBP and Field Offices of the SBP Banking Services Corporation (SBP BSC). With the successful completion of this phase of bringing exchange business under the corporate discipline, a vast majority of such transactions will now come under proper documentation and shall be subject to the internationally accepted norms of KYC policy, identification/detection of suspicious transactions and will provide support to the efforts against money laundering.

Besides the formation of Exchange Companies, "Restricted Authorization" has also been granted to 3, 4 and 5 star hotels to purchase/encash foreign currency notes, coins and travelers cheques from the hotel customers.

3.6 Foreign Exchange Regime Liberalization

The SBP is transforming its role from a controlling body to one that provides timely guidance and continuous monitoring. This year the SBP decentralized and delegated the operational control of a number of foreign exchange transactions to the local offices of its subsidiary, the SBP BSC. The SBP in turn will only decide policy issues on foreign exchange matters. This initiative will enable the SBP to focus on the smooth liberalization of the policy framework on foreign currencies.

This year the SBP further liberalized policy framework to accommodate other facilities extended to exporters and importers under the Trade Policy 2003-04. Authorized Dealers (ADs) have been delegated the powers for effecting remittances of aircraft lease rental by airlines incorporated in Pakistan up to the guaranteed hours. However, if the amount exceeds the guaranteed hours, the SBP BSC will extend approval, subject to fulfillment of certain conditions. ADs have also been granted general permission to release foreign exchange up to a maximum of US$100,000 or equivalent in other currencies per invoice for private sector companies incorporated in Pakistan, for payments on account of utilization of various IT services, after being satisfied with the underlying documents. Eligible items to be included are:

a) Satellite Transponder charges.
b) International Bandwidth charges.
c) International Internet service charges.

d) International Private Line charges.
e) Software licence/maintenance & support fees for proprietary/ specialized software.
f) Subscriptions/payments for access to foreign electronic media & databases.

In order to facilitate individuals maintaining non-resident rupee accounts, issuance of Automated Teller Machine (ATM) Cards as well as Supplementary ATM Cards by the respective banks is allowed. However, withdrawals through these cards are allowed only in Pakistan.

To provide up-to-date information on foreign exchange market players and authorized dealers the foreign exchange manual is being revised. A much more user friendly and easy to understand version is being developed. The manual will be circulated in the next fiscal year.

3.6.1 Financing Scheme for Long-Term Export Oriented Projects

To provide medium to longer term financing to the export oriented projects, a new scheme called "Scheme for Long Term Financing for the Export Oriented Projects (LTF-EOP)" was launched on 18 May 2004. The new scheme allows the eligible financial institutions to provide funding facilities to the export oriented units, who meet the financing criteria, on attractive terms and conditions for import of machinery, plant, equipments and accessories etc. (not manufactured locally). The basic objective of the scheme is to support the capacity building of the exporting entities in non-SME as well as SME sectors. The scheme also synchronized the incentives announced by the government under Trade Policy 2003-04. One of the distinct features of the scheme is multiple pricing option on the basis of the period of financing. The rates of mark up, under the scheme are linked with the weighted average yield on 12 months T-Bills as well as PIBs of 3 years and of 5 years maturity. The other vital feature of the scheme is that it is a window of financing for intangible products like brand name acquisition.

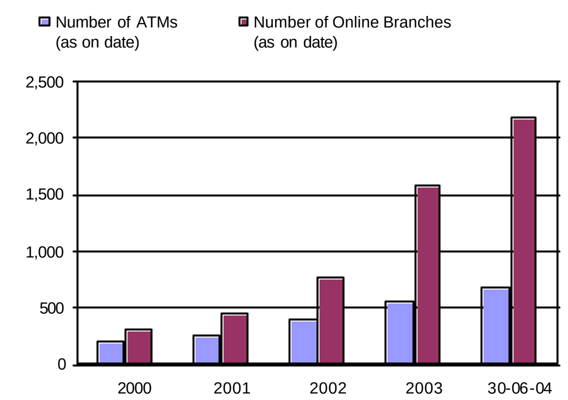
Banks/DFIs while working as an interface will undertake the credit risk for which they can earn a maximum spread of 3 percent. The sanctioning of limit to banks/DFIs depend upon their credit rating, CAMELS and their past experience in project financing. The scheme also envisages that financing shall be provided to those projects/units, which export at least 50 percent of their annual production directly or indirectly. The other conditionality of the scheme is that borrowers with export overdue bills of more than 365 days shall not be entitled to financing under the scheme. The scheme is expected to give a major boost to the development of exporting entities in SME sector.

4 Strengthening of the Payment System

4.1 Overview

An efficient and well functioning payment system, besides reducing the systemic and operational risks, lowers the transaction costs and aids in efficient use of financial resources. It helps the financial market to become more liquid and promotes stability in the financial system. The SBP completed its two-phase strategy this year to ensure efficiency in the payment system of the country. In the first phase, all banks were asked to connect to either one of the ATM Switches (M-Net and 1-Link). Later, in the second phase, both the ATM switches were interconnected. With this interconnectivity, ATM users now have the convenience of operating their accounts from a countrywide network.

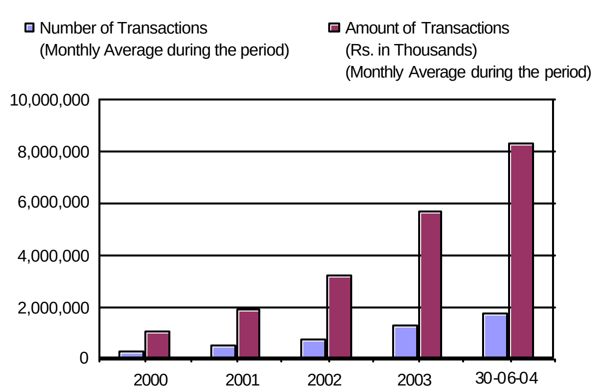
Figure 4.1: No. of ATMs and Online Branches



The number of ATMs, which was close to 207 at the end of 2000, has increased to 676 ATMs as of June 2004. Similarly, online branches of commercial banks have grown over 6 times to 2,181 during the same period. The volume and value of business transactions through the ATMs have also witnessed a steady rise. The number of credit card holders has multiplied three-fold from 200,000 to over 600,000 cardholders during the last four years. Also, the average monthly volume of transactions has more than doubled in the same period.

Meanwhile, the Payment Systems Department (PSD) has started functioning on a modest scale to coordinate and monitor all payment related issues. The PSD will also be responsible to coordinate internally with the various concerned departments like BSD, BPD, ISD, Exchange and Debt Management Department (EDMD) and Accounts Department in addition to keeping abreast with the current international best practices and dealing with the banking sector on all issues related to the payment system.

Figure 4.2: ATM Transactions



The framework for the oversight of the payment system is being developed. Statistics on various payment instruments such as the number of ATMs, number of online branches as on date and the number and value of ATM transactions, both paper based and electronic, are being collected on a quarterly basis and uploaded on the SBP website regularly.

In February 2004, a joint mission of the International Monetary Fund (IMF) and the World Bank carried out an independent assessment of the SBP's compliance with Core Principles under the Financial Sector

Assessment Program (FSAP) of the country. This was the first such assessment and it provided an independent evaluation of the level of robustness of the supervisory framework of the country. The mission has submitted its draft report and it is a matter of great satisfaction that the mission's observation upheld the assessment already made internally by the SBP. Out of a total of 30 (extended) principles, the SBP was assessed as fully compliant with 22 principles; largely compliant with 5, and materially non-compliant with 3.

Steps are also being undertaken to implement the recommendations agreed during the Financial Sector Assessment Program (FSAP) review, which was conducted in February 2004 for the payment system by the PSD in consultation with all stakeholders.

4.2 Real Time Gross Settlement (RTGS)

The RTGS system will automate the current manual inter-bank settlement process of large value payments at the SBP. At present, counterparties face risks like credit risk, liquidity risk and settlement risk due to time lag during the settlement of large value transactions through a manual system. The gross settlement (transaction by transaction settlement) in real time will minimize these risks. An important component of the project is reviewing the existing legal framework and updating this to cater to the RTGS system. The system is scheduled to go live in 12 months time after the signing of contract with the vendor. The RTGS system is based on SWIFT (Society for Worldwide Inter-bank Financial Telecommunication) topology and includes the functionalities of Queue management, Grid Lock Resolution and interfacing with Globus.

4.3 NIFT

Clearing and settlement of transactions is one of the major functions of the payment system. To provide an efficient clearing and settlement facility, the SBP assigned this activity to National Institutional Facilitation Technologies (Pvt.) Limited (NIFT). NIFT has established centers in seven cities, which are Karachi, Lahore, Islamabad, Rawalpindi, Faisalabad, Hyderabad and Peshawar. The NIFT services are likely to be expanded to Multan and Quetta by the end of 2004. A complete range of conventional clearing services has also been introduced. These include Overnight Clearing, Same Day High Value Clearing and Intercity Clearing etc. This effectively covers the bulk of the cheque clearing transactions in the country. Besides NIFT, NBP is also providing clearing and settlement services at all those places where the SBP offices do not exist.

4.4 Local US Dollar Instruments Collection and Settlement System

The foremost development during the year has been the commencement of Local US Dollar Clearing in Pakistan. Right now the US Dollar denominated instruments dominate the local foreign currency business. This clearing will provide facilitation to the US Dollar account holders in all banks, who are working in Pakistan only. Introduction of Local US Dollar Clearing has brought about a profound efficiency in the dollar clearing system. By avoiding routing through New York, the new settlement system will facilitate the foreign currency account holders in terms of processing time and cost. The new system has reduced the clearing time of US Dollar cheques from three weeks to only four days and has reduced the cost to the account holders. Banks and their branches in eleven cities are utilizing this facility. However, expansion of this system to more cities is under consideration.

4.5 SWIFT

Payments to different financial institutions all over the world are made through the SWIFT secure fund transfer system. For better functioning of the SWIFT system, an up-gradation of SWIFT Alliance Access Server was done as per the standards of SWIFT. It has also been upgraded from 4.1 to 5.0 version and under the SWIFT contingency plan a second back up server was installed. To keep records in more useful form, system based recording of SWIFT payments messages was implemented. During the year, a major milestone was that SWIFT was cut over from the X.25 connectivity to Internet Protocol (IP) Network globally referred to as SWIFTNet migration. This successful transfer to IP Network was achieved by the SBP within Pakistan's country window and since then, it has been operating satisfactorily.

4.6 Electronic Transactions Ordinance

In order to facilitate e-Commerce in Pakistan, the Electronic Transactions Ordinance was promulgated in 2002. This ordinance provides the legal coverage to electronic transactions against paper-based transactions. The Public-Key Infrastructure (PKI) is the combination of software encryption technologies and services that enables enterprises to protect the security of their communications and business transactions on the Internet. The PKI protects the information assets in several ways:

- Digital certificates issued as part of the PKI allow individual users, organizations, and web site operators to confidently validate the identity of each party in an Internet transaction.
- A digital certificate ensures that the message or document the certificate "signs" has not been changed or corrupted in transit online.
- Digital certificates protect information from interception during Internet transmission.
- PKI digital certificates replace easily guessed and frequently lost user identification and passwords to streamline intranet login security and reduce MIS overhead.
- With PKI solutions, the enterprises can control access privileges for specified online transactions.
- Digital certificates validate their users' identities, making it nearly impossible to later repudiate a digitally "signed" transaction, such as a purchase made on a website.

Management Strategy of the SBP

5 Information Technology and Infrastructure Development
6 Human Resource Development
7 Improved Accountability

5 Information Technology and Infrastructure Development

5.1 Overview

In recent years, the SBP has enhanced its focus on internal operational efficiency and information management capabilities. With the objective of moving towards process automation and enhanced data analysis capabilities, Arthur Andersen was entrusted with the preparation of a study outlining an Information Systems Strategy Plan. The direction and focus of the study was to enhance the management decision-making processes and to bring about an improvement in the quality and usage of technology in the bank's operations. The working document, dated 15 January 1999 was then put into execution under the World Bank's assistance program with the objective of upgrading the information technology being used at the SBP. The contract was signed in September 2000 and the actual work started in December 2000.

Hyundai Information Technologies (HIT) was assigned the role of the lead consultant for the design and deployment of the upgrade envisioned by Arthur Andersen. The project has evolved into a comprehensive integrated solution, a seamless amalgamation of individual solutions for the banking and non-banking operational automation at the SBP. The project was affected by the unforeseen incidents like 9/11 incident, May 2002 bomb blast in Karachi, Afghan United States war, and border tensions with India. However the project team was able to keep on track and managed to minimize the delay to a mere 12 months. The project is expected to complete by September 2005. The major components of the automation project are:

- Networking
- Hardware
- Trainings
- Globus (Banking Solution)
- Enterprise Resource Planning (ERP) Solution
- Enterprise Data Warehouse

5.2 Networking

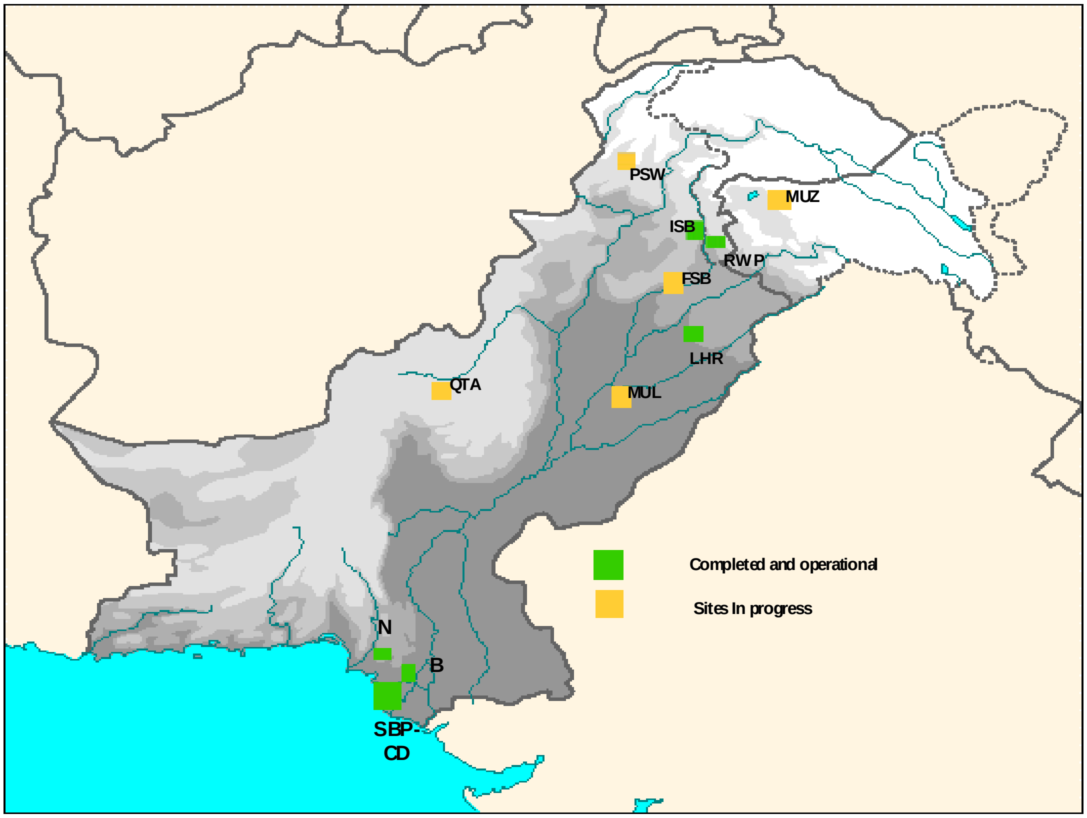
A network infrastructure has been established in order to provide connectivity to the three-core applications' end users. The network provides reliable, scalable and secure way of information exchange among department and other remote offices. The SBP network has Centralized Architecture with all the core Application servers for Globus, Oracle ERP and Data Warehousing located in the SBP main building. The SBP's countrywide network consists of more than 2,900 Fast Ethernet nodes in 17 different buildings. The entire scope has been divided in the following major tasks:

a) Local Area Networking (LAN)
b) Metropolitan Area Networking (MAN)
c) Wide Area Networking (WAN)

5.2.1 LAN

The SBP Main Building, Canteen Building and Annexe Building are connected to the main server room through Giga bit Fiber Optic backbones and consists of more than 1300 network points available to connect desktops and laptops. The primary and backup high-end N-Class servers with state of the art External Disk arrays are real time synchronized with campus clustering plan. A very high-speed Internet connection and mail services for the countrywide network is also operational with secure centralized file storages for end users.

Map 5.1: Local Area Network Infrastructure Deployment Status



5.2.2 MAN

The SBP has three MAN sites; North Nazimabad office, Bolton Market (Prize Bond) and Press Building office. These three offices are connected to the centralized operation center in main building through Microwave Radio Modem S-band links.

5.2.3 WAN

For remote sites to connect to the central operation center, the SBP has opted for both wire and wireless media in order to bring resilience to ensure availability of the services for the remote end users. For wire media National Telecommunication Corporation nationwide fiber optic media backbone has been selected with DXX (Digital Cross Connect) technology connecting all remote sites to the main operation center. Very Small Aperture Terminal (VSAT) has been chosen as the backup, while the main load of traffic is routed through the DXX media of the SBP data communication setup. So far the SBP BSC Islamabad, Rawalpindi and Lahore offices are connected to Central operation room in Karachi through both media DXX and the VSAT. At the SBP BSC Lahore office VSAT commissioning is underway. A backup 256 kbps DXX link is commissioned between the SBP BSC Lahore and Islamabad office. The Quetta, Multan, Faisalabad, Muzaffarabad and Peshawar sites are completed but not yet operational.

A total of 11 out of 19 LAN sites are deployed and tested by the project. Router redundancy at the core LAN level as well as the WAN side has reached testing phase. The project team was also successful in facilitating 64 kbps (Executive) Internet Circuit for SBP BSC Lahore and Islamabad offices. The maintenance contract with HIT for the network equipment procured under Technical Assistance for Banking Sector (TABS) was finalized in the last quarter of FY04. In addition to this, delivery of networking equipment for the 4^{th} purchase order through HIT is completed.

5.3 Hardware

- 1376 PCs have so far been installed as workstations covering 85 percent Officers Grade-2 (OG-2) and above level.
- 104 Laptops distributed to different officers of the SBP.
- Three N-Class servers are hosting three main software applications i.e. Globus, ERP and Data Warehouse.
- Two N-Class Servers are working as backup servers for these applications in the backup site.
- Primary and backup site is connected through High speed Gigabit backbone.
- 4 large High-end Laser Printers have been installed in different offices.
- 21 color printers are operational at different locations of the SBP.
- 75 Network Printers have been delivered and installed in different offices/departments of the SBP.
- 120 dot matrix printers are operational in different offices/departments.
- 130 desktop laser printers have been installed.
- 1 Plotter and 1 Scanner have been installed in ISD.

5.4 Trainings

A well-equipped computer lab comprising 18 Personal Computers (PCs) has been established in January 2004 at Lahore Center. The purpose of the aforesaid lab is to train the officers of the Bank. This lab would also cater to the needs of the nearby SBP centers.

The training unit of Project Management Office (PMO) has successfully coordinated trainings of 876 resources out of which 134 resources in Globus were trained this year and 154 resources are trained in Oracle ERP. Of these 87 resources were trained in Oracle Financials & Distributions and 57 resources were trained in Oracle Human Resource Management System (HRMS) this year.

5.5 Globus Banking Application

The Globus banking system will automate the retail and treasury banking activities of the SBP and sixteen offices of the SBP BSC. The core Globus system has been customized and implemented in the core banking areas of the SBP (Accounts and EDMD) and the SBP BSC (Karachi, Rawalpindi and Islamabad offices). The main application is housed on a central server located at Karachi with all the offices accessing it simultaneously via wide area connectivity.

This project can be broadly divided into two set of activities viz. application rollout and branch rollout. The application rollout stage has the new product development and deployment in the SBP and the Karachi Office of the SBP BSC. In this stage the focus is more on application development, testing, data conversion and deployment. The branch rollout stage relates to rolling out of the retail banking applications in the sixteen local offices of the SBP BSC and is more focused on employee training, data conversion and hand holding.

5.5.1 Application Deployment Stage

The Globus application has been rolled out and is in operation in the following areas of the SBP and the SBP BSC Karachi Office:

i. Deposit Banking
ii. Government Banking
iii. Local Remittances
iv. Export Refinance
v. Tellers
vi. General Banking
vii. Government Securities
viii. Foreign Exchange

Apart from this, Globus system has been set up and configured for the back and middle offices that have been established in the SBP to handle foreign currency and money market placements. The following products are presently being rolled out at Karachi:

ix. Prize Bonds
x. Currency Issue
xi. National Savings Schemes
xii. US Dollar Bonds

All these products are stock-intensive in nature and require external developments to the Globus System, which itself is a core banking solution. The other activities that are in the pipeline are:

xiii. Streamlining and re-engineering the inter-company transactions
xiv. Establishing the interface between Globus and Oracle General Ledger

5.5.2 Branch Rollouts

As indicated above, this stage consists of rolling out the system in the field offices of the SBP BSC. The major functions of the field offices are retail banking [from (i) to (v)], currency management, prize bonds and national savings schemes [from (ix) to (xii)]. A major part of the branch rollout consists of Globus navigation and product trainings and data conversion. It may be mentioned that branch rollouts are dependent on other components of the automation project like the availability of PCs, printers, networking and Basic Office Automation Training.

So far, products mentioned at (i) to (v) have been rolled out at Islamabad and Rawalpindi offices. Prize bonds, Currency Management and National Savings will be rolled out in these offices after successful implementation in the Karachi Office. The next branch selected for the rollout is the Lahore office. Globus navigation and product trainings in this office have been successfully completed.

5.5.3 Current Status of New System Development

Presently, the application is being deployed in the areas of Prize Bonds, Currency Issue, National Savings Schemes and US Dollar Bonds. As all these products are stock-intensive in nature and are specific to SBP's requirements, they are being developed externally in Globus. Detailed status of the new development is given below:

Prize Bonds

The User Acceptance Testing (UAT) has been completed and data conversion exercise is in progress. It must be mentioned that the Prize Bond operations are performed in all the offices of the SBP BSC but the data is consolidated in two Public Debt Offices (PDOs) viz. Karachi and Lahore. Therefore data conversion cells have been established at Karachi and Lahore offices that will consolidate the data of other offices and update it on the system as well. Initial training has been imparted to the selected officers and staff of the prize bond divisions at Karachi and Lahore offices. Parallel operations at Karachi Office have already started.

National Savings Schemes (NSS)

The UAT has been completed and data conversion exercise is in progress. As the product is not only stock intensive but complex as well, a mechanism is put in place to ensure that the data already converted on the new system is kept up-to-date as well. Furthermore, in November 2003, the system of coupons was discontinued and replaced with profit chequebooks because of which the method of profit calculation on Special Saving Schemes (SSCs) also changed. The design of the system that was being developed had to be altered to cater for both the methods of profit calculation. The data of NSS has been completely converted onto the Globus system.

Currency Issue (CI)

For the purpose of automation, the currency management operations at SBP BSC have been divided into two broad areas viz. Cash Management in all the local offices and Currency Issue Management in the four circle offices as well as SBP BSC Head Office. The UAT for cash management has been completed in September 2004. The Currency Issue system has been designed and is currently in the implementation stage.

US Dollar Bonds (USDB)

This is another stock intensive application requiring external development. Its UAT has been completed, however the data conversion is yet to begin.

Streamlining And Re-Engineering the Inter-Company Transactions

The inter-company transactions are those transactions that happen in one office of the SBP BSC and affect the accounting books of other offices of the SBP BSC head office or the SBP. After the implementation of new systems like Oracle ERP and Globus it was felt that such transactions should be streamlined so that optimum benefit of the technological infrastructure be obtained.

The Globus implementation team submitted a system solution design document outlining the treatment of inter-company transactions in the Globus system to the Accounts departments of the SBP and the SBP BSC and after extensive consultations the said document was signed-off by all parties. To facilitate the process a Project Coordination Committee (PCC) has been formed that comprises of the SBP IT auditors, the SBP system implementers and core users from the Accounts departments of the SBP and the SBP BSC and the Karachi Office.

Establishment of an Interface between Globus and Oracle General Ledger

The interface has been developed and is under the testing of Oracle Applications team. In the general banking area, the Globus system has been setup and configured to cater for the US Dollar local clearing and the cash/ special reserve requirements for Islamic banks.

5.6 Oracle Enterprise Resource Planning

Oracle applications provide a clear road map for business process improvement. The processes, inherent in the e-Business Suite, are based on the flow of information through natural linkages of business activities. Using these best practices, HIT has aimed at bringing fundamental changes to the business operations within the Finance, Distribution and Human Resource Management functions of the bank. They form the backbone of the changes that will enhance workflows and procedural efficiency at the SBP. The upgraded systems will not only process transactions promptly and accurately at lower costs, but will also be scalable enough to handle the increase in transaction volumes in the future, based on economic growth and developments in the banking industry. The new system is designed while taking into account the mission critical nature of SBP's operations with full consideration given to security and the necessary system access controls.

5.6.1 Core HRMS in the SBP

Five modules of Oracle Core HRMS Recruitment, Employee Information Management, Compensation & Benefits, Leave Administration and Human Resources (HR) Policy – Work Structure have been successfully implemented in Human Resources Department (HRD) of the SBP.

5.6.2 Oracle Training Administration

Solution Design document has been submitted to the Training Division of the SBP. Final discussions and meetings have been arranged with the users to get the sign-off on Solution Design document. UAT and detailed training sessions were successfully held with the users.

5.6.3 Oracle Self Services HR

A demonstration has been arranged for the HR users to explain the standard functioning of Self Services HR. A document on Standard Processes of Self Services HR has been submitted to HR.

5.6.4 Rollout Core HRMS in the BSC Head Office and Karachi Office

Operation Analysis document is complete and Solution Design document has been submitted to the respective departments for sign-off. Training sessions were given to key users at the SBP BSC Head Office and Karachi Office on the HRMS core modules by master trainers of the SBP BSC in close supervision of PMO team. Nearly 70 percent of HRMS setups for Head Office and Karachi Office are complete. The UATs for Performance Evaluation Report (PER) and disciplinary actions are also done. The team was also successful in finalizing the parameters on production instance of six Oracle HRMS modules. The team has also developed 20 new reports for the system users.

Historical data of active employees from five offices of the SBP BSC was successfully collected and put through the cleanup/filtration process. The data conversion/migration was also successfully done. The team was successful in data collection and cleanup/filtration of ex-employees along with their dependents from all offices of the SBP BSC and the SBP. The team was also successful in developing securities profiles as per users requirements. The team completed development of HRMS responsibilities.

5.6.5 Systems Enabled Process Re-alignment Document

Revised Systems Enabled Process Re-alignment (SEPR) documents on Recruitment, Employee Information Management, Leave Administration and Compensation & Benefit have been signed-off by HRD.

5.6.6 Oracle Payroll

The payroll systems comprise of four main modules i.e. *salary module, advances module, fund module and pension module*. In *Salary module,* the procedure for updating of monthly Monetized Salary/Salary from Oracle HRMS was finalized after necessary verification of data with the help of HRMS Project Team as well as concerned users. Income tax calculation procedure was modified for monthly recovery of tax, up to the last month of a retiring person's service during a financial year. New reports to represent department-wise/cost center-wise /employee-wise status of monthly salary were prepared as per requirement of HRD. These reports are presently being used for the approval of monthly salary.

In the area of *Advances module*, controls have been introduced in the system to make Advances-General Ledger (GL) Interface live. Necessary modification for charging interest on the basis of merit increase for the past entries of interest were made to rectify the issue of interest calculation due to delay in the merit increase for different employees of the Bank. Four new reports have been included in the system as per the requirements of the users.

In *fund module,* application level user security has been implemented. Procedures for updating contribution and recoveries from employees posted at other offices of the SBP BSC as well as for the employees sent to other organizations on deputation were completed. Thirty reports of the system has been finalized and tested. The *pension module* will go live after updating of the data of all pensioners from legacy HRMS.

5.6.7 Oracle Finance and Distribution

In Oracle Finance and Distribution track, the PMO facilitated in preparation and delivery of following nine deliverables requested by Accounts Department:

a) Application security architecture
b) Responsibilities Oracle General Ledger
c) Responsibilities Oracle Assets
d) Responsibilities Oracle Payables
e) Responsibilities Oracle Purchasing
f) Responsibilities Oracle Inventory
g) Responsibility Matrix (Finance and Distribution) as on 16 January, 2004
h) Security Rules for Oracle General Ledger and Oracle Assets
i) Cross validation rules listing

The team provided support on five modules of Oracle ERP in Accounts Department, Procurement Division and HRD. It facilitated establishment of an ERP lab. at Karachi Office to facilitate rollout activities at the SBP BSC, coordinated workshops related to multi-org. The team coordinated trainings in Oracle Inventory, Accounts Payables and Purchasing for SBP BSC Karachi Office and Head Office users. The team also conducted General Ledger Globus interface testing. The team also actively worked with the SBP Business Process Re-engineering (BPR) team and significantly contributed to the final BPR report. Enhancements and reports made for end users of Oracle ERP:

- Redefined currency related process for Accounts Department (Oracle Payables and Oracle Purchasing modules).
- Developed interface between Oracle Payables and Payroll application for tax deduction.

- Developed ten new reports for Oracle Payables, Oracle Purchasing, Oracle Inventory, Oracle Assets and Oracle General Ledger.
- Coordinated with ISD's development team to develop a 'Telephone billing system' and integrating it with Oracle ERP.

5.7 Enterprise Data Warehouse

Most business organizations today consider the acquisition, organization and analysis of data to be a core requirement in support of their primary strategic goals. For a central bank however, the acquisition, organization and analysis of data is the primary strategic goal is. Without this, it would not be possible for a central bank to perform its primary function of supporting and regulating a healthy financial environment, conducive to the growth and financial prosperity of its citizens and the country as a whole.

An Enterprise Data Warehouse (EDW) is the core tool at any organization's disposal for achieving this goal. Whereas, most organizations evolved a requirement for an EDW, central banks have always had a requirement for a coherent, robust and extensible information system capable of handling and analyzing large quantities of data. The effectiveness with which a central bank can achieve this goal is directly proportional to two key attributes of the EDW it chooses to adopt:

a) **Architecture**: A model for the framework and standards for the data warehouse at an enterprise level.
b) **Business Process**: A collection of activities that takes one or more kinds of input and creates an output that is of value to the customer.

EDW architecture alone makes up less than half the story. Without a clearly defined business process to manage the EDW, the solution often becomes mired in technical difficulties and fast loses confidence of its users. SBP has sourced an EDW solution that encompasses both of the above elements. The EDW environment envisaged for the SBP invokes a completely new paradigm regarding the acquisition, preparation, dissemination and analysis of data. It will represent a fundamental shift in the manner and means by which the SBP will perform its decision-making role. Development of nine subject areas is complete and under testing. One out of ten subject area is live and the internal customers are using the application to run analytics in CIB.

Table 5.1: Showing subject wise progress in EDW

Subject Areas	Activities In Progress
Credit Information Bureau (CIB)	Live Since Aug 2003
Balance Of Payment (BoP)	Release 2 Complete (After User's initial review of the product)
Banking Sector ASIS Model (Banking + Money & Credit Merged In One)	Development and History Data Loading In Progress
Capital Markets	Release 2 Under review by SBP user
External Debt	Release 2 Complete (After User's initial review of the product)
Price Trend	Release 2 under development (After users initial Review of the product)
Socio Economics	Release 2 Under review by SBP user
Public Finance	Release 2 under development (After users initial Review of the product)

Subject Areas	Activities In Progress
Domestic Debt	Release 2 under development (After users initial Review of the product)
Economic Growth, Investment & Savings	Release 2 Under review by SBP user

Source: Project Management Office, SBP

Pilot testing of Mindscape data Acquisition Gateway (MAG) with six banks has been completed. The release 2.0 is under development after initial review of the product. The Globus and EDW interface requirements gathering is completed and the team is working on mapping Globus with EDW.

5.8 Operational Support by ISD

The ISD has played a vital role in continuously strengthening the SBP on technology fronts. By facilitating the setting up of a modern age IT infrastructure and providing reliable IT solutions and services, the ISD has reduced the operating costs, improved end user performance and met overall goals. The department formulates and implements the IT security policies and procedures to protect the information assets of the SBP.

The FY04 has seen ISD take the SBP to a higher level of automation. IT policies and procedures were initiated, IT Security Plans were worked out and the operational costs were substantially reduced with the introduction of cutting edge technologies such as video conferencing. In line with the overall objective of the SBP to facilitate the growth of banking sector in Pakistan, ISD played its part in enhancing and facilitating the growth of IT and its impact on the operational development of the entire banking sector. In this connection, the CIB, IRAF and Money Market Monitoring System were the major tasks undertaken by ISD. ISD in consultation with PBA automated CIB for implementing state-of-the-art solution for prompt availability of information. ISD played a key role in resolving technical issues related to the interconnectivity of two ATM switches operational in Pakistan.

5.8.1 In-House Software Development and Support

During FY04, the In-house Development Division (IDD) substantially facilitated improvement in bank's internal as well as external operations. IDD developed software applications for different departments of the SBP to enable them to decrease their business operating costs and customer response time while dramatically increasing their operational efficiency. IDD further facilitated the automation of diverse business domains of the SBP with the development, implementation and continued support of the following projects completed during the fiscal year under review:

Library KitabWare System

This system has all the features of a modern library management system. It completely automates the library processes from Acquisition and Cataloging to Membership etc. Using KitabWare the SBP Library Catalog is available to the SBP via the intranet / Electronic Bulletin Board (EBB). In additional KitabWare is providing an option for search of more then 500 library catalogs across the globe via the Internet.

Prize Bond Tracker

Prize Bond Tracker is being developed as a replacement of the obsolete Informix system in use. Prize Bond Tracker is responsible for keeping track of different draws, stock of bonds and sale and purchase of bonds. This system involves deployment at 13 of the BSC Offices.

Call Accounting System

The Call Accounting System allows the communication section of Accounts Department, to capture detailed monthly telephone bill history. Any payments against new connections are also captured. It saves redundancy and duplication of labor and provides detailed breakup of phone usage. MIS reports such as monthly expenditure of telephones, monthly and yearly average telephone usage, Internet accounts and cellular phone usage etc is also available.

Export Overdue

The system comprises two parts. The data capturing part, which is installed in banks and the data analyzing part, which is installed in the SBP. Using data capturing part, banks can report all the export over-due cases and recovery statuses of different export cases to the SBP every month. The SBP uploads this information and generates different MIS reports.

Export Finance Scheme System

A special assignment by the Governor, SBP to computerize the last five years' export refinance scheme data for analysis purposes is also being undertaken.

Visitor Tracking

Monitors and keeps track of information about visitors to the bank. The system is installed at the reception where Internal Bank Security Department's (IBSD) officers take the complete information from visitors like name of the department and the officer being visited, National Identity Card number, name and address of the visitor and purpose of visit etc.

Funds Accounting System (Phase 1)

This is a Financial Accounting System developed to maintain different types of Funds invested by the SBP in different securities (T-Bills, PIBs etc) on behalf of Khushali Bank and Government of Pakistan.

Letter Management System

This is a revised version of Inward/ outward system previously developed by ISD. It includes central management of different letters of the SBP and comprises of new features along with enhancement of existing options and reports. It contains information of inward /outward movement of different circulars, notifications, cases and tracking of documents and emails etc.

SECP companies' database

A special assignment by the Governor SBP to computerize the last five years' financial data of listed and un-listed companies in the SECP, for analysis purpose.

Biometrics Attendance System

Developed for ISD to implement electronic attendance system based on latest biometric technology. It maintains late coming, absentees, permissions to come late. It also comprises of various MIS reports including monthly statistics for late comings, number of days (employee present and absents) etc.

MSD Token System

Token System developed for Medical Services Department (MSD) provides convenience to all the SBP employees. The employees can now return to their seats and check on their token status via the Electronic Bulletin Board.

Revamping of Website

This aims at revamping the existing website by improving its look, promoting ease of navigation, making it a smooth browsing experience. It will focus on better organization and display of content & introduction of Frequently Asked Questions, Survey Polls, etc.

Revamping of E-Board

In pursuit of ISD's aim to provide value-added services to the SBP Employees, ISD undertook the project to revamp the Electronic-Board with a totally new and attractive 'look n feel' that makes the browsing experience not only more appealing, but also more content-rich, informative and effectively organized.

Online Recruitment/Application Posting System

This is an online application submission system, which simplifies the recruitment process and turn-around time of HRD. The system comprises two parts. The first part, which is web-based, enables a candidate to submit online his/her credentials including his/her resume and picture against the specified post/posts offered by the SBP from time to time. The second part, which is the data analyzing part, provides different options to HRD to process online submitted applications and generates different MIS reports.

5.9 Physical Environment

The technological up-gradation currently underway required a comparative change in the physical environment at the SBP. The office layout and infrastructure was redesigned to suite the efficient use of the IT equipment and covered area of the SBP building. Renovation and refurbishing work of five floors of the SBP building that started in 2000, was completed this year.

6 Human Resource Development

6.1 Overview

Following the implementation of modern management practices in the areas of performance management, career advancement, training and development, and recruitment, the focus of HRD activities during 2003-04 has been on post implementation review of these policies to ensure effective implementation as well as alignment of these polices with all other changes taking place in the SBP. During the year, HRD focused on consolidating the changes already introduced, through creating awareness, responding to user feedback on simplification of procedures and updating allied policies and procedures to ensure effective implementation of the new initiatives.

The HR focus in the area of automation during the year has been on maximizing the return on investment through utilizing the automated processes and strengthening the linkages/integration between various automated modules. As a result most of the decisions are being made on the basis of this automated system, which has aided in promoting transparency and efficiency in decision-making.

6.2 Recruitment

This year the SBP incorporated web-based application processing and automated its whole recruitment process through adopting the recruitment sub module of Oracle HRMS. The SBP recruited 175 officers this fiscal year, of which almost half were inducted in the specialized fields of IT, Research and Legal. The remaining officers (87 in number) were inducted in the general side. Ten officers of the SBP and 1 of the SBP BSC were also selected as Joint Directors, after competing with outside candidates.

Table 6.1: Recruitment

S. No	Cadre	No.
1	SBOTS	68
3	Research Analysts	20
4	Joint Directors	16
5	Director-IBD	1
6	Legal Professionals	7
7	Assistant Directors	3
8	IT Professionals	58
9	Senior Research Analyst	2
Total		**175**

Source: Human Resource Department, SBP

To promote diversity within the organization and encourage greater participation of educated females in economic activity, a special recruitment was conducted through the State Bank Officials Training Scheme (SBOTS). Ninety-seven female candidates successfully passed through the test and interview stage. Of these the top 24 were recruited by the SBP, 24 by the SBP BSC and 30 by the First Women Bank. Fourteen clerical and non-clerical staff members were also promoted directly to Officer Grade (OG)-1 through an open competitive process. In addition, 6 OG-1 were promoted as OG-2 after acquiring higher qualifications.

6.3 Training

Training has been an important aspect of the strategy adopted by the SBP to enhance the quality of human resources. Continued training and process of learning have played a vital role towards successful accomplishment of the mandated responsibilities in recent times. By providing the employees with an opportunity for acquisition and enhancement of skills, linking the learning process with results and making learning an inherent part of the Performance Management System (PMS), training has been transformed into a requirement and not just an option.

In order to improve the effectiveness of training and development activities and align them more closely with the overall capacity building and various change initiatives at the SBP the Training Department was merged into the HRD as one of its divisions.

6.3.1 Training Tracks

The training policy has been designed to provide skill development and enhancement opportunities through the introduction of the concept of Training Tracks, in line with career growth in the organization. These multidimensional training tracks are designed to provide the pre-requisite trainings to career progression in different grades. In addition to the usual focus on central banking skills, the scope of the training include management and specialized skills development as an integral part of the training policy.

a) **Central Banking Track:** Courses in this track are designed to develop technical skills in core functions of Central Bank. The courses are divided into three levels i.e. Foundation, Intermediate and Advanced to provide customized skill development in line with employees' career growth in the SBP.

b) **Management Track:** Courses in this track are designed to develop competencies in the area of personal effectiveness, supervisory skills, leadership, performance management, and communication skills.

c) **Function Specific Track:** This track offers a flexible framework for Head of Departments (HoDs) and Group Management Teams to nominate employees in their respective areas to participate in targeted skills development courses at local or foreign institutions to broaden their knowledge in their specialized functions, in line with the industry specific best practices.

6.3.2 Training Status

Continuing the policy of promoting technical know-how among officers and enhancing their capability to reflect the core values in their individual and collective behaviors, extended training opportunities were provided during FY04. To this effect a total of 1,065 officers (from OG-2 to OG-5) attended various domestic and foreign training programs during FY04 compared to 916 officers during the previous year.

Domestic Training Programs

Courses held at NIBAF: With the coordinated efforts of the Training Division, National Institute of Banking and Finance (NIBAF) and the Departmental Training Coordinators (DTCs), 711 officers attended the NIBAF training programs offered during FY04 as against 561 officers during FY03. This increase reflects the higher awareness amongst the officers about the importance of these programs in their career development. Moreover, greater availability of one-week duration modules could have been another contributory factor, which allowed the participants to go for training without any severe setback to their work schedule.

Table 6.2: Training Programs arranged at NIBAF

	Modules	No. of Weeks	Participants
2000-01	2	5	60
2001-02	19	62	936
2002-03	24	59	561
2003-04	37	46	711

Source: Human Resource Department, SBP

The higher number of modules offered during FY04, which facilitated the officers in managing their training schedule without any conflict to their work plan, resulted in a decline in the average number of participant per module. This dropped from almost 23 officers per training module in FY03 to only 19 officers in FY04. This may be due to the fact that a number of targeted officers had already acquired the training on the specific modules. This suggests that fewer number of modules need to be offered on foundation courses and more emphasis needs to be placed on conducting a higher number of intermediate and advance level courses of the central banking track in the following year.

Courses Other than NIBAF: Under this category 197 officers attended training programs at various public and private sectors' organizations/institutions during FY04 compared to 227 officers the previous year. A sharp decline in participation for courses offered by National Institute of Public Administration (NIPA) from 33 in FY03 to only 9 in FY04 appeared to be the major factor behind this shortfall.

Foreign Training Programs

To keep pace with the on-going changes in the field of monetary management taking place throughout the world, due importance was given to availing the maximum number of fully-funded program at the IMF. During the year, a total of 157 officers, from all grades, attended the relevant foreign training programs compared to 128 officers during FY03. The duration of these programs varied from one day to a maximum of eight-week.

These programs were offered in risk management, banking supervision, banking inspection, financial programming and policies, payment system, international rules of auditing, inflation targeting, foreign exchange management and many other areas of special interest to central banking. Officers from OG-2 to OG-5 were selected to attend these programs. Selection of officers within the various grades was tied to the program requirement and the availability of the officers with the matching experience.

Table 6.3: Participation of Officers in Foreign Training Programs

Period	OG-2	OG-3	OG-4	OG-5	OG-6	Total
2000-01	11	17	6	19	14	**67**
2001-02	6	51	10	24	27	**118**
2002-03	19	48	11	22	28	**128**
2003-04	31	53	15	33	25	**157**

Source: Human Resource Department, SBP

6.3.3 Management/HR Development Project

Work on technical and financial assessment of a Management /HR Development Project funded by World Bank under its TABS Program was completed during the year. The contract was awarded to a consortium led by Anjum Asim Shahid Associates (Pvt.) Ltd. in association with Hay Group from Dubai and Institute of Business Administration (IBA). The objective of the program is to prepare the SBP management team to upgrade their knowledge and skills in human resource development. The focus of this capacity building initiative will be to:

- Prepare HRD staff in HR technical and soft skills.
- Prepare Line Managers (Directors and various level Supervisors) in people management skills.
- Advise and counsel employees for career development.

To achieve the program objectives, the consultants shall deliver the following training programs during the next 22 months:

- Top Management Leadership Program
- Middle Management Training as People Managers
- HRM for Line Managers
- Strategic Planning
- Coaching and Counseling
- HRM Courses for HRD Staff
- Customer Services
- Facilitation Skills
- Human Resource Planning
- Organization Development
- Values-Shared Behaviors for HR Staff
- Techniques of Advising and Counseling Staff in Career Development.

6.3.4 Internship Programs

In addition to the regular 8 week internship program for 60 students (30 male and 30 female) selected on the basis of merit and provincial quota from at least 29 accredited universities from all over Pakistan, a special internship program was also run for 20 students from Balochistan University to achieve greater diversity in terms of geographical reach. Additionally, separate internship programs varying from four to six weeks were also offered for 13 students from IBA and Hamdard School of Law.

6.3.5 Training Evaluation

A system of informal evaluation of training effectiveness was replaced with the Donald Kirkpatrick model of evaluation. This model is an easy to understand, simple, and flexible system of training evaluation, which takes into account non-quantitative data as well. The continuous evaluation of trainings will help streamline and transform the training evaluation methodology by linking the evaluation to the nomination process and post training interventions. This will also helps us in creating a database for evaluating effectiveness of past, current and future training programs.

Box 6.1: The Four Levels of Donald Kirkpatrick Model evaluation are:

1. Evaluating Reaction
2. Evaluating Learning
3. Evaluating Behavior
4. Evaluating Results

Source: Human Resource Department, SBP

In order to create the required level of aw areness and knowledge base among line managers, DTCs, awareness workshops have been planned for FY05.

6.4 Performance Management

To enhance a continuous development and growth culture in the SBP, an interview based performance management system, which is based on achievement of goals and competencies, was introduced. The system is a developmental tool, through which the appraisers provide feedback on the employee's performance and rates his or her performance. The following post implementation simplification measures were adopted for the FY04 based on feedback in the annual Change Management Conference, inputs received through structured interviews with the users and general feedback from employees.

Alignment of Performance Planning Process with the Business Planning Process

- Cascading Departmental goals to Divisional, Unit and individual goals.
- Establishing the position of Divisional Head as the minimum level of 1st appraiser and the Head of the Department as 2nd appraiser.

Simplification of Forms

- The goals setting form was further simplified by taking out the columns of Action Plan and Resource Developmental Requirements.
- In order to ensure independent appraisal by the 1st and 2nd appraisers the appraisal form was split into two, one for the 1st appraiser and the other for the 2nd appraiser.

6.4.1 Introduction of Bell Curve Principles

In order to provide a level playing field for all employees with respect to the performance appraisal, the concept of grade-wise comparative ranking of performance within departmental clusters (Banking, Foreign Reserve Management, HRD, Research) was introduced. Under the Bell Curve Principle, the top 10 percent employees in each Grade of respective clusters were ranked as "A" performers and the next 20 percent as "B+", the middle 60 percent as "B" and the bottom 10 percent as "C".

6.4.2 Merit Increase/Performance Bonus

Annual Merit Increase (AMI) was awarded to all employees with effect from 1 January 2004 against a budget of 4 percent of the annual monetized pay. Employees in Grade OG-2 to OG-6 were awarded AMI on the basis of their Bell Curve ranked, performance evaluations marks on the following scale:

Table 6.4: Bell Curve Ranking

	A	B+	B	C
Percent of Employee	10%	60%	20%	10%
AMI	7 %	5.5 %	3.5 %	1.5 %

Source: Human Resources Department, SBP

In addition to the AMI, employees (OG-2 to OG-6) ranked as "A" performers were also awarded a Performance Bonus (from a pool of funds equal to 1 percent of the total monetized pay of the SBP) to strengthen and inculcate the concept of performance based management culture. Employees in grades

OG-1 and below were awarded AMI on the basis of their performance appraisal rating on the following scale:

Table 6.5: Appraisal Rating

	49-50	47-48	41-46	11-40	0-10
AMI	4.5%	4%	3%	2%	0%

Source: Human Resource Department, SBP

6.4.3 Competency Model

To improve the understanding of the users about the concept of competencies and its application in the new PMS, the SBP Competency Model has been divided into three tiers:

- Core Competencies
- Grade Specific Competencies
- Function Specific Competencies

Box 6.2: The SBP Competency Model

Core Competencies
Applicable across the SBP e.g. Accountability, Professional Integrity etc.

Grade Specific Competencies
Applicable to specific grades e.g. Change Orientation, Team Leadership etc

Function Specific Competencies
Applicable to distinguished functions e.g. quantitative analysis, Concern for detail etc.

Source: Human Resource Department, SBP

Further improvements in the Competency Model are also in progress which are aimed at revising the definition of various competencies using behavioral examples from the SBP work environment, simplifying the existing rating mechanism, dividing the Grade and Function specific competencies into four further categories:

- Individual Contributor
- First Line Supervisor
- Manager
- Leader

The effectiveness of evaluating the employees' competence relative to given levels of a competency or on a continuum is also being reviewed.

6.5 Core Values

A set of six Core Values was identified in the concept paper for capacity building of the SBP in 2000. The definitions and required behaviors of these identified Core Values were to be crystallized through a participative and consultative process. The aim of developing the Core Values through a consultative process was to create ownership of the new value system from top to bottom of the hierarchy. The process was completed this year. The SBP's Core values were defined and every staff member is committed to practice these values on a daily basis.

Box 6.3: Core Values of the SBP

Trust
Openness
Courage
Teamwork
Problem Solving Approach
Commitment to Excellence

6.6 Employee Recognition Policy

A formal employee recognition policy and program was introduced for the first time in the SBP with effect from July 2003. This policy provides the required tools to reward and recognize employees who demonstrate positive behavior through their performance towards achieving goals or enhancing the image of the SBP. The reward and recognition encompasses non-monetary as well as monetary awards. It ranges from a simple pat-on-the-back to giving substantial monetary awards, which can be given to individual employees as well as to a group or a team.

Box 6.4: Employee Recognition Awards

Annual Budget: 1 percent of Annualized Monetized pay

Level 1- Individual Contribution Award
(Thank you note, No cash Award)

Level 2-Departmental Commitment Award
(Cash Award of Rs. 5,000)

Level 3-Organizational Competence Award
(Cash Award Rs. 15,000)

Level 4- Excellence Award
(Cash Award Rs. 30,000)

Source: Human Resource Department, SBP

SBP wide workshops to create awareness about Employee Recognition Program were arranged for all employees of the SBP. It resulted in the training of more than 900 employees. During the first year of its implementation some apprehensions were expressed about the objectivity of the awards. Safeguards against the discretionary powers exercised to recognize a few favorites or immediate personal staff of the Heads of Departments have to be built in. The need to align this reward and recognition policy with the core values of the Bank has also been identified to promote greater employee interest towards adoption of Core Values.

6.7 Promotion Policy

A merit-based and competency driven promotion policy, in line with introduction of modern management concepts in the SBP, was introduced in July 2003. Under the new promotion policy a merit list of employees is prepared, based on evaluation of their performance in the last three years, improvement in qualification, marks obtained in training and seniority. Employees short-listed on the basis of this initial merit list are evaluated by a promotion committee through competency-based interviews for their suitability to perform in higher jobs. All promotions in this fiscal year took place under the new merit based promotion policy. The detailed breakup is:

Cadre	Promotions 2003-04
OG-1 to OG-2	9
OG-2 to OG-3	9
OG-3 to OG-4	15
OG-4 to OG-5	2
OG-5 to OG-6	2
OG-6 to OG-7	1

Box 6.5: Promotion Criteria	Weightage in Total Score	
	OG-2 and OG-3	OG-4 and OG-5
Performance Appraisal	40%	30%
Qualification	5%	5%
Training	10%	10%
Seniority	5%	5%
Interview	40%	50%
Total Marks	**100%**	

Source: Human Resource Department, SBP

6.7.1 Succession Planning

Implementation of interdepartmental rotation of officers was intensified to enhance development of broad based skills set, improve employees' career advancement opportunities as well as provide flexibility for the organization to address succession demands in an effective manner. Officers who had completed 3 years of service in their present grade or department were rotated to other departments. Managerial jobs are now internally posted and options are sought. The applicant are then screened, interviewed and short-listed for the jobs based on their competencies and future aspirations. Further, the SBP introduced a new interdisciplinary skill enhancement policy this year. Through this policy, officers of general and specialist side can be transferred to specialist and general areas to get a well-rounded exposure to the functions performed by the SBP.

7 Improved Accountability

7.1 Overview

It is a basic principle of democratic societies that public authorities are accountable to the general public for their actions. In the central banking context, accountability can be understood as the legal and institutional obligation of an autonomous central bank to explain its decisions clearly and thoroughly to the citizens and their elected representatives. The accountability demanded from the SBP, as the central bank of the country, is intended to increase all stakeholders' participation in overseeing every policy taken by the SBP. The SBP being fully aware of its responsibilities considers accountability and transparency as essential components of its mandate

The discussion on accountability encompasses two aspects: accountability of the SBP to its external stakeholders and the accountability arrangements within the SBP itself. The different features of instruments currently being used to gauge accountability of the SBP will now be discussed in more detail in respect of these two dimensions:

- Accountability *vis-á-vis* external stakeholders
- Accountability *vis-á-vis* internal stakeholders

7.2 Accountability *vis-á-vis* External Stakeholders

7.2.1 Parliament

Quarterly Reports to Parliament

Under the framework of the SBP Act 1956, the Central Board of Directors of the SBP are required to submit quarterly reports on the state of the economy to the Parliament, with special reference to economic growth, money supply, credit, balance of payments and price developments. These reports provide an objective and candid review of the economic policies pursued and therefore provide an important assessment of the performance of the central bank itself.

By analyzing the rationale and objectives of the SBP policies, and incorporating extensive coverage of real and fiscal developments, the reports help in developing a better public understanding of the interaction between monetary and fiscal policies and their impact on the overall growth of the economy. Moreover, the analysis contained in the reports allows meaningful guidelines to policy makers both in the SBP as well as in the government. In addition to this, these reports also help in rationalizing market expectations and guiding public perceptions on important economic issues, which consequently, make the implementation of policies much easier.

Sub-committees of the Senate and National Assembly

Under the parliamentary system of democracy in practice in Pakistan, various committees of the National Assembly and the Senate have been established and empowered to go into matters of all the ministries. A matter can be remitted to a standing committee by the Speaker of the Assembly *suo moto* and without moving any motion.

The committees have also been empowered to invite or summon before it any member or any other person having a special interest in relation to any matter under its consideration and may hear expert evidence and hold public hearing. The Governor can be invited to proceedings of the various committees to respond to specific questions and queries regarding the various aspects of the performance of the SBP. The Governor of the SBP can inform the Parliament and its members about the activities of the SBP through presentations to the various Committees of the Senate and National Assembly.

The National Assembly Sub-Committee on Finance invited the Governor to brief the Committee on the activities of the SBP and the banking sector at its meeting held on 15 July 2004. Similarly, the Senate Sub-Committee on Finance visited the SBP on 6 August 2004 and had a detailed hearing on the state of the economy as well as the performance of the SBP.

Questions raised in the National Assembly and Senate

The questions raised by members of the National Assembly can also serve as an important vehicle for interaction between senior management of the SBP and the public representatives. The questions received through this channel cover a wide range of issues from the rationale and anticipated results of macro-economic policies to the financial, legal and managerial issues associated with the working of the banking sector.

7.2.2 Cabinet

The Governor, SBP is invited to participate in the Cabinet meetings on Annual Budget, Trade Policy and other economic and financial issues. He also attends the meetings of the National Economic Council headed by the Prime Minister of Pakistan, Export Development Board, Economic Advisory Council and other similar forum.

On these occasions the viewpoint of the central bank are presented while the SBP's policies and actions are scrutinized and questioned.

Economic Coordination Committee of the Cabinet

The Economic Coordination Committee (ECC) is the highest economic policy making body formed by the Cabinet to take decisions pertaining to various economic issues involving government interests and reviews key economic indicators. The ECC normally meets once a week and consists of all the key ministers heading economic ministries. The Governor, SBP is a member of the ECC, fully participates in the deliberations and reports regularly on major developments pertaining to SBP to the Committee.

7.2.3 Monetary and Fiscal Policies Coordination Board

In order to achieve coordination between the SBP and the federal government on monetary and fiscal policies, the MFPCB was established in 1994. The Chairman of the Board is the Minister of Finance and its members include the Minister or Secretary Commerce, Deputy Chairman Planning Commission, Governor SBP and the Secretary, Finance Division. The major responsibilities of the Board include:

a) Coordinating fiscal, monetary and exchange rate policies by ensuring consistency among macroeconomic targets,
b) Determine government borrowing from commercial banks on the basis of liquidity expansion determined by the Central Board of the SBP,
c) Review the consistency of macroeconomic policies on quarterly basis and revisit initial limits/targets depending on developments in the economy, and
d) Review expenditures incurred on raising of loans and government borrowing.

7.2.4 Monetary Policy Statement

The transparency of the monetary policy of any central bank is greatly enhanced by means of a publicly announced monetary strategy. With this objective in mind, the SBP initiated publication of six-monthly monetary policy statements to indicate its expected monetary policy stance in January 2003.

The first statement of FY 2004 came out in July 2003, which provided justification for the easy monetary policy stance; it also explained the major developments and their potential linkage with the conduct of monetary policy. The second statement was issued in January 2004; it discussed the rising inflationary and interest rates trends and their potential impact on economic recovery and growth. However, SBP considered it appropriate to maintain its easy monetary policy stance for the next six months unless some unexpected events occurred. The perspective of the SBP was that inflation was still within tolerable limits and rising interest rates at their current levels were not expected to disturb the investment plans of the private sector.

7.2.5 General Data Dissemination System and Special Data Dissemination System of the IMF

The General Data Dissemination System (GDDS) is an evolutionary system reflecting changing needs of data users over time. Member countries of the IMF voluntarily elect to participate in the GDDS. The GDDS framework is built around four dimensions -- data characteristics, quality, access, and integrity -- and is intended to provide guidance for the overall development of macroeconomic, financial, and socio-demographic data. Participation requires:

a) Committing to using the GDDS as a framework for statistical development.
b) Designating a country coordinator
c) Preparing metadata that describe;
   i. Current practices in the production and dissemination of official statistics, and
   ii. Plans for short and longer-term improvements in these practices.

Pakistan has opted to participate in the GDDS and has been accepted as a member of GDDS in November 2003. Consequent upon the participation in GDDS, the SBP in collaboration with other relevant organization of Government of Pakistan prepared the required documents for comprehensive frameworks and data categories and indicators. Under the GDDS, Pakistan has committed to compilation and dissemination of economic, financial and socio-demographic data in accordance with international standards. GDDS covers data related to Real, Fiscal, Financial, External and Socio-demographic Sectors. The SBP has a major contribution towards GDDS in both Financial and External Sectors. The GDDS will enhance the credibility of our data in the international community.

Similar to the GDDS, the Special Data Dissemination Standard (SDDS) has been established by the IMF to guide members that have, or that might seek, access to international capital markets in the provision of their economic and financial data to the public. The SDDS, in taking a comprehensive view of the dissemination of economic and financial data, identifies four dimensions of data dissemination: The data: coverage, periodicity, and timeliness; Access by the public; Integrity of the disseminated data; and Quality of the disseminated data.

The Observance of Standards and Codes mission of IMF visited Pakistan in December 2003 reviewed the data dissemination practices of the SBP against the IMF's GDDS and SDDS. The mission focused on statistical practices related to monetary statistics and balance of payments. They have given detailed reports on the said area. The SBP has responded on the report regarding issues related to

Monetary Statistics and Balance of Payments. The finalization of report will lead Pakistan to become a member of SDDS.

Both the GDDS and the SDDS are expected to enhance the availability of timely and comprehensive statistics and therefore contribute to the pursuit of sound macroeconomic policies; the SDDS is also expected to contribute to the improved functioning of financial markets.

7.2.6 Financial Sector Assessment Programme

A joint IMF-World Bank Mission consisting of 16 experts drawn from all over the world visited Pakistan in February and April 2004 to carry out a comprehensive assessment of the Financial Sector in Pakistan. The FSAP Mission, which reported its findings to the Executive Board of IMF, was very positive about Pakistan's banking system and the SBP. The Mission concluded that "far reaching reforms have resulted in a more efficient and competitive financial system. In particular, the predominantly state-owned banking system has been transformed in to one that is predominantly under the control of the private sector. The legislative framework and the SBP's supervisory capacity have been improved substantially. As a result, the financial sector is sounder and exhibits an increased resilience to shocks".

The most noteworthy achievement of the Financial Sector Reforms in Pakistan is that about 80 percent of banking assets today are owned and managed by the private sector compared to 8 percent in 1990. These reforms have created a healthy competitive environment but, at the same time, strengthened the capacity of the regulator to oversee and supervise the banking system in an effective manner.

7.2.7 Audited Financial Statements

The SBP is required to release its audited financial statements to the public as laid down in the SBP Act 1956. The SBP publishes its audited balance sheet, profit and loss account and statement of cash flows in its annual report. The Report of the Auditors is appended to the Annual Report

The SBP Act requires the appointment of two Auditors for auditing the financial record and statements of the SBP every year. These firms are selected from the top five practicing firms in the field and the Audit Sub-committee of the Central Board independently approves their appointment. As a matter of prudence and good governance these companies are generally rotated after every three years as against the internationally acceptable benchmarks of five years.

The audit firms independently review the financial record and statements and report directly to the Audit Committee of the Board on their findings and status as to a true and fair view in conformity with the International Accounting / Auditing Standards. The external auditors also provide an independent view on the Internal Control weaknesses observed during the course of Audit directly to Audit Sub-committee of the Board of Directors. The Accounts are approved first by the Audit Sub-Committee and then presented to the Central Board of Directors for their approval.

7.2.8 Auditor-General of Pakistan

Auditor-General of Pakistan (AGP) is the head of Supreme Audit Institution (SAI) of the country and is appointed by the President. Articles 168 to 171 of the Constitution of the Islamic Republic of Pakistan, 1973 provide a constitutional status to the Auditor-General and his Department. The SBP as an autonomous body falls under the purview of audit by the Auditor General of Pakistan. The Director General Commercial Audit carries out audit of operations of the SBP every year. The auditors carry out a comprehensive audit of the business transactions and submit their report to the AGP. The report is discussed in Departmental Audit Committee of the Ministry of Finance and they report serious observations to the Public Accounts Committee for review and action.

7.2.9 External Stakeholder Survey

An external stakeholders survey was conducted on behalf of the SBP by the Institute of Bankers Pakistan (IBP) on a diverse sample of banks, stock exchanges etc. The response rate from the participating sample was:

Survey Sample	**Response Rate**
Banks DFIs	90 percent
Stock Exchanges	67 percent
Multinationals	33 percent
Chambers –Large	60 percent
Chambers-Small	04 percent

The objective of the survey was to determine the level of external stakeholders' satisfaction in their dealings with the SBP on the following dimensions.

Survey Dimensions:
- Monetary Policy
- Managing Exchange rates and reserves
- Economic Analysis and research
- Credit Management
- SBP's Developmental roles
- Website
- Maintaining BoP
- External Debt Management
- Proactive Regulation, supervision
- Quality, accuracy of data
- SBP staff behavior

The survey results revealed that highest level of interaction between the SBP Officials and External Stakeholders is at the level of Directors, Senior Joint Director and Joint Directors. The survey responses were solicited on various survey dimensions on a scale of Excellent, Good/Fair and Unsatisfactory. On an overall basis 80 percent of the respondents rated the SBP performance as Good/Fair, with 18 percent as Excellent and 2 percent as Unsatisfactory.

Responses against all the survey dimensions represented a uniform pattern with no major shift in the level of response from one dimension to the other. The survey also tracked stakeholder satisfaction in their interaction with the various SBP departments on a scale of Good, Fair and Unsatisfactory. On an overall basis 23 percent of the respondents rated their interaction with the departments as Good, 75 percent as Fair and 2 percent as Unsatisfactory.

7.3 Accountability *vis-á-vis* Internal Stakeholders

It would be unrealistic to expect any organization to display accountability and transparency to its external stakeholders when the system of self-accountability within the organization itself is weak. The system of internal checks and balances within the SBP is very well defined and comprehensive comprising of the following components:

a) Central Board of Directors
b) Internal Audit
c) Change Management Conference
d) Internal Stakeholder Survey

7.3.1 The Central Board of Directors

Under the provisions of the SBP Act 1956, the "general superintendence and direction of the affairs and business of the bank" rests with the Central Board of Directors. Through an amendment in the SBP Act in February 1994, the Central Board of Directors was enlarged which now consists of the Governor; Secretary Finance, Government of Pakistan and seven directors nominated by the Federal Government. From these seven Directors, one Director from each province is nominated while ensuring representation to agriculture, banking and industrial sectors. The Board being the highest decision making body of the SBP is responsible for:

- Formulating, evaluating and monitoring monetary and credit policy.
- Determining the expansion of liquidity, consistent with targets of growth and inflation ensuring that the monetary and credit policy is consistent with macroeconomic policy objectives.
- Determining and enforcing the limit of credit by the SBP to the Federal and Provincial Governments.
- Acting as a policy adviser to the Federal Government.
- Submitting a quarterly report on the state of the economy to the Parliament.

The Governor is the Chairman of the Central Board and all decisions are taken by majority of the members present and voting with the provision that in the event of equality of votes, the Governor may exercise a casting vote.

7.3.2 Internal Audit

The SBP has an Audit Department, which is responsible for ensuring that the various departments of the central bank are complying with the regulatory requirements. During its annual inspection of the Bank, the Inspection and Surveillance teams of the Audit Department look for instances of non-compliance with current regulatory requirements, identify problems and propose solutions and investigate financial bungling. The Inspection and Surveillance Reports assign compliance responsibilities to directors of the concerned departments. Brief Appraisals highlighting serious/major irregularities detected by the Inspection Teams are submitted to the Governor proposing action against the delinquents.

In recent years, the Audit Department has shifted its focus towards examining and evaluating whether the SBP's framework of risk management, control, and governance processes is adequate and functioning properly. Internal auditing has been strengthened recently by new management of the Audit Department, which now reports directly to the Governor/ Audit Committee of the Board. During the year 2003-04, the Audit department has completed risk-based audit of 16 departments, including two service departments of the SBP BSC.

7.3.3 Change Management Conference

An annual series of Change Management Conferences has been launched since 2000 when the change management process was embarked upon in the State Bank. The CMC acts as a forum where the senior management of the SBP gathers to focus on the status of change initiatives put in place since

2000. The Conference serves as an important tool of self-accountability as it brings together top management of the SBP in a consultative, consensus seeking mode and sets targets for achievement of the organizational objectives. Senior management, on a quarterly basis, then reviews the progress made in realizing these targets.

7.3.4 Quarterly Review of Business Plans and Budgets

The business planning and budgeting process was initiated in the SBP in the FY03 as an integrated approach towards achieving organizational efficiency and accountability. Under this approach, all HoDs lead their teams to develop operational goals and developmental goals based in relation to the overall strategic direction. The resource requirements for achieving these goals in terms of manpower, IT and training are then converted into operational and capital budgets. Departmental budget plans after consolidation are reviewed by the Budget Committee and resource allocations to each department are made on broader institutional guidelines given by the Governor. The Governor then reviews the progress on the budget plan of each department on a quarterly basis and any deviations from the original plan are observed and further action is recommended.

7.3.5 Internal Stakeholder Survey

Employee Surveys are used in world-class organizations as a feedback channel to identify areas of strengths and gaps where improvement is required. The first formal Employee Survey in the SBP was conducted (in-house) in 2002. During the Change Management Conference 2002 it was decided to introduce the Employee Survey process as a regular feature in the SBP. In order to provide the internal stakeholders the required confidence to provide feedback in a totally anonymous manner, services of an external consultant were engaged to carry out Employee Motivation Survey in 2003 with the responsibility to administer the survey and report its results without the involvement of anyone from the SBP.

Accordingly an Employee Motivation Survey was conducted in November 2003, among OG-2 and above, of the SBP. The participation rate in this purely voluntary survey was 74 percent against the industry-wide average of 58 percent.

The scope of the survey was to determine the current level of employee satisfaction in respect of employee motivation factors, strengths and weaknesses of policies related to employees and approval rating for various change initiatives. Employees were asked to respond to 52 statements representing 15 broad categories.

- Objectives & Strategies
- Communication
- Job Responsibilities
- Supervisory Relationship
- Teamwork
- Performance Appraisal/Career Development
- Compensation, Benefits & Reward
- Training & Development
- Work Environment & Culture
- General
- Change Initiative
- Technology Up-gradation Project
- Performance Management System
- Business Planning
- Training Facilities

Those who participated in the survey registered an average satisfaction score of 3.99 out of 6.0, which falls in the borderline of high and medium level of satisfaction. Employees in OG-6 and above as well as those with more than 10 years of service registered the highest level of satisfaction. HRD followed by employees in Corporate and Media Affairs Department (CMAD) registered highest satisfaction levels amongst the departments. Based on the overall survey results the primary areas of strength and concern for an employee at the SBP are:

Strengths
- Good understanding o Goals and Objectives
- Clear understanding of job responsibilities & work expectations
- Availability of survey forum to express views
- Satisfaction with personal accomplishments associated with work
- Confidence that employees will provide honest feedback through the survey

Concerns
- Career growth opportunities
- Lack of recognition & reward to encourage good performance
- Inability of compensation structure to differentiate between levels of performance, motivate and retain employees
- The new PMS has not significantly improved the appraisal process

As has been noted in chapter 6 of this report, nearly all of the concerns identified in the survey have been addressed through various initiatives taken during the course of the year.

The SBP Subsidiaries

8 State Bank of Pakistan Banking Services Corporation
9 National Institute of Banking and Finance

8 State Bank of Pakistan Banking Services Corporation

8.1 Overview

The SBP BSC is a body corporate, created upon promulgation of the SBP Banking Services Corporation Ordinance-2001, as a subsidiary of the SBP. It emerged as a part of overall organizational restructuring of the SBP and was created to focus on the retail banking functions. Previously these functions were being performed at 16 Field Offices of the SBP. The SBP BSC started its operations with effect from January 2, 2002 immediately after approval of the Governor of the SBP for the transfer of related assets, liabilities and employees in accordance with the provision of the Transfer Order dated December 29, 2001. A comprehensive performance report of SBP BSC covering a period of two and a half years has already been published and is also available on the SBP website.

8.2 Contributions as a Banker to the SBP

Upon its creation, the prime function assigned to the SBP BSC was to act as banker to the SBP, to handle all retail banking functions performed at 16 Field Offices. This enabled the SBP to concentrate on its core policy functions of Monetary Management, Exchange Rate Management, Banking Supervision and Payment System.

The operations of its 16 Field Offices are regulated by the Head Office situated in Karachi, which comprises of the following departments:

a) Administration Department
b) Accounts Department
c) Foreign Exchange Operations Department (FEOD)
d) Internal Audit Department
e) Medical Services Department
f) Engineering Department
g) Internal Bank Security Department
h) Foreign Exchange Adjudication Department

It was decided that the three common services departments (MSD, Engineering Department and Internal Bank Security Department) would continue to provide services to the SBP and its employees without any disruption. The heads of these departments report to Managing Director (MD), SBP BSC for all administrative purposes but they continue to be responsible for rendering services in their respective areas of work for all on-going and future projects of the SBP as well. The services of all Joint Directors (OG-5) and below, working in and on the strength of field offices have been permanently transferred to the SBP BSC. However, a number of OG-6/OG-5 Chief Managers/Joint Directors, whose services had not been transferred to the SBP BSC continue to retain their option in the SBP.

The main functions and responsibilities of the SBP BSC have been segmented through SBP BSC Ordinance 2001. The Ordinance *interalia* envisages the following line functions for the SBP BSC:

- Revenue collection and payments for and on behalf of the Federal Government, provincial governments, local governments, local bodies or any other governmental body, institution, company or corporation;

- Maintenance of the accounts of the Federal Government, provincial governments, local governments, local bodies or any other governmental bodies, authorities, institutions, companies, corporations and of other banks and financial institutions;
- Operational work relating to management of debt;
- Operational work relating to foreign exchange;
- Prize bonds and Government Savings Schemes;
- Cash and other business as provided for in agreements between the SBP and the Federal Government and between the SBP and the Provincial Government or in the SBP Act, the Foreign Exchange Regulation Act, 1947 (VII of 1947), the Banking Companies Ordinance, 1962 (LVII of 1962), the Public Debt Act, 1944 (XVIII of 1944), the Securities Act 1920 (X of 1920) or in any other applicable laws, rules, regulations, orders and notifications made or issued thereunder; and
- Any other business, offices or departments, and functions, in full or in part, as may be setout in or authorized or delegated by the Transfer Order dated December 29, 2001.

8.3 Corporate Structure of the SBP BSC

The general superintendence, direction and management of the affairs and business of the subsidiary and overall policy making in respect of its operations is vested in its Board of Directors which comprises of:

- All members of the Central Board of the SBP.
- Managing Director of the SBP BSC.

The Board of the SBP BSC during FY03 and FY04 took up the following agenda items:

- Special Early Retirement Package for employees of Engineering Department and all clerical/non-clerical staff.
- Quarterly review of revenue and capital expenditure against budget allocation of BSC for the quarter ended September 30, 2002.
- Currency and cash management aspects of SBP BSC's operations.
- Outsourcing of maintenance services for SBP building at Karachi.
- Increase in salaries.
- Leave policy.
- Payment of pension and benefits to employees retired under Voluntary Golden Hand Shake - 1997.
- Promotion of clerical/non-clerical staff as OG-1.
- Scheme for study leave in Pakistan.

8.4 Constitutions of Sub-Committees

Like the corporate setup of the SBP, the SBP BSC has also adopted the setup of various Sub-Committees of Board. The purpose of a Sub-Committee is to provide inputs and improvements in respective areas of operations assigned to them. The following four Sub-Committees of the Board have been constituted. Since the corporate structure of the SBP BSC is the same therefore, SBP BSC has adopted the same terms of reference for Sub-Committees as approved by the Board of the SBP. The committees hold meetings to deliberate on the issues referred to them as per the terms of references approved by the Board.

- Sub-Committee on HR
- Sub-Committee on Audit
- Sub-Committee on Budget and Expenditures

✍ Sub-Committee on Building Projects

8.5 Functions of the SBP BSC

The SBP BSC has been entrusted with the core operational activities of a Central Bank in the areas of Currency Management, Foreign Exchange Operations at Field Offices, Banker to the Federal and Provincial Governments, Banker to Banks, Remittances of Funds, National Savings Schemes (including Prize Bond Scheme etc.). The issues relating to Accounting Procedures, Administrative Policies, Human Resource Management and Human Resource Development are taken care of at the SBP BSC Head Office level.

8.5.1 Banker to the Government

The SBP BSC performs the treasury functions on behalf of Federal as well as Provincial Governments at its 16 Field Offices. All the Government receipts and payments are routed through Field Offices for the areas falling within their respective jurisdiction. Besides all the receipts/payments made by the NBP on behalf of the Government, are also reported to the concerned SBP BSC Field Office, which provides the interface between the NBP, the Government and the SBP BSC's Accounts Department at its Head Office Karachi, where the complete accounting procedure for maintenance of consolidated Government accounts is carried out.

8.5.2 Currency Management

The SBP BSC has a major challenge of currency management function. The task is difficult since the economy is predominantly cash-based. Elaborate efforts have been made recently ranging from the formulation of currency management framework/guidelines to training of the relevant stakeholders, to manage the currency related matters. Now that the direction/goals have been set, developments in better currency management are relatively easier to work upon. It should be mentioned here that not only have the rules been set, a lot of work has been initiated for automation of the related processes/activities. A detailed coverage of currency management is available in SBP BSC performance report.

8.5.3 Debt Management and Savings Regime of the Government of Pakistan

As the banker to the Government it is obligatory on the SBP to provide debt management services on different accounts of floatation of loans, repayments, redemption etc. The operational management of several debt schemes and debt instruments like Foreign Exchange Bearer Certificates, Federal Investment Bonds, PIBs, US Dollar Bonds, Special US dollar Bonds including their sale, purchase, encashment, cancellation by banks remain the vital concern for the Field Offices. The debt management services provided by different sections of Field Offices include prompt reporting mechanism of data, which is maintained in prescribed format and regularly sent to the policy departments of the SBP.

Management of Government Saving Schemes

In order to boost the savings in the economy, the SBP BSC is playing a key role by providing services to the Government and the public for maintenance of various public debt instruments like the Prize Bonds and National Savings Certificates. The following points summarize the contribution of the SBP BSC in this regard:

a) Maintenance of sale and encashment of National Bonds and reporting to Finance Divisions, Central Directorate of National Savings, Islamabad and other concerned quarters.

b) Maintenance of sale and encashment of National Savings Certificates and reporting to Finance Divisions, Central Directorate of National Savings, Islamabad and other concerned quarters.
c) Making transparent draw arrangements of all denominations of Prize Bonds at all Field Offices of the SBP BSC on a timely basis.

8.5.4 Operational Arm of the SBP

The SBP BSC is also performing the functions as an operational arm of a pre-dominantly policymaking regulatory authority, the SBP. This role has no specific boundaries, as it is the statutory obligation of the SBP BSC to perform the functions entrusted by the SBP. Some very important areas of such functionality during the period under review are as follows:

Export Finance-Disbursement and Monitoring

The SBP formulates schemes for boosting exports. The process of disbursement of credit through all these schemes is carried out through Field Offices of the SBP BSC. These offices have contributed towards disbursement of export finance at the industrial centers of the country. Moreover, the offices have effectively monitored the disbursement in this area made through the commercial banks.

Foreign Exchange Operations

While the SBP is dealing with the policy matters relating to foreign exchange, some operational functions related to this area are assigned to the FEOD of the SBP BSC. The FEOD is responsible for implementation of foreign exchange policies framed by the SBP for exchange rate stability. It operates through the respective Units formed at the Field Offices. The supervision and final compilations are carried out at the BSC Head Office. The inflow and out flow of different foreign remittances including commercial remittances, private remittances, shipping companies are dealt with at the FEOD. All matters relating to imports, exports, and matters of Export Overdue cases, Exchange Companies etc. are the prime concern of the SBP BSC in close coordination with EPD of the SBP.

Local Credit Advisory Committees-Holding of Meetings at Field Offices

In accordance with the Governor's vision to keep close contact with all stakeholders, Local Credit Advisory Committees have been formed at the Field Offices of the SBP BSC. These committees have representation from various segments of economic activity. The committees work under the chairmanship of the relevant Chief Manager of the Field Offices and have representation from the commercial banks, DFIs, Government departments, and members/representatives of bodies of traders, farmers and other businessmen. Regular meetings of these committees are held at the respective Field Offices. The minutes of these meetings are recorded and the forum works as an effective feedback channel for the SBP.

Operational Role in Monetary Management

Field Offices work strategically to help in the implementation of the monetary policy, which is formulated at the SBP. At an operational level, since they maintain the accounts of the commercial banks and other financial institutions for placements, the Field Offices facilitate concerned departments of the SBP in monitoring of the statutory requirements for maintaining various reserves. Moreover, back office support is provided in conducting of OMOs through the Karachi Office. There is continuous close interaction with officials working in EDMD of the SBP with regard to the auction of T-Bills and PIBs.

Payment System

In order to assist the SBP to carry out its prime responsibility as a custodian of the payment system, the SBP BSC Field Offices perform multiple payment services through their counters and perform clearing house activities through which inter-bank fund transfers are effected. The heavy quantum of ready cash payments, cheques passed through clearings, bank drafts, pay orders, Government drafts, mail transfer, telegraphic transfer, income tax refund cheques and pension bills are the peculiar feature of payment services handled at Public Accounts Department / Deposit Accounts Department counters of the SBP BSC Field Offices. The clearinghouse functions are monitored at the Chief Manager level, where Chief Managers of Field Offices act as Chairman of the Local Clearing House. After an agreement with NIFT most of the functions of clearing and settlement of payment instruments have been automated and the time cycle for completion of transactions has been reduced. This network will be further improved once the project of RTGS is implemented.

8.6 Financial Profile – Income Generating Avenues

Currently the SBP BSC is concentrating on the efficient monitoring of its budgetary resources in order to save financial resources by having a proper controlling mechanism and avoiding unnecessary expenditures, like traveling, utility expenses, payment of daily allowances, overtime, honorarium etc.

While following this approach, the SBP BSC is also exploring avenues for income generation in the future. A number of proposals already approved by the Corporate Management Team (CMT) include:

a) **Collection of Sales Tax Challans at the SBP BSC Counters:** Presently sales tax challans are being collected by the NBP alone, for which they charge Rs15 per challan from the stakeholders as per their agreement with the CBR. The SBP BSC can also make similar arrangements with the CBR.

b) **Collection of Custom Duties etc. by the SBP BSC at the Custom House:** The SBP BSC can place online terminals at Custom House, Karachi for collection of custom duties in order to save the collection cost being paid to NBP at the rate of 0.15 percent under the treasury arrangement.

c) **Withdrawal of the NBP Chest Branches at Selected Places:** In cities where the SBP BSC Field Offices can provide chest services to the provincial and federal Government, the NBP chest branches can be asked to withdraw.

d) **Fee for Issuance of SBP Chequebooks:** A small fee can be charged for issuance of the SBP chequebooks to the account holders.

e) **Increase in Clearing House Membership Fee:** The clearinghouse membership fee can be raised to Rs100,000.

f) **Increase in the Rate of Telegraphic Transfer Commission:** The rate of IT commission can be increased to 0.06 percent in line with the market trend.

8.7 Human Resources

As of June 30, 2004, the SBP BSC had a total of 5510 regular employees out of which 4867 were working in Field Offices and 643 were serving at different departments of the SBP BSC Head Office.

Table 8.1: Worki ng Strength of SBP BSC Head Office and Field Offices

Offices	Year 2004
Head Office Karachi	643
Karachi	1172
Lahore	924
Peshawar	426
Quetta	206
Rawalpindi	303
Faisalabad	308
Multan	240
Islamabad	256
Hyderabad	243
Sialkot	144
North Nazimabad	140
Sukkur	172
Bahawalpur	102
Gujranwala	79
Muzaffarabad	61
Dera Ismail Khan	91
Total	**5510**

Source: State Bank of Pakistan Banking Services Corporation

The SBP BSC has been aggressively pursuing its HR policy to maintain an efficient profile by composing a blend of new skills and experience. Several policy parameters including rotation, transfer, promotion and recruitment have been meticulously followed by the SBP BSC management to build its human resource capacity in a cost effective manner.

9 National Institute of Banking and Finance

9.1 Overview

The SBP took over the ownership and management of NIBAF in 1997 and has transformed it into an apex centre for learning and advancement with the mission of developing human resource in the fields of banking and finance.

NIBAF was set up in 1994 (under the Companies Ordinance 1984) as a Guarantee Limited Company by the erstwhile Pakistan Banking Council (PBC) and five banks namely NBP, HBL, UBL, ABL and MCB. Later on upon dissolution of PBC in 1997, NIBAF became a subsidiary of SBP with 85 percent share holding while the remaining 15 percent shareholding remained with NBP.

NIBAF is housed in a purposefully designed campus at Islamabad comprising of state of the art training/academic block with residential facilities. A Rural Finance Resource Centre has been set up at the Islamabad Campus in collaboration with ADB for specialized training of commercial bankers and MFIs. NIBAF also has another campus at Karachi located in the SBP Building in North Nazimabad.

9.2 Setup

The overall direction and policy of NIBAF rests with the Board of Directors. The Directors of Board during the current year are:-

a)	Dr. Ishrat Husain, Governor SBP	Chairman
b)	Mr. Khair Mohamed Junejo	Member
c)	Mr. Azhar Hamid	Member
d)	Mr. Zia Khaleeli (retired in January 2004)	Member
e)	Mr. R.A. Chughtai, Deputy Governor SBP (Retired on June 19, 2004)	Member
f)	Mr. S. Ali Raza, President NBP	Member
g)	Mr. Kazi Abdul Muktadir, MD NIBAF	Member

The Managing Director as Chief Executive is assisted by the Incharge Academics and Head Administration in running the day to day affairs. The Academic side comprises of 3 tracks: Economics, Banking and Management each headed by a Team Leader and supported by Training Managers whose strength is drawn on rotational basis from the SBP. The concept is to sustain the continuum of standard and quality. Best performing officers of the SBP who show potential of future leadership are selected as Training Manager for a 2-year period during which they would not only sharpen skill of others but also enhance their own concepts through interaction, dialogue and learning. The Institution, *interalia*, is reposed with the following core functions:

- Training design.
- Training programs development and delivery.
- Engaging trainers, developing training material handbook.
- Costing, budgeting, disbursal, record keeping, reporting.
- Developing detailed operational manual, rules and regulations for efficient operations.

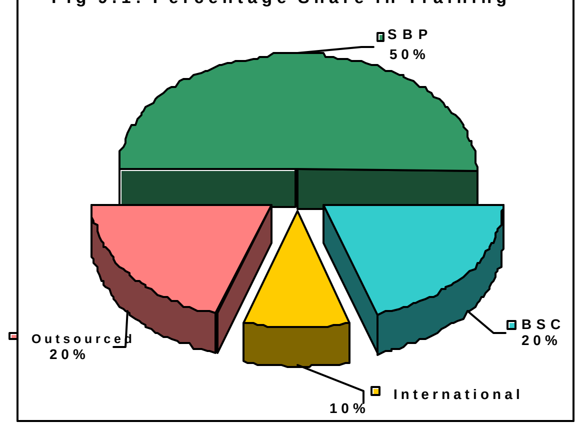
9.3 Training Activities and Performance

To attain substantial progress in the goals set for training activities, some key initiatives were undertaken to address a number of concerns. The first and foremost concern emerged from the fact that while the short term training needs of the SBP employees at the foundation and intermediate level could more or less be met, but there was a need to broaden the stakeholders base. Accordingly, for the first time, training to the SBP BSC employees at the post induction and skill up-gradation level was offered. At the same time, job specific training modules were offered for the SBP BSC. Simultaneously, training programs in collaboration with international and local organizations were initiated and made an integral part of the business plan. These initiatives were imperative to address the challenge of optimal utilization of the institute's capacity and resources.

9.3.1 Academic Performance

An unprecedented target of 206 training weeks covering 1500 participants was set for FY04 that was fully achieved. During 2003-04 NIBAF mainly catered to the SBP and the SBP BSC training needs but also facilitated training activities of the financial sector at domestic and international level. Fifty percent of the total trainings were delivered to the SBP employees at both the Islamabad and Karachi campuses, whereas training to the SBP BSC accounted for 20 percent. Participation in the international courses also reached a record level of 20 weeks (10 percent of the total).

Fig 9.1: Percentage Share in Training



As evident from the figures, the training activities continued to gain momentum in each consecutive year. Annual comparative analysis of performance in terms of training delivery in weeks and coverage manifest a visible increase in training momentum and coverage over the recent past. Coverage in terms of participants' trained, exceeded the target for the first time in FY04 1917 people were trained. This was possible due to the enhanced collaboration with the SBP and the SBP BSC.

Figure 9.2: Training Delivery

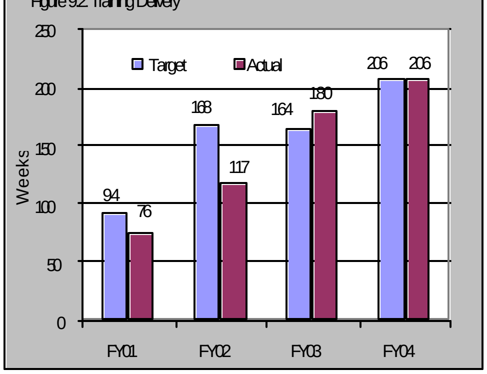
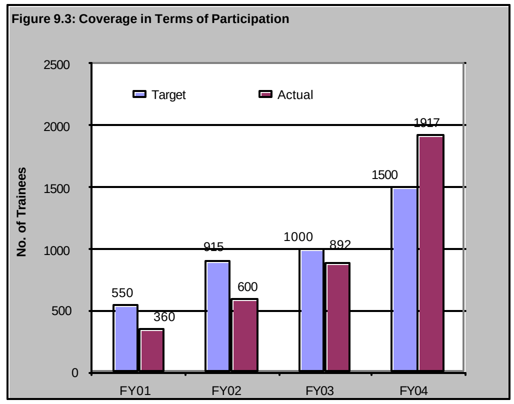


Figure 9.3: Coverage in Terms of Participation



During the previous fiscal year, some of the post induction and skill up-gradation programs originally planned, to cater to the demand of the SBP and the SBP BSC, could not materialize due to the low number of nominations. This shortfall in the targeted weeks was replenished by shifting emphasis and focus to international and outsourced programs and by increasing training weeks under ADB program and other agencies. NIBAF's target was achieved even though the strength of Training Managers had been reduced from 18 to 10. Similarly, maximizing on NIBAF's resources, the support staff was substantially reduced without impacting the quality or quantity of course/program delivered.

Table 9.1: Overview of Training Weeks Delivered During FY04

	Target	Outcome Jul-Jun	Shortfall/ Excess
Overall	**206**	**206**	**0**
SBP	**110.5**	**91.5**	**-19**
Post Induction	**54.5**	**43.5**	**-11**
SBOT-7	2	2	0
SBOT-7 A	7	7	0
Analyst Training Programme-2	12	12	0
SBOT-8	20.5	20.5	0
Joint Director's Training Programme	8	2	-6
LEGAL	5	0	-5
Skill Up-gradation	**56**	**47.5**	**-8.5**
Foundation	34	34	0
Intermediate	17	13	-4
Advanced	5	0.5	-4.5
SBP BSC	**48.5**	**41.5**	**-7**
Post Induction	16.5	16.5	0
Skill Up-gradation	32	25	-7
International	**27**	**32**	**5**
SBP/GoP	12	12	0
ADB	10.5	15.5	5
IMF	2	2	0
IDB/IRTI	2.5	2.5	0
Outsourced	**20**	**41**	**21**
Institute of Bankers Pakistan	2	2.5	0.5
CBR	1	1	0
Khushhali Bank	4	13	9
Askari Bank	2	8.5	6.5
UBL	0	1	1
Others	11	15	4

Source: National Institute of Banking and Finance

9.3.2 New Areas of Training During 2003-04

Besides the increased quantum of training, a number of new areas of trainings both in domestic and international courses were introduced. In domestic courses, the institute introduced a whole range of new courses for SBP BSC, hitherto a completely neglected area. The new courses were designed and delivered for all the layers of SBP BSC management including inductees, middle level and senior management level. A senior level management training program for the chief managers and deputy chief managers was a distinct success. The objective of this training program was to reinforce concepts and to enhance the knowledge of chief managers/deputy chief managers in order to improve their ability to perform their functions efficiently as representatives of the SBP at the field stations.

In international courses, a new training facet on the subject of "Risk Management" was conducted under the technical assistance of ADB for the institutional strengthening of the SBP. Initially eight programs spread over 10.5 weeks were planned. However, with the concerted efforts, NIBAF not only out-performed the target but also made the training more involving and result oriented. In this regard ten programs of 14.5 weeks were conducted, in which 266 officers of the SBP were trained in different areas of risk management using lesson plans approved by Federal Reserve Bank and

American Bank Association's computer simulation models and exercises. The purpose of the model and exercise was to develop an understanding of the participants about the complexities of managing banks in a dynamic economy and the need for an integrated, consistent set of policies to maintain the profitability, safety, and growth of the banking firm.

Another international course on Monetary and Fiscal Policies with a focus on Islamic Economics was introduced in collaboration with Islamic Research and Training Institute (IRTI) of Islamic Development Bank (IDB). The course participants were invited from the member countries of the IDB. In the same context, to share knowledge and expertise seminars on Awqaf and Retakaful were held at NIBAF in collaboration with the International Islamic University Islamabad/IRTI.

9.3.3 Efficient Utilization of Resources

NIBAF has attempted to utilize its resources and capacity optimally to be cost effective and competitive both in domestic and international courses. A comparison between the cost of training delivery and the number of training weeks delivered during recent years has been done. During FY01 the training cost was Rs20 million against which 76 weeks of training were delivered. The cost went up to Rs47 million in FY02 against a delivery of 117 weeks of training. However, in FY03 there was a marked reduction of 33 percent in the cost of training delivery and in sharp contrast the quantum of training delivery increased to 180 weeks. In FY04 the target for delivery was enhanced by 10 percent and cost was further decreased. The objective was achieved by:

a) Inviting more trainers from the SBP and the SBP BSC who cost less and are qualitatively better as compared to external trainers.
b) The number of training managers and support staff was significantly reduced.
c) Responsibilities of training managers were increased. As a result training managers are now performing some functions, which were performed by external coordinators in the past.

During 2003-04 efforts to market NIBAF facilities proved to be very fruitful and as a result substantial business was attracted, which generated an income of Rs16.70 million almost equivalent to the fixed costs of Rs17.59 million during the year.

9.3.4 Qualitative Changes

The number of training programs was enhanced to meet the needs of the SBP and other stakeholders. The range of subjects included new courses like payment system, mercantile law, concessionary finance, poverty in Pakistan, IT related training and risk focused simulation models. However, it was felt that there was room for qualitative improvement for which the curriculum and training material is being revisited. This is an area of focus in the Business Plan for 2004-05.

Improvements have also been made in the modes of learning that include rigorous class room training, exposure to functioning of organizations, case studies, group projects, assignments, presentations, role playing simulation exercises and field trips. Besides the module-based trainings, continuous efforts are made to inculcate core values and group dynamics, keeping in view the basic competencies required for efficient and competitive managers.

Another important mode of sharing knowledge during the year was a series of lectures delivered by the Governor SBP and Scholars from Warwick Business School United Kingdom, NIPA and market recognized professional managers. Seminars and conferences on challenges faced by the financial and fiscal sector are being planned and are expected to become an integral part of the business plan activities for 2004-05.

Finances of the SBP and its Subsidiaries

10 Review of Business Planning and Budgeting
11 Annual Financial Performance Review
12 Consolidated Financial Statements of the SBP and its Subsidiaries
13 Financial Statements of the SBP
14 Financial Statements of the SBP BSC
15 Financial Statements of NIBAF

10 Review of Business Planning and Budgeting

The Business Planning and Budgeting exercise was introduced at the departmental level during 2002-03 to achieve the organizational objective in a productive and effective manner. The key organizational objectives are to:

- Clearly define goals and performance evaluation criteria
- Establish benchmarks
- Strengthen corporate governance and accountability at all levels
- Allocate available resources with appropriate delegation of powers so that the functions of the SBP are carried out in an efficient manner.
- Provide tools for ongoing monitoring and evaluation of performance

The benefits in the shape of greater productivity, accountability and cost effectiveness are always visible. Besides carrying out the usual operational functions, various other developmental projects were also implemented during the year within the stipulated budgetary allocation. Hence, the total expenditures of the SBP for the year 2003-04 remained at Rs7,908.87 million against the budgetary allocation of Rs8,308.2 million thereby, reflecting a positive variance of Rs399.33 million (4.8 percent). The total expenditure of the SBP can be classified into the following broad categories:

- Corporate Cost
- Establishment Expenses
- Operating Expenses

10.1 Corporate Cost

The Corporate Cost includes agency commission charges, note and cheque printing charges and Special Drawing Rights (SDRs) charges, which constitute 47.4 percent of the total expenditures. These expenses stood at Rs3,746.04 million against the budgetary allocation of Rs3850.04 million thus reflecting a positive variance of Rs103.96 million.

10.2 Establishment Expenses

The establishment expenses include salaries, staff benefits, pension payments, medical expenses and training expenses. The total establishment expenses for the year under review were Rs3,162.35 million as against the budgetary allocation of Rs3,445.10 million, resulting in a positive variance of Rs282.75 million (8.2 percent) in spite of the induction of two batches, instead of one, of officers under the SBOTS.

10.3 Operating Expenses

The Operating Expenses of the SBP during the period under review were Rs899.62 million as against budgetary allocation of Rs1,013.10 million, hence reflecting a positive variance of Rs113.49 million (11.2 percent). Retirement Cost – which is a one-off expense however, remained at Rs100.87 million against the budget of Rs98.44 million due to an increase in number of retirees under Early Retirement Incentive Scheme of the SBP.

10.4 Un-Budgeted Expenses

The un-budgeted expenses during the year amounted to Rs176.41 million which primarily include the Privatization Commission charges of Rs138.58 million, paid for the privatization of HBL and the disinvestment of shares of NBP. This also includes professional charges of Rs.37.83 million that were spent mainly on acquiring services of a consultant and a law firm for appointment of fund managers and custodians for optimal utilization of foreign exchange reserves.

Table 10.1: Executive Summary of Expenditure Budget of the SBP for the Year 2003-2004

Head of Account (Rupees in million)	BSC Budget Budget	SBP Budget	Consolidated Budget	BSC Actual	SBP Actual	Consolidated Actual	Variance	Variance %age
	1	2	3=(1+2)	4	5	6=(4+5)	7=(3-6)	8=7/3*100
1) Corporate Costs	**-**	**3,850.000**	**3,850.000**	**-**	**3,746.041**	**3,746.041**	**103.959**	**2.7%**
1.1) Agency Charges		1,500.000	1,500.000		1,554.969	1,554.969	(54.969)	-3.7%
1.2) Notes and Cheques Printing Charges		2,050.000	2,050.000		1,963.777	1,963.777	86.223	4.2%
1.3) SDR Charges		300.000	300.000		227.295	227.295	72.705	24.2%
2) Establishment Expenses	**2,311.100**	**1,134.000**	**3,445.100**	**2,113.546**	**1,048.801**	**3,162.347**	**282.753**	**8.2%**
2.1) Salaries	1,960.800	590.000	2,550.800	1,784.542	547.904	2,332.446	218.354	8.6%
2.2) Rest & Recreation allowance	53.000	27.500	80.500	57.022	14.539	71.561	8.939	11.1%
2.3) Pension, Gratuity & Other Benefits	89.300	346.000	435.300	38.903	347.634	386.537	48.763	11.2%
2.4) Medical Expenditure	203.000	90.000	293.000	227.767	85.595	313.362	(20.362)	-6.9%
2.5) Training Expenditure								
Own	5.000	5.500	10.500	5.312	7.179	12.491	(1.991)	-19.0%
NIBAF		75.000	75.000		45.950	45.950	29.050	38.7%
3) Operating Expenses	**399.560**	**613.542**	**1,013.102**	**292.529**	**607.087**	**899.616**	**113.486**	**11.2%**
3.1) Rent, Taxes, Insurance & Lighting:	109.300	38.000	147.300	103.098	42.229	145.327	1.973	1.3%
i) Rent, Taxes & Insurance	9.500	26.000	35.500	6.999	26.905	33.904	1.596	4.5%
ii) Utilities	99.800	12.000	111.800	96.099	15.324	111.423	0.377	0.3%
3.2) Fees paid to Outsiders:	2.700	23.300	26.000	3.737	21.043	24.780	1.220	4.7%
i) Directors		2.000	2.000		1.812	1.812	0.188	9.4%
ii) Auditors	1.500	1.300	2.800	1.500	1.279	2.779	0.021	0.7%
iii) Legal	1.200	7.644	8.844	2.237	7.018	9.255	(0.411)	-4.6%
iv) Professional		12.356	12.356		10.934	10.934	1.422	11.5%
3.3) Stationery	8.900	4.500	13.400	8.430	7.450	15.880	(2.480)	-18.5%

Head of Account	BSC Budget	SBP	Consolidated	BSC	SBP	Consolidated	Variance	Variance %age
	Budget	Budget	Budget	Actual	Actual	Actual		
	1	2	3=(1+2)	4	5	6=(4+5)	7=(3-6)	8=7/3*100
3.4) Depreciation to Bank Property:	133.500	412.000	545.500	26.646	391.345	417.991	127.509	23.4%
i) Depreciation of Property (Except Vehicles)	133.500	401.000	534.500	26.646	380.601	407.247	127.253	23.8%
ii) Depreciation on Car facility (Vehicles)		11.000	11.000		10.744	10.744	0.256	2.3%
3.5) Travel Expenditure incl uding allowances	23.100	44.000	67.100	21.512	53.398	74.910	(7.810)	-11.6%
i) Traveling	5.000	17.500	22.500	6.154	19.668	25.822	(3.322)	-14.8%
ii) Daily allowance	10.500	21.500	32.000	10.019	29.825	39.844	(7.844)	-24.5%
iii) Conveyance & Fuel Charges	7.600	5.000	12.600	5.339	3.905	9.244	3.356	26.6%
3.6) Communication Expenditure:	14.210	42.000	56.210	12.627	37.052	49.679	6.531	11.6%
i) Postage, Telephone, Fax, Internet & Website Charges	14.210	20.000	34.210	12.627	22.385	35.012	(0.802)	-2.3%
ii) V-Sat Charges		12.000	12.000		1.368	1.368	10.632	88.6%
iii) SW IFT & Reuter's Charges		10.000	10.000		13.299	13.299	(3.299)	-33.0%
3.7) Computer Consumables	5.000	10.000	15.000	3.094	5.112	8.206	6.794	45.3%
3.8) Repairs & Maintenance to Bank Assets:	8.900	10.500	19.400	6.466	25.568	32.034	(12.634)	-65.1%
Repairs & Maint. of Property, Vehicles, Equipment, etc.	8.900	10.500	19.400	6.466	25.568	32.034	(12.634)	-65.1%
3.9) Miscellaneous Expenditure:	93.950	29.242	123.192	106.919	23.890	130.809	(7.617)	-6.2%
4) Retirement Cost (OneOff Expenses)		**98.443**	**98.443**		**100.866**	**100.866**	**(2.423)**	**-2.5%**
Total (A)	**2,710.660**	**5,695.985**	**8,308.202**	**2,406.075**	**5,502.795**	**7,908.870**	**399.332**	**4.8%**
UN-BUDGETED EXPENSES						-	-	
Privatization Commission Charges	-		-		138.579	138.579	(138.579)	
Professional Charges					37.833	37.833		
Total (B)	-	-	-	-	**176.412**	**176.412**	-	-
GRAND TOTAL (A+B)	**2710.660**	**5695.985**	**8308.202**	**2406.075**	**5679.207**	**8085.282**	**222.92**	**2.7%**

Source: Accounts Department, SBP

11 Annual Financial Performance Review

The SBP earned a net profit of Rs6,221 million as compared to the profit of Rs243 million earned in FY03. The reasons for the increase in profit over the previous year include the turnaround in exchange earnings, enhanced income from interest and discount on foreign currency reserves, profit on sale of investments besides effective expenditure management which resulted in a decline in establishment cost and operating expenditure. The impact of these positive developments was, however, mitigated by reduced earning on government and banks' borrowing in view of the low interest scenario prevalent in the international market in general and in the country in particular. A detailed analysis of expenditure and income is given below:

11.1 Expenditure

Bank expenditure may be classified into the following broad categories:

- Corporate cost (47 percent)
- Establishment cost (35 percent)
- Operating expenses (18 percent)

The principal head of expenditure i.e. establishment cost consists of two major items; current staff salaries and benefits (53.2 percent) and retirement benefits (46.81 percent). This cost decreased by Rs69.02 million from last year's figure. Similarly, operating expenses have also shown significant decline to the tune of Rs52.95 million this year. The corporate cost (comprising note printing charges, SDR charges and agency commission to NBP), however, escalated by Rs238.07 million due to increased volume of higher denomination notes printed during the year under the clean note policy of the SBP and also due to an increase in government transactions.

11.2 Discount, Interest/ Markup and/or Return Earned

SBP's earnings streams has undergone a basic change whereby interest/discount income on foreign assets comprising foreign currency reserves has surpassed the earnings on domestic assets comprising government and banking sector borrowings, as tabulated below:

Table 11.1: Interest/Discount/Return Income on Foreign and Domestic Assets

Rupee in million

	2004	2003
Interest/discount income on foreign assets	6,979	6,357
Interest/discount/return income on domestic assets	4,755	14,803
Total	**11,734**	**21,159**

Source: Accounts Department, SBP

Income from foreign currency reserves increased despite the prevalence of low interest rates in the international market. This escalation is due to the increase in interest rates and enhanced volume of foreign currency reserves built up by the SBP despite prepayment of ADB loans equivalent to US$1,172 million, which was arranged out of a sinking fund created by the SBP. Breakup of foreign currency reserves is as under:

Table 11.2: Foreign Currency Reserves
Equivalent US Dollars in million

	2004	2003
Securities	2,378	953
Deposits accounts	8,436	8,474
Current accounts	58	322
Special drawing rights with IMF	238	244
Total	**11,110**	**9,993**

Source: Accounts Department, SBP

On the other hand, the decrease in income from domestic assets is attributable to a decline witnessed in income from T-Bills and government securities in addition to banking sector borrowing from the SBP. Though outstanding credit against the government and the banking sector registered an increase as tabulated below, particularly due to the prepayment of the ADB loan, the decline in yield on T-Bills and low rate of markup on export refinance provided to the banking sector, adversely affected the return on this account.

Table 11.3: Lending to Government and Financial System
Rupee in million

	2004	2003
Government securities	134,515	110,917
Overdraft to governments	17,533	12,040
Banks and financial institutions	187,906	162,143
Total	**339,954**	**285,100**
Yield on Treasury Bills	**1.212% to 4.32%**	**1.64% to 6.40%**
Markup on Export finance	**1.5% to 2.0%**	**2.0% to 6.5%**

Source: Accounts Department, SBP

11.3 Interest and Markup Expense

Interest and markup expense increased from Rs2,578 million to Rs5,202 million. The principal reason for this increase is the SBP's share of loss under the profit and loss arrangements with the ZTBL, booked at Rs3,815 million. If this one-off impact is not taken into account, the overall interest expense reflects a favorable comparison to last year's interest expense. Consequently, the decline in interest expenses was due to the termination of the Special Rupee Deposit Accounts, FE-45 deposits and also owing to the decrease in the rate of interest on foreign exchange liabilities.

11.4 Commission Income

The SBP derives commission income from management of public debt, issuance of drafts and payment orders, and prize bonds and National Saving Certificates. The commission income for the year worked out at Rs496 million thereby registering an increase of Rs173 million over last year's commission income of Rs323 million.

11.5 Exchange Gain/(Loss) - Net

The exchange gain/loss of the SBP is dependant on three variables, namely: quantum of the SBP foreign exchange assets, volume of foreign exchange liabilities and exchange rate parity of the Rupee with major foreign currencies, principally the US Dollar and SDR. The year under review witnessed a continuation of the rising trend in foreign exchange reserves of the SBP, which increased from US$9,993 million as on June 30, 2003 to US$11,110 million by end June 2004. The enhanced volume of reserves coupled with a modest appreciation of the US$ vis-à-vis the Rupee resulted in a substantial exchange gain. However, the depreciation of the Rupee against the SDR partially offset the above gain. Comparison of exchange rate of the Rupee against major foreign currencies as at 30 June of year 2003 and 2004 is given below.

Table 11.4: Exchange Rate of Rupee against Foreign Currencies and Appreciation/ Depreciation of Exchange Rate

	EXCHANGE RATE		Appreciation(+) Depreciation(-)	
	30.06.2004	30.06.2003		
	Rs	Rs	2003-04	2002-03
US Dollar	58.16	57.81	(-) 0.60%	(+) 3.82%
Pound Sterling	105.95	95.76	(-) 9.62%	(-) 4.20%
Japanese Yen	0.54	0.48	(-) 11.11%	(+) 4.16%
Euro	70.69	65.93	(-) 6.73%	(-) 9.66%
SDR	85.23	80.99	(-) 4.97%	(-) 1.34%

Source: Accounts Department, SBP

The detailed breakup of exchange account is as under:

Table 11.5: Exchange Gain / (Loss) – Net

	2004	2003
Gain / (loss) on:	**(Rupees' 000)**	
- Foreign currency placements, deposits and other accounts - net	**3,372,849**	(12,951,336)
- Open market operations (including currency swap arrangements)	**(38,963)**	(1,730,900)
- Forward covers under Exchange Risk Coverage Scheme	**(156,485)**	1,206,876
- Payable to IMF	**(3,853,758)**	(1,000,142)
- Special Drawing Rights of IMF	**669,601**	130,213
- Others	**424,750**	224,093
	417,994	(14,121,196)
Exchange risk fee income	**337,178**	2,311,731
	755,172	(11,809,465)

Source: Accounts Department, SBP

On an overall basis, the exchange account posted a gain of Rs755 million as compared to the previous year's exchange loss of Rs11,809 million. The turnaround in exchange earnings is the principal reason for the increase in earnings of the current year as compared to the previous year.

11.6 Dividend Income

The SBP has a significant equity investment portfolio valued at Rs36.142 billion (at cost). The portfolio comprises shares of banks and financial institutions. Dividend income on investments increased from Rs1,168.5 million during the previous year to Rs1,422.1 million during the year 2003-04, yielding an average return of 3.93 percent on the equity investment portfolio. The reason behind this increase is the receipt of dividend from UBL after its privatization and the enhanced dividend from the Pak Kuwait Investment Company Limited.

11.7 Other Operating Income and Other Income

The principal item of other income is profit on sale of investments. Other operating income i.e. penalties etc from banks increased from Rs279.7 million in the FY03 to Rs367.8 in the current year. However, the phenomenal rise from Rs2,019.8 million to Rs7,242.0 million was registered due to gain on sale of shares of HBL and NBP, and profit on sale of the SBP properties. During the year the Bank sold 26 percent of its stake in HBL to AKFED through the Privatization Commission.

11.8 Distributable Profit

After accounting for provision against loans and advances to the tune of Rs566.9 million, the SBP utilized the remaining profit of Rs6,220.9 million for a dividend of Rs10 million and the payment of surplus profit to the federal government amounting to Rs6,210.9 million.

Table 11.6: Summary Statement of Profit and Loss

	(Rupees in million)	
	2003-04	**2002-03**
Income		
Net interest income	6,532	18,582
Exchange gain/(loss)	755	(11,810)
Dividend income	1,422	1,169
Commission	496	323
Other operating income	368	280
Other income	7,355	2,224
Gross Income	16,928	10,768
Expenditure		
Corporate costs	3,746	3,508
Establishment costs	5,079	5,148
Operating costs	994	1,036
Other expenditure	321	333
Provision against loans and advances	567	500
	10,707	10,525
Net Profit	**6,221**	**243**

Source: Accounts Department, SBP

12 Consolidated Financial Statements of the SBP and its Subsidiaries

A. F. FERGUSON & CO.
CHARTERED ACCOUNTANTS
STATE LIFE BUILDING 1-C
I. I. CHUNDRIGAR ROAD
KARACHI

TASEER HADI KHALID & CO.
CHARTERED ACCOUNTANTS
1st FLOOR, SHEIKH SULTAN TRUST
BUILDING NO. 2
BEAUMONT ROAD
KARACHI

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the annexed consolidated financial statements comprising consolidated balance sheets of the **Issue and Banking Departments of the State Bank of Pakistan and its subsidiaries, SBP Banking Services Corporation and National Institute of Banking and Finance (Guarantee) Limited** as at June 30, 2004 and the related consolidated profit and loss account, consolidated cash flow statement and consolidated statement of changes in equity together with the notes forming part thereof, for the year then ended. We have also expressed separate joint opinions on the financial statements of the State Bank of Pakistan and its subsidiary, SBP Banking Services Corporation. The other subsidiary, National Institute of banking and Finance (Guarantee) Limited was audited by another firm of chartered accountants, whose report has been furnished to us and our opinion in so far as it relates to the amounts included for such company, is based solely on the report of such other auditors.

It is the responsibility of the management of State Bank of Pakistan to establish and maintain a system of internal control, and prepare and present the financial statements in conformity with the International Accounting Standards approved for adoption by the Central Board of the Bank. Our responsibility is to express an opinion on these financial statements based on our audit.

Except for the matters referred to in the following paragraph, we conducted our audit in accordance with the auditing standards as applicable in Pakistan. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of any 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 policies and significant estimates made by management, as well as, evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion and, after due verification, we report that:

Events have rendered impossible the verification of the assets recoverable from the Reserve Bank of India or the Government of India or pertaining to transactions in former East Pakistan included in the financial statements. Realisability of these assets amounting to Rs. 6,291.558 million is subject to final settlement between the Government of Pakistan and the Governments of India and Bangladesh respectively. Out of these, assets valuing Rs. 1,930.008 million have been included in the Issue Department as backing against the liability towards notes in circulation. Had these assets not been included in the Issue Department, foreign currency reserves or Government securities of the equivalent value would have been transferred from the Banking Department to the Issue Department as replacement. In addition, pending finalization of the restructuring process of Zarai Taraqiati Bank Limited (ZTBL) and its impact on ZTBL's future profits and cash flows and due to non-availability of any estimate of the fair value of the Bank's investment in United Bank Limited (UBL), we are unable to satisfy ourselves as to the carrying value of the Bank's investment in ZTBL and UBL.

Except for the financial effect of the matters stated in the preceding paragraph:

(a) in our opinion the consolidated balance sheets and related consolidated profit and loss account, consolidated cash flow statement and consolidated statement of changes in equity together with the notes thereon have been drawn up in conformity with the International Accounting Standards approved for adoption by the Central Board of the Bank and are further in accordance with accounting policies consistently applied; and

(b) in our opinion and to the best of our information and according to the explanations given to us, the consolidated balance sheets, consolidated profit and loss account, consolidated cash flow statement and consolidated statement of changes in equity together with the notes forming part thereof conform with the International Accounting Standards approved for adoption by the Central Board of the Bank, and, give the information required by these Standards in the manner so required, and respectively give a true and fair view of the state of the affairs of the Bank and its subsidiaries as at June 30, 2004 and of the profit, their cash flows and changes in equity for the year then ended.

A. F. Ferguson & Co.	**Taseer Hadi Khalid & Co.**
Chartered Accountants	**Chartered Accountants**
Karachi	**Karachi**
Date:September 7,2004	**Date: September 7,2004**

State Bank of Pakistan and its Subsidiaries - Issue Department
Consolidated Balance Sheet
As at June 30, 2004

	Note	2004	2003
		(Rupees in '000)	
ASSETS			
Gold reserves held by the Bank	3	**47,532,115**	41,246,479
Foreign currency reserves	4	**500,312,132**	459,116,601
Special Drawing Rights of the International Monetary Fund	5	**13,826,690**	-
Notes and rupee coins:			
- Indian notes representing assets receivable from the Reserve Bank of India	7	**543,793**	535,162
- Rupee coins	8	**2,799,163**	2,351,138
		3,342,956	2,886,300
Investment in securities	9	**45,671,523**	18,558,695
Commercial papers	10	**78,500**	78,500
Assets held with the Reserve Bank of India	11	**1,139,741**	1,004,469
		611,903,657	522,891,044
LIABILITIES			
Bank notes issued	12	**611,903,657**	522,891,044

The annexed notes 1 to 46 form an integral part of these financial statements.

Ishrat Husain	**Tawfiq A. Husain**	**Aftab Mustafa Khan**
Governor	**Deputy Governor**	**Director Accounts**

State Bank of Pakistan and its Subsidiaries - Banking Department
Consolidated Balance Sheet
As at June 30, 2004

	Note	2004	2003
		(Rupees in '000)	
ASSETS			
Local currency	*8*	**160,830**	214,170
Foreign currency reserves	*4*	**132,021,383**	104,384,628
Earmarked foreign currency balances	*6*	**3,780,277**	53,113,531
Special Drawing Rights of the International Monetary Fund	*5*	**-**	14,092,081
		135,962,490	171,804,410
Reserve tranche with the International Monetary Fund under quota arrangements	*13*	**10,062**	9,560
Current account of the Government of Balochistan	*19.5*	**5,533,119**	-
Investments	*9*	**124,986,262**	134,543,853
Loans, advances and bills of exchange	*14*	**200,225,826**	174,734,753
Balances due from the Governments of India and Bangladesh (former East Pakistan)	*15*	**3,846,494**	3,631,027
Fixed assets:			
- Operating fixed assets	*16*	**7,110,834**	7,471,411
- Capital work-in-progress	*17*	**365,202**	278,899
		7,476,036	7,750,310
Other assets	*18*	**12,911,864**	25,716,668
Total assets		**490,952,153**	518,190,581
LIABILITIES			
Bills payable		**494,365**	671,931
Current accounts of the Government*	*19*	**48,889,002**	81,717,903
Deposits of banks and financial institutions	*20*	**156,170,805**	141,665,048
Other deposits and accounts	*21*	**83,028,804**	80,968,153
Payable to the International Monetary Fund	*22*	**102,405,234**	120,933,384
Other liabilities	*23*	**20,313,153**	18,905,465
		411,301,363	444,861,884
Deferred liability - staff retirement benefits	*24*	**9,151,321**	8,910,263
Deferred income	*25*	**286,195**	415,106
Total liabilities		**420,738,879**	454,187,253
Net assets		**70,213,274**	64,003,328
Share capital	*26*	**100,000**	100,000
Capital receipt	*27*	**1,525,958**	1,525,958
Reserves	*28*	**16,714,474**	16,714,474
		18,340,432	18,340,432
Unrealised appreciation on gold reserves	*29*	**45,205,621**	38,883,231
Surplus on revaluation of fixed assets	*16.1*	**6,637,328**	6,749,772
Minority interest		**29,893**	29,893
		70,213,274	64,003,328
Contingencies and commitments	*30*		

*Government includes Federal and Provincial Governments of Pakistan and Government of Azad Jammu and Kashmir.

The annexed notes 1 to 46 form an integral part of these financial statements.

Ishrat Husain	**Tawfiq A. Husain**	**Aftab Mustafa Khan**
Governor	**Deputy Governor**	**Director Accounts**

State Bank of Pakistan and its Subsidiaries
Consolidated Profit and Loss Account
For the year ended June 30, 2004

	Note	2004	2003
		(Rupees in '000)	
Discount, interest / mark-up and / or return earned	*31*	**11,734,111**	21,159,843
Interest / mark-up expense	*32*	**(5,202,091)**	(2,578,162)
		6,532,020	18,581,681
Commission	*33*	**496,454**	322,991
Exchange gain / (loss) - net	*34*	**755,172**	(11,809,465)
Dividend income		**1,422,058**	1,168,526
Other operating income	*35*	**367,824**	279,727
		9,573,528	8,543,460
Direct operating expenses			
Note printing charges	*36*	**(1,963,777)**	(1,845,963)
Agency commission	*37*	**(1,554,969)**	(1,398,128)
Provision against loans and advances	*14.4*	**(566,906)**	(500,000)
		5,487,876	4,799,369
Establishment costs	*38*	**(6,073,234)**	(6,183,361)
OPERATING LOSS		**(585,358)**	(1,383,992)
Other income	*39*	**7,241,967**	2,019,843
		6,656,609	635,851
Other charges	*40*	**(548,111)**	(596,540)
NET PROFIT FOR THE YEAR		**6,108,498**	39,311
Surplus on revaluation of fixed assets realised on disposal	*16.1*	**112,444**	203,747
AVAILABLE FOR APPROPRIATION		**6,220,942**	243,058
Appropriation:			
Dividend to the Government of Pakistan @ Rs 10 per share (2003: Rs 10 per share)		**(10,000)**	(10,000)
Transferred to Reserve Fund		-	(14,474)
BALANCE TRANSFERRED TO THE GOVERNMENT OF PAKISTAN		**6,210,942**	218,584

The annexed notes 1 to 46 form an integral part of these financial statements.

Ishrat Husain **Governor**	**Tawfiq A. Husain** **Deputy Governor**	**Aftab Mustafa Khan** **Director Accounts**

State Bank of Pakistan and its Subsidiaries

Consolidated Cash Flow Statement

For the year ended June 30, 2004

	Note	2004	2003
		(Rupees in '000)	
Profit for the year after non-cash items	41	**15,075,209**	1,183,285
(Increase)/decrease in assets			
Reserve tranche with the International Monetary Fund under quota arrangements		**(502)**	(559)
Investments		**(17,894,456)**	231,664,449
Loans, advances and bills of exchange		**(26,057,979)**	8,060,054
Foreign currency reserves not included in cash and cash equivalents		**(1,528,452)**	(41,867)
Indian notes representing assets receivable from the Reserve Bank of India		**(8,631)**	(6,522)
Assets held with the Reserve Bank of India		**(33,929)**	(13,510)
Other assets - net		**7,246,304**	807,380
		(38,277,645)	240,469,425
Increase/(decrease) in liabilities			
Notes in circulation		**89,012,613**	64,516,540
Bills payable		**(177,566)**	348,638
Current accounts of the Government*		**(38,362,020)**	25,425,280
Deposits of banks and financial institutions		**14,505,757**	8,714,935
Other deposits and accounts		**2,060,651**	275,752
Payable to the International Monetary Fund		**(18,528,150)**	7,880,350
Other liabilities - net		**(240,555)**	(10,261,954)
		48,270,730	96,899,541
		25,068,294	338,552,251
Payment of retirement benefits and employees' compensated absences		**(2,123,594)**	(1,371,566)
Receipt of dividend income		**1,431,808**	1,170,781
Gold purchased		**(64,589)**	(48,012)
Fixed capital expenditure		**(264,026)**	(85,511)
Proceeds from disposal of fixed assets		**272,923**	288,433
		(747,478)	(45,875)
Dividend paid to the Government of Pakistan		**(10,000)**	(10,000)
Surplus profits paid to the Government of Pakistan		**(6,210,942)**	(218,584)
		(6,220,942)	(228,584)
Increase in cash and cash equivalents during the year		**18,099,874**	338,277,792
Cash and cash equivalents at beginning of the year		**632,199,004**	293,921,212
Cash and cash equivalents at end of the year	42	**650,298,878**	632,199,004

*Government includes Federal and Provincial Governments of Pakistan and Government of Azad Jammu and Kashmir.

The annexed notes 1 to 46 form an integral part of these financial statements.

Ishrat Husain	**Tawfiq A. Husain**	**Aftab Mustafa Khan**
Governor	**Deputy Governor**	**Director Accounts**

State Bank of Pakistan and its Subsidiaries

Consolidated Statement of Changes in Equity

For the year ended June 30, 2004

	Share capital	Capital receipt	Reserves						Unrealised appreciation on gold reserves	Surplus on revaluation of fixed assets	Profit and loss account	Total
			Reserve Fund	Rural Credit Fund	Industrial Credit Fund	Export Credit Fund	Loans Guarantee Fund	Housing Credit Fund				
Balance at June 30, 2002	100,000	1,525,958	5,400,000	2,600,000	1,600,000	1,500,000	900,000	4,700,000	37,033,311	6,953,519	-	62,312,788
Net profit for the year ended June 30. 2003	-	-	-	-	-	-	-	-	-	-	39,311	39,311
Surplus on revaluation of fixed assets realised on disposal	-	-	-	-	-	-	-	-	-	(203,747)	203,747	-
Dividend to the Government of Pakistan	-	-	-	-	-	-	-	-	-	-	(10,000)	(10,000)
Profit transferred to Reserve Fund	-	-	14,474	-	-	-	-	-	-	-	(14,474)	-
Balance profit transferred to the Government of Pakistan	-	-	-	-	-	-	-	-	-	-	(218,584)	(218,584)
Unrealised appreciation on gold reserves during the year	-	-	-	-	-	-	-	-	1,849,920	-	-	1,849,920
Balance at June 30, 2003	100,000	1,525,958	5,414,474	2,600,000	1,600,000	1,500,000	900,000	4,700,000	38,883,231	6,749,772	-	63,973,435
Net profit for the year ended June 30. 2004	-	-	-	-	-	-	-	-	-		6,108,498	6,108,498
Surplus on revaluation of fixed assets realised on disposal	-	-	-	-	-	-	-	-	-	(112,444)	112,444	-
Dividend to the Government of Pakistan	-	-	-	-	-	-	-	-	-	-	(10,000)	(10,000)
Balance profit transferred to the Government of Pakistan	-	-	-	-	-	-	-	-	-	-	(6,210,942)	(6,210,942)
Unrealised appreciation on gold reserves during the year	-	-	-	-	-	-	-	-	6,322,390	-	-	6,322,390
Balance at June 30, 2004	100,000	1,525,958	5,414,474	2,600,000	1,600,000	1,500,000	900,000	4,700,000	45,205,621	6,637,328	-	70,183,381

The annexed notes 1 to 46 form an integral part of these financial statements.

Ishrat Husain
Governor

Tawfiq A. Husain
Deputy Governor

Aftab Mustafa Khan
Director Accounts

State Bank of Pakistan & its Subsidiaries
Notes to the Consolidated Financial Statements
For the year ended June 30, 2004

1. STATUS AND NATURE OF OPERATIONS

1.1 State Bank of Pakistan (the Bank) is the Central Bank of Pakistan and is incorporated under the State Bank of Pakistan Act, 1956. The Bank is primarily responsible for the management of credit, foreign exchange and currency in the country and also acts as the fiscal agent of the Government. The activities of the Bank mainly include:

- implementing the monetary and fiscal policies;
- issuing of currency;
- facilitation of free competition and stability in the financial system;
- licensing and supervision of credit institutions;
- organisation and management of the inter-bank settlement system and promotion of smooth functioning of payment systems;
- providing of loans and advances to the Government, banks, financial institutions and local authorities under various facilities;
- purchase, holding and sale of securities of banks and financial institutions on the directives of the Federal Government; and
- acting as depository of the Government under specific arrangements between the Government and certain institutions.

1.2 The subsidiaries of the Bank and the nature of their respective activities are as follows:

- SBP Banking Services Corporation – wholly owned subsidiary

  SBP Banking Services Corporation was established under the SBP Banking Service Corporation Ordinance, 2001 and commenced its operations with effect from January 2, 2002. It is responsible for carrying out certain statutory and administrative functions and activities principally relating to public dealing on behalf of the State Bank of Pakistan.

- National Institute of Banking and Finance (Guarantee) Limited - shareholding at 59.4%

  National Institute of Banking and Finance (Guarantee) Limited was incorporated under the Companies Ordinance, 1984 as a private limited company limited by guarantee. The Institute is engaged in providing education and training in the field of banking, finance and allied areas.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation

- These financial statements have been prepared in accordance with the requirements of the International Accounting Standards (IASs) approved for adoption by the Central Board of the Bank. Under the powers conferred by the State Bank of Pakistan Act, 1956, the Central Board approved IAS 1 to IAS 38 from those applicable in Pakistan for adoption by the Group.
- The consolidated financial statements include collectively the financial statements of the State Bank of Pakistan (Bank) and its subsidiaries (the Group). Financial statements of the subsidiaries have been consolidated on a line-by-line basis.
- All inter-group balances and transactions have been eliminated.

2.2 Accounting convention

These financial statements have been prepared under the historical cost convention, except that gold reserves and certain fixed assets, as referred to in notes 2.6 and 2.7 have been included at revalued amounts and certain employee benefits, as referred to in notes 2.9(c) and 2.10 have been stated at their present values.

2.3 Bank notes and rupee coins

The liability of the Bank towards bank notes issued as a legal tender under the State Bank of Pakistan Act, 1956 is stated at the face value and is represented by the specified assets of the Issue Department of the Bank. The cost of printing of notes is charged to the current profit and loss account. Any unissued bank notes lying with the Bank are not reflected in the books of account.

The Bank also issues coins of various denominations on behalf of the Government of Pakistan. These coins are purchased from the Government at their respective face values. The unissued coins form part of the assets of the Issue Department.

2.4 Impairment

The carrying amount of the assets is reviewed at each balance sheet date to determine whether there is any indication of impairment of any asset or a group of assets. If such indications exist, the recoverable amount of such assets is estimated and the impairment loss recognised in the profit and loss account. Balances considered bad and irrecoverable are written off from the books of account.

Provisions against impairment are reviewed at each balance sheet date and adjusted to reflect the current best estimates. Changes in the provisions are recognised as income / expense currently.

2.5 Investments

- Investments in debt securities are stated at cost. The cost of securities is adjusted for any amortisation of discounts or premiums on a straight-line basis over the period to maturity.
- Investments in marketable securities, other than debt securities mentioned above, are stated at the lower of cost and market value.
- Investments in unlisted securities (other than debt securities mentioned above) are stated at cost less impairment losses, if any.

State Bank of Pakistan enters into transactions of outright sale, repurchase (Repo) and resale (Reverse Repo) of securities at contracted rates for specified periods of time. These are recorded as follows:

i) in case of outright sale or sale under repurchase (Repo) obligations, the securities are deleted from investments and the charges arising from the differential in sale and face / repurchase value are accrued on a prorata basis and recorded as discount expense which is deducted from the discount, interest / mark-up and / or return earned on these securities. On maturity, the securities are reinstated at their respective original cost.

ii) in case of purchase under resale obligations, the securities are included under investments at the contracted purchase price and the differential of the contracted purchase and resale price is amortised over the period of the contract and recorded under discount, interest / mark-up and / or return earned on these securities.

2.6 Gold reserves

Gold reserves, including those held with the Reserve Bank of India, are stated at the revalued amounts of the fine gold content thereof in accordance with the requirements of the State Bank of Pakistan Act, 1956 and the State Bank of Pakistan General Regulations. Appreciation or depreciation, if any, on revaluation is taken to "unrealised appreciation on gold reserves" account. Appreciation realised on disposal of gold reserves is credited to the retained earnings.

2.7 Fixed assets and depreciation

Operating tangible assets except freehold land and capital work-in-progress are stated at cost or revalued amounts less accumulated depreciation and impairment losses, if any. Freehold land is stated at revalued amount less accumulated impairment losses, if any, while capital work-in-progress is valued at cost.

Depreciation is calculated using the straight-line method so as to write off the assets over their expected useful lives without taking into account any residual value.

Depreciation on additions is charged from the month in which the asset is put to use while no depreciation is charged in the month in which the assets are deleted. Normal repairs and maintenance are charged to the profit and loss account as and when incurred; major renewals and improvements are capitalised and the assets so replaced, if any, are retired. Gains and losses on disposal of fixed assets are included in income currently.

Intangible assets are carried at cost less accumulated amortisation and accumulated impairment losses, if any. Amortisation is calculated using the straight-line method so as to write off the assets over their expected useful lives without taking into account any residual value.

2.8 Deferred income

Grants received on account of capital expenditure are recorded as deferred income. These are amortised over the useful life of the relevant asset.

2.9 Staff retirement benefits

The Group operates:

a) an un-funded contributory provident fund (old scheme) for those employees who joined prior to 1975 and have opted to remain under the old scheme;

b) an un-funded general contributory provident fund (new scheme) for all employees who joined after 1975 and those employees who had joined prior to 1975 but have opted for the new scheme;

c) following other staff retirement benefit schemes:

- an un-funded gratuity scheme for all its employees other than those who opted for the new general provident fund scheme or joined the Bank after 1975 and are entitled only to pension scheme benefits;
- an un-funded pension scheme;
- an un-funded benevolent fund scheme; and
- an un-funded post retirement medical benefit scheme.

Annual provisions are made by the Group to cover the obligations arising under these schemes based on actuarial recommendations. The actuarial valuations are carried out under the Projected Unit Credit Method. Unrecognised actuarial gains and losses are recognised in the profit and loss account over the expected average remaining working lives of the employees.

The above staff retirement benefits are payable to staff on completion of prescribed qualifying period of service.

2.10 Compensated absences

The Group makes annual provision in respect of liability for employees' compensated absences based on actuarial estimates.

2.11 Revenue recognition

- Discount, interest / mark-up and / or return on loans and advances and investments are recorded on accrual basis. However, income on balances pertaining to transactions in former East Pakistan (now Bangladesh), doubtful loans and advances and overdue return on investments are recognised as income on receipt basis.
- Dividend income is recognised when the Group's right to receive dividend is established.
- Gains on disposal of securities are taken to profit and loss account currently.
- All other revenues are recognised on accrual basis.

2.12 Finances under profit and loss sharing arrangements

The Bank provides various finances to financial institutions under profit and loss sharing arrangements. Share of profit / loss under these arrangements is recognised on accrual basis.

2.13 Taxation

The income of the State Bank of Pakistan is exempt from tax under section 49 of the State Bank of Pakistan Act, 1956. The income of SBP Banking Services Corporation and National Institute of Banking and Finance (Guarantee) Limited is also exempt from tax under section 25 of the SBP Banking Services Corporation Ordinance, 2001 and section 49 of the State Bank of Pakistan Act, 1956 respectively.

2.14 Foreign currency transactions

Transactions denominated in foreign currencies are translated to Pak Rupees at the foreign exchange rate ruling at the date of transaction. Monetary assets and liabilities in foreign currencies are translated into rupees at the rates of exchange prevailing at the balance sheet date or at contracted rates.

Exchange gains and losses are taken to the profit and loss account except for certain exchange differences on balances with the International Monetary Fund, referred to in note 2.15, which are transferred to the Government of Pakistan account.

Exchange differences arising under Exchange Risk Coverage Scheme and on currency swap transactions are recognised in the books of account on accrual basis.

2.15 Transactions and balances with International Monetary Fund

Transactions and balances with the International Monetary Fund (IMF) are recorded on the basis of International Accounting Standards and the guidelines contained in the Aide Memoire and specific arrangements entered into between the Bank and the Government. A summary of the policies followed by the Bank for recording of these transactions and balances is as follows:

- the Government's contribution for quota with the IMF is recorded by the Bank as depository of the Government and exchange differences arising under these arrangements are transferred to the Government account.
- exchange gains or losses arising on revaluation of borrowings from the IMF are recognised in the profit and loss account except for the gains or losses transferable to the Government under specific arrangements.
- the cumulative allocation of Special Drawing Rights by the IMF is treated as capital receipt and is not revalued.
- income or charges pertaining to balances with the IMF are taken to the Government account, except for the following which are taken to the profit and loss account:
  - charges on borrowings under credit schemes other than fund facilities;
  - charges on net cumulative allocation of Special Drawing Rights; and
  - return on holdings of Special Drawing Rights.

2.16 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources with be required to settle the obligation and a reliable estimate of the amount can be made.

2.17 Cash and cash equivalents

Cash and cash equivalents include cash, balances in the current and deposit accounts and securities that are realisable in known amounts of cash within three months and which are subject to insignificant changes in value.

2.18 Financial instruments

Financial assets and liabilities are recognised at the time when the Group becomes a party to the contractual provisions of the instrument. Any gain or loss on the derecognition of the financial assets and liabilities is included in the profit and loss account currently.

Financial instruments carried on the balance sheet include foreign currency reserves, investments, loans and advances, government accounts, other deposit accounts and liabilities. The particular recognition methods adopted are disclosed in the individual policy statements associated with each financial instrument.

2.19 Offsetting

A financial asset and a financial liability is offset and the net amount is reported in the balance sheet when the Group has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

		Net content in troy ounces	2004	2003
			(Rupees in '000)	

3. GOLD RESERVES HELD BY THE BANK

		Net content in troy ounces	2004	2003
Opening balance		2,062,180	**41,246,479**	39,378,223
Additions during the year		2,730	**64,589**	48,012
Appreciation during the year due to revaluation	*29*	-	**6,221,047**	1,820,244
		2,064,910	**47,532,115**	41,246,479

4. FOREIGN CURRENCY RESERVES

		2004	2003
Securities		**138,313,415**	55,074,419
Deposit accounts	*4.2*	**490,621,651**	489,839,438
Current accounts	*4.2*	**3,398,449**	18,587,372
		632,333,515	563,501,229

The above foreign currency reserves are held as follows:

	2004	2003
- Issue Department of the Bank	**500,312,132**	459,116,601
- Banking Department of the Bank	**132,021,383**	104,384,628
	632,333,515	563,501,229

4.1 At June 30, 2004, above assets included Rs. 167.974 million (2003: Rs. 165.307 million) recoverable from the Government of India. Realisability of these assets is subject to final settlement between the Governments of Pakistan and India.

4.2 The balance in current and deposit accounts carry interest at various rates ranging between 0.97 to 4.52 (2003: 0.9 to 3.6) percent per annum.

5. SPECIAL DRAWING RIGHTS OF THE INTERNATIONAL MONETARY FUND

Special Drawing Rights (SDRs) are the foreign reserve assets which are allocated by the International Monetary Fund (IMF) to its member countries in proportion to their quota in the Fund. In addition, the member countries can purchase the SDRs from the IMF and other member countries in order to settle their obligations. The above represents the rupee value of the SDRs held by the Bank at June 30, 2004. Interest is credited by the IMF on the SDR holding of the Bank at weekly interest rates on daily products of SDRs held during each quarter.

At June 30, 2004, the SDRs were held as follows:

	2004	2003
By the Issue Department of the Bank	**13,826,690**	-
By the Banking Department of the Bank	**-**	14,092,081
	13,826,690	14,092,081

6. EARMARKED FOREIGN CURRENCY BALANCES

These represent certain foreign currency balances held by the State Bank of Pakistan with the banks and financial institutions which are earmarked to meet specific foreign currency liabilities and commitments of the Bank.

7. INDIAN NOTES REPRESENTING ASSETS RECEIVABLE FROM THE RESERVE BANK OF INDIA

These represent Pak Rupee equivalent of Indian rupee notes which were in circulation in Pakistan until retirement from circulation and are to be repatriated to India under the Monetary Order from the Government of Pakistan. Realisability of these assets is subject to final settlement between the Governments of Pakistan and India.

	Note	2004	2003
		(Rupees in '000)	

8. LOCAL CURRENCY

	Note	2004	2003
Bank notes held by the Banking Department of the Bank	*12*	**160,830**	214,170
Rupee coins		**2,799,163**	2,351,138
		2,959,993	2,565,308
Rupee coins held as assets of the Issue Department of the Bank	*8.1*	**(2,799,163)**	(2,351,138)
		160,830	214,170

8.1 As mentioned in note 2.3, the Bank is responsible for issuing coins of various denominations on behalf of the Government. The closing balance represents the face value of unissued coins held by the Bank at June 30, 2004.

9. INVESTMENTS

	Note	2004	2003
Government securities	*9.1*		
Market Treasury Bills		**129,240,662**	105,439,847
Federal Investment Bonds		**2,150,000**	2,150,000
Federal and Provincial Government scripts		**2,740,000**	3,326,947
Pakistan Investment Bonds		**384,506**	-
		134,515,168	110,916,794
Banks and other financial institutions			
Ordinary shares			
- Listed		**1,100,807**	1,147,537
- Unlisted		**35,041,806**	32,288,214
	9.2	**36,142,613**	33,435,751
Advance against issue of share capital		**-**	8,749,999
Term Finance Certificates		**282,400**	282,400
		36,425,013	42,468,150
Other investments			
Certificates of Deposits		**112,351**	112,351
		171,052,532	153,497,295
Provision against diminution in value of investments		**(394,747)**	(394,747)
		170,657,785	153,102,548
Investment in securities held as assets of the Issue Department of the Bank	*9.3*	**(45,671,523)**	(18,558,695)
		124,986,262	134,543,853

9.1 Investment in Government securities

These represent investments guaranteed / issued by the Government. The profile of return on securities during the year is as follows:

	2004	2003
	(% per annum)	
Market Treasury Bills	**1.2116 to 4.3247**	1.6389 to 6.4045
Federal Investment Bonds	**15**	15
Federal and Provincial Government scripts	**3 to 16**	3 to 16

9.2 Investment in shares of banks and other financial institutions *9.2.1*

	Holding more than 50% 2004	Holding more than 50% 2003		2004	2003
	%	%		(Rupees in '000)	
Listed investments					
National Bank of Pakistan	**75.18**	78.39	*9.2.2*	**1,100,807**	1,147,537
Unlisted investments					
Habib Bank Limited	**73.05**	98.42	*9.2.3*	**14,739,777**	11,986,185
Zarai Taraqiati Bank Limited	**99.69**	99.69	*9.2.4*	**3,204,323**	3,204,323
Federal Bank for Cooperatives	**75.00**	75.00		**150,000**	150,000
Equity Participation Fund	**65.81**	65.81		**102,000**	102,000
				18,196,100	15,442,508
Other investments with holding less than or equal to 50%			*9.2.5*	**16,845,706**	16,845,706
				35,041,806	32,288,214
				36,142,613	33,435,751

9.2.1 Investments in above entities have been made under the specific directives of the Government in accordance with the provisions of the State Bank of Pakistan Act, 1956 and other relevant statutes. The management of the Bank does not exercise significant influence or control over these entities except for any regulatory purposes or control arising as a consequence of any statute which applies to the entire sector to which these entities belong. Accordingly, these entities have not been consolidated as subsidiaries or accounted for as investments in associates.

9.2.2 Market value of the Bank's investment in the shares of National Bank of Pakistan at June 30, 2004 amounted to Rs. 24,604.850 million (2003: Rs. 8,781.527 million).

9.2.3 During the year, the Bank alongwith the Privatisation Commission, Government of Pakistan, entered into an agreement dated February 26, 2004 with The Aga Khan Fund for Economic Development S.A. (AKFED) for the transfer of ownership of 51% shares of Habib Bank Limited's (HBL) total paid-up capital to AKFED for USD 389.929 million. Under this agreement, the Bank has transferred ownership of 26% of HBL's total paid-up capital, proceeds of which amounting to USD 198.787 million have been received by the Bank resulting in a gain of Rs. 6,086.171 million, as mentioned in note 40.1 to the financial statements. Under the terms of this agreement, the title to remaining 25% shares will be transferred to AKFED after payments due there against have been received. These payments are due by February 25, 2005 and February 25, 2006 in two equal installments of USD 95.571 million each and carry mark-up at 2.5% above London Inter Bank offer rate on the unpaid amount.

The remaining 25% shares are presently in the name of the Bank which is entitled to any dividend and/ or bonus shares declared by HBL proportionate to these shares till the time their ownership is eventually transferred to AKFED upon compliance with the above-mentioned payment and other operational covenants prescribed in the agreement. In view of the above, the management of the Bank considers that risks and rewards of the remaining 25% shares still vests with the Bank as the transfer of their ownership is subject to compliance by AKFED with the above-mentioned conditions and, accordingly, the investment in these shares has not been derecognised during the year.

The break-up value of the Bank's investment in HBL amounted to Rs. 17,154.974 million at December 31, 2003 based on the financial statements of HBL for the year then ended.

9.2.4 This represents the cost of 99.69% holding in the shares of Zarai Taraqiati Bank Limited (ZTBL - former Agricultural Development Bank of Pakistan). During the year, the Central Board of Bank has approved the restructuring of the Bank's exposure in ZTBL (including the investment in the shares of former ADBP) by its conversion into a term loan on certain terms and conditions. Terms of the loan have not been finalised which has delayed the conversion process. Pending the finalisation of this process, the balance continues to be disclosed as investment.

The management is confident that the interest of the Bank will be completely safeguarded in the restructuring process of ZTBL which will result in the conversion of ZTBL into a commercially viable entity capable of generating sufficient profits and cash flows to repay its obligations towards the Bank.

9.2.5 Other investments include Rs. 14,791.674 million (2003: Rs. 14,791.674 million) representing the cost of investment in the shares of United Bank Limited (UBL). The break-up value of this investment amounted to Rs. 6,759.768 million based on the financial statements of UBL for the year ended December 31, 2003 (2003: Rs. 5,390.394 million based on the financial statements for the year ended December 31, 2002). During the year ended June 30, 2002, 51% shares in UBL were sold at Rs. 47 per share as against the carrying value per share of Rs. 59 thereby resulting in a total loss of Rs. 3,144.657 million. The current carrying value per share of UBL remains at Rs. 59. However, no provision has been made in these financial statements in respect of this investment as the management is confident that the cost of the remaining investment will be recovered in full as privatisation of UBL will enhance its value and substantial future profits are likely to be earned by UBL.

9.3 These represent Market Treasury Bills allocated to the Issue Department of the Bank.

10. COMMERCIAL PAPERS

These represent face value of certain commercial papers amounting to Rs. 78.5 million (2003: Rs. 78.5 million) which are held in Bangladesh (former East Pakistan). The realisability of the underlying amount is subject to final settlement between the Governments of Pakistan and Bangladesh (Former East Pakistan).

11. ASSETS HELD WITH THE RESERVE BANK OF INDIA

		2004	2003
		(Rupees in '000)	
Gold reserves			
- Opening balance		**671,736**	642,060
- Appreciation from revaluation during the year	*29*	**101,343**	29,676
		773,079	671,736
Sterling securities		**350,140**	316,471
Government of India securities		**12,757**	12,553
Rupee coins		**3,765**	3,709
		1,139,741	1,004,469

The above assets were allocated to the Government of Pakistan as its share of the assets of Reserve Bank of India under the provisions of Pakistan (Monetary System and Reserve Bank) Order, 1947. The transfer of these assets to the Bank is subject to final settlement between the Governments of Pakistan and India.

12. BANK NOTES ISSUED

Notes held with the Banking Department of the Bank	*8*	**160,830**	214,170
Notes in circulation		**611,742,827**	522,676,874
		611,903,657	522,891,044

13. RESERVE TRANCHE WITH THE INTERNATIONAL MONETARY FUND UNDER QUOTA ARRANGEMENTS

Quota allocated by the International Monetary Fund	**88,097,392**	83,716,673
Liability under quota arrangements	**(88,087,330)**	(83,707,113)
	10,062	9,560

14. LOANS, ADVANCES AND BILLS OF EXCHANGE

Government	*14.1*	**12,000,000**	12,040,000
Government owned / controlled financial institutions	*14.2*	**110,623,197**	112,729,636
Private sector financial institutions	*14.3*	**77,283,785**	49,413,274
		187,906,982	162,142,910
Employees		**5,059,663**	4,725,756
		204,966,645	178,908,666
Provision against doubtful balances	*14.4*	**(4,662,319)**	(4,095,413)
		200,304,326	174,813,253
Commercial papers	*10*	**(78,500)**	(78,500)
		200,225,826	174,734,753

	2004	2003
	(Rupees in '000)	

14.1 Loans and advances to the Government

	2004	2003
Federal Government	**12,000,000**	12,000,000
Provincial Government (of Balochistan)	**-**	40,000
	12,000,000	12,040,000

14.1.1 During the year, mark-up on above balances due from the Federal and Provincial Governments was charged at various rates ranging between 1.3795 to 1.9197 (2003: 1.7035 to 6.379) percent per annum.

14.2 Loans and advances to Government owned / controlled financial institutions

(Rupees in '000)

		Scheduled banks		Non-banking financial institutions		Total	
		2004	2003	**2004**	2003	**2004**	2003
Agricultural sector	*14.2.2*	**58,005,280**	55,686,785	**-**	-	**58,005,280**	55,686,785
Industrial sector	*14.2.2*	**2,381,409**	2,725,071	**840,261**	1,613,217	**3,221,670**	4,338,288
Export sector		**16,424,361**	14,780,711	**786,123**	3,567	**17,210,484**	14,784,278
Housing sector		**66,907**	66,907	**12,607,300**	14,157,300	**12,674,207**	14,224,207
Others		**10,629,456**	11,563,145	**8,882,100**	12,132,933	**19,511,556**	23,696,078
		87,507,413	84,822,619	**23,115,784**	27,907,017	**110,623,197**	112,729,636

14.2.1 Above balances include Rs. 515.056 million (2003: Rs. 511.306 million) which are recoverable from various financial institutions operating in former East Pakistan. The realisability of these balances is subject to final settlement between the Governments of Pakistan and Bangladesh (former East Pakistan).

14.2.2 Exposure to the agricultural and industrial sectors respectively include Rs. 50,174.089 million and Rs. 1,083.124 million representing the cumulative Government guaranteed financing of Rs. 51,257.213 million (2003: Rs. 51,257.213 million) to Zarai Taraqiati Bank Limited (ZTBL). As mentioned in note 9.2.4, the restructuring of ZTBL is in progress and detailed terms of repayment of these finances are expected to be finalised in due course.

14.3 Loans and advances to private sector financial institutions

(Rupees in '000)

	Scheduled banks		Non-banking financial institutions		Total	
	2004	2003	**2004**	2003	**2004**	2003
Industrial sector	**499,796**	153,752	**3,577,792**	3,577,792	**4,077,588**	3,731,544
Export sector	**69,409,072**	41,952,396	**587,000**	10,000	**69,996,072**	41,962,396
Others	**3,210,125**	3,719,334	**-**	-	**3,210,125**	3,719,334
	73,118,993	45,825,482	**4,164,792**	3,587,792	**77,283,785**	49,413,274

14.4 Movement of provision

	2004	2003
	(Rupees in '000)	
Opening balance	**4,095,413**	3,865,230
Provision during the year	**566,906**	500,000
Provision written back during the year	**-**	(269,817)
	4,662,319	4,095,413

14.5 The interest/mark-up rate profile of the interest/mark-up bearing loans and advances is as follows:

	2004	2003
	(% per annum)	
Government owned / controlled and private sector financial institutions	**1.5 to 12**	4 to 12
Staff loans	**10**	10

		2004	2003
		(Rupees in '000)	

15. BALANCES DUE FROM THE GOVERNMENTS OF INDIA AND BANGLADESH (FORMER EAST PAKISTAN)

		2004	2003
India			
Advance against printing of notes		**39,616**	39,616
Receivable from the Reserve Bank of India		**837**	837
		40,453	40,453
Bangladesh (former East Pakistan)			
Inter office balances		**819,924**	819,924
Loans and advances	*15.2*	**2,986,117**	2,770,650
		3,806,041	3,590,574
		3,846,494	3,631,027

15.1 The realisability of the above balances is subject to final settlement between the Government of Pakistan and Governments of Bangladesh (former East Pakistan) and India.

15.2 These represent loans and advances provided to the Government of former East Pakistan.

16. OPERATING FIXED ASSETS

(Rupees in '000)

	Cost / revalued amount at July 1, 2003	Additions / (deletions) / transfers* during the year	Cost / revalued amount at June 30, 2004	Accumulated depreciation / amortisation at July 1, 2003	Charge for the year / (accumulated depreciation on deletions) / transfers*	Accumulated depreciation/ amortisation at June 30, 2004	Net book value at June 30, 2004	Annual rate of depreciation / amortisation %
Tangible assets								
Freehold land	917.806	- (109.924)	807.882	-	-	-	807.882	-
Leasehold land	4,996,893	-	4,996,893	228,147	110,250	338,397	4,658,496	over the term of lease
Building on freehold lanc	787.316	210 (7.557)	779.969	197.487	45.336 (2.345)	240.478	539.491	5
Building on leasehold lan	1.100.839	28.934	1.129.773	202.757	69.282	272.039	857.734	5
Furniture and fixtures	117.131	21.170 (5,860)	132.441	49.325	10.873 (3,858)	56.340	76.101	10
Office equipment	693.530	43.763 (1.134) 2.634 *	738.793	648.200	22.172 (715) 1.427 *	671.084	67.709	20
EDP equipment	503.843	29.273 (64) (2,634)*	530.418	348.930	139.828 (1.427) *	487.331	43.087	33.33
Motor vehicles	60.984	60.731 (11.704)	110.011	43.001	12.679 (5.633)	50.047	59.964	20
Library books	712	14	726	712	14	726		
	9.179.054	184.095 (136.243)	9.226.906	1.718.559	410.434 (12.551)	2.116.442	7.110.464	
Intangible asset								
Computer software	32,260	207	32,467	21,344	10,753	32,097	370	33.33
2004	9,211,314	184,302 (136,243)	9,259,373	1,739,903	421,187 (12,551)	2,148,539	7,110,834	

		2004	2003
		(Rupees in '000)	

16.1 Surplus on revaluation of fixed assets

Opening balance		**6,749,772**	6,953,519
Surplus realised on disposal of fixed assets		**(112,444)**	(203,747)
		6,637,328	6,749,772

Certain items of freehold land, leasehold land, buildings on freehold and leasehold land were revalued on June 30, 2001 by Iqbal A. Nanjee & Co., Valuation and Engineering Consultants, on the basis of market value. The revaluation resulted in a surplus of Rs. 6,953.519 million at that date. Out of this surplus, Rs. 6,121.173 million remains undepreciated at June 30, 2004 (2003: Rs. 6,404.136 million) and has been included in the carrying value of the related assets.

17. CAPITAL WORK-IN-PROGRESS

Building on freehold land		**2,943**	2,943
Building on leasehold land		**44,529**	4,447
Furniture and fixtures		**15,830**	1,900
Office equipment		**34,944**	2,771
EDP equipment		**2,023**	1,905
Intangible assets		**264,933**	264,933
		365,202	278,899

18. OTHER ASSETS

Amounts due from financial institutions under currency swap arrangements	*18.1*	**2,674,429**	2,717,230
Accrued interest / mark-up and return		**935,986**	884,060
Exchange gain recoverable under exchange risk coverage scheme		**7,691**	41,800
Stationery and stamps on hand		**8,681**	25,036
Other advances, deposits and prepayments		**532,322**	543,721
Balance receivable from the Government of Pakistan		**5,692,379**	9,494,275
Share of profit recoverable from Zarai Taraqiati Bank Limited under profit and loss sharing arrangements - net		**-**	5,548,751
Others		**3,060,376**	6,461,795
		12,911,864	25,716,668

18.1 This represents the Bank's right to receive rupee counterpart of the foreign currency on the maturity of certain currency swap arrangements with commercial banks and non-banking financial institutions. The related obligation of the Bank to exchange foreign currency with the rupee counterpart has been disclosed in note 23.

19. CURRENT ACCOUNTS OF THE GOVERNMENT

Federal Government	*19.1*	**14,681,524**	48,841,890
Provincial Governments			
- Punjab	*19.2*	**13,913,754**	20,292,864
- Sindh	*19.3*	**13,206,367**	3,361,749
- North West Frontier Province (NWFP)	*19.4*	**4,134,839**	5,532,498
- Balochistan	*19.5*	**-**	1,198,843
		31,254,960	30,385,954
Government of Azad Jammu and Kashmir		**2,952,518**	2,490,059
		48,889,002	81,717,903

			2004	2003
			(Rupees in '000)	
19.1	**Federal Government**			
	Non-food account		**484,991**	34,630,083
	Food account		**20,693**	63,972
	Zakat fund account		**15,857,448**	18,565,798
	Railways - ways and means advances	*19.6*	**(2,798,603)**	(4,939,204)
	Fertilizer account		**44,137**	(216,577)
	Saudi Arab special loan account		**4,124**	4,124
	Pakistan Baitul Mal fund account		**85**	85
	Pakistan Railways special account		**1,063,373**	728,333
	Government deposit account no. XII		**5,276**	5,276
			14,681,524	48,841,890
19.2	**Provincial Government - Punjab**			
	Non-food account		**(4,365,339)**	(6,239,821)
	Food account		**1,254,266**	1,057,546
	Zakat fund account		**50,117**	7,772
	District Government account no. IV		**16,974,710**	13,177,552
	Social action program		**-**	12,289,815
			13,913,754	20,292,864
19.3	**Provincial Government - Sindh**			
	Non-food account		**9,483,511**	(154,058)
	Food account		**108,558**	211,914
	Zakat fund account		**75,083**	144,917
	District Government account no. IV		**3,539,215**	3,158,976
			13,206,367	3,361,749
19.4	**Provincial Government - NWFP**			
	Non-food account		**3,054,159**	3,885,304
	Food account		**203,073**	389,095
	Zakat fund account		**2,007**	611
	District Government account no. IV		**875,600**	1,257,488
			4,134,839	5,532,498
19.5	**Provincial Government - Balochistan**			
	Non-food account		**(9,865,206)**	(2,526,162)
	Food account		**463,836**	1,950
	Zakat fund account		**5**	302,171
	District Government account no. IV		**3,868,246**	3,420,884
			(5,533,119)	1,198,843
	Classified as a receivable balance	*19.6*	**5,533,119**	-
	Net credit balance		**-**	1,198,843

19.6 At the year end, these balances carried mark-up at 1.92 (2003: 1.7035) percent per annum.

		2004	2003
		(Rupees in '000)	

20. DEPOSITS OF BANKS AND FINANCIAL INSTITUTIONS

		2004	2003
Foreign currency			
Scheduled banks		**14,212,278**	19,885,202
Held under Capital Reserve Requirement scheme		**32,020,008**	27,083,275
		46,232,286	46,968,477
Local currency			
Scheduled banks		**108,946,952**	94,076,143
Non-banking financial institutions		**991,567**	620,428
		109,938,519	94,696,571
		156,170,805	141,665,048

20.1 The interest / mark-up rate profile of the interest / mark-up bearing deposits is as follows:

	2004	2003
	(% per annum)	
Foreign currency	**0.59 to 0.67**	0.80 to1.34
Local currency	**0.99 to 1.70**	10.67 to 14.79

		2004	2003
		(Rupees in '000)	

21. OTHER DEPOSITS AND ACCOUNTS

		2004	2003
Foreign currency			
Foreign central banks		**26,172,872**	26,015,103
International organisation		**14,539,525**	14,451,875
		40,712,397	40,466,978
Local currency			
Special debt repayment	*21.2*	**22,108,042**	18,802,147
Government	*21.3*	**17,952,963**	19,817,965
Others		**2,255,402**	1,881,063
		42,316,407	40,501,175
		83,028,804	80,968,153

21.1 The interest rate profile of the interest bearing deposits is as follows:

	2004	2003
	(% per annum)	
Foreign central banks	**1.36 to 1.79**	1.39 to 2.21
International organisation	**2.96 to 3.1**	3.10 to 4.50

21.2 These represent amounts kept in separate special accounts to meet forthcoming foreign currency debt repayment obligations of the Government of Pakistan.

21.3 These represent rupee counterpart of the foreign currency loan disbursements received from various international financial institutions on behalf of the Government and credited to separate deposit accounts in accordance with the instructions of the Government.

		2004	2003
		(Rupees in '000)	

22. PAYABLE TO INTERNATIONAL MONETARY FUND

Borrowings under:			
- Fund facilities	*22.1*	**25,041,465**	54,409,694
- Other credit schemes	*22.2*	**77,363,692**	66,523,617
		102,405,157	120,933,311
Current account for administrative charges		**77**	73
		102,405,234	120,933,384

22.1 These facilities are secured by demand promissory notes issued by the Government of Pakistan.

22.2 This includes Rs. 255.676 million (2003: Rs.728.887 million) in respect of the finance provided by the Saudi Fund for Development (SFD) under Enhanced Structural Adjustment Facility programme of the International Monetary Fund (IMF). The amount has been paid through IMF in its capacity as a Trustee for SFD in respect of this arrangement.

23. OTHER LIABILITIES

Foreign currency			
Amounts due to financial institutions under currency swap arrangements	*18.1*	**2,617,115**	2,601,338
Accrued interest and discount on deposits		**243,021**	256,799
Charges on allocation of Special Drawing Rights of IMF		**42,000**	38,000
Others		**4,603**	2,888
		2,906,739	2,899,025
Local currency			
Overdue mark-up and return		**3,444,098**	3,223,263
Unearned exchange risk fee		**12,183**	67,030
Remittance clearance account		**607,501**	246
Exchange loss payable under exchange risk coverage scheme		**45,721**	-
Share of loss under profit and loss sharing arrangements		**3,274,752**	3,543,166
Dividend payable to the Government		**10,000**	10,000
Payable to Government in respect of privatisation proceeds		**2,929,066**	2,929,066
Other accruals and provisions	*23.1*	**3,744,498**	3,093,916
Others		**3,338,595**	3,139,753
		17,406,414	16,006,440
		20,313,153	18,905,465

		2004	2003
		(Rupees in '000)	

23.1 Other accruals and provisions

Interest, mark-up and discount		**18,451**	20,806
Printing charges		**10,064**	147,187
Agency commission		**362,115**	326,514
Provision for employees' compensated absences	*38.2*	**1,739,000**	1,673,004
Others		**1,614,868**	926,405
		3,744,498	3,093,916

24. DEFERRED LIABILITY - STAFF RETIREMENT BENEFITS

Provident fund scheme		**906,742**	852,658
Gratuity		**106,579**	101,036
Pension		**6,980,000**	6,744,560
Benevolent fund scheme		**814,000**	848,184
Post retirement medical benefits		**344,000**	363,825
	24.1	**9,151,321**	8,910,263

24.1 The following is a movement in the net recognised liability in respect of the defined benefit schemes mentioned above:

					(Rupees in '000)
	Net recognised liability at July 1, 2003	**Charge for the year (note 38.4.3)**	**Payments during the year**	**Employees contribution**	**Net liability at June 30, 2004**
Gratuity	101,036	11,000	(5,457)	-	106,579
Pension	6,744,560	1,009,000	(773,560)	-	6,980,000
Benevolent	848,184	113,000	(149,184)	2,000	814,000
Post retirement medical benefits	363,825	116,000	(135,825)	-	344,000
	8,057,605	1,249,000	(1,064,026)	2,000	8,244,579

	2004	2003
	(Rupees in '000)	

25. DEFERRED INCOME

Opening balance	**415,106**	480,754
Grants received during the year	**6,579**	69,381
Amortisation during the year	**(135,490)**	(135,029)
Closing balance	**286,195**	415,106

This represents grant received for capital expenditure and, as indicated in note 2.8 to these financial statements, is being amortised over the useful lives of the related assets.

26. SHARE CAPITAL

Number of shares			
	Authorised share capital		
1,000,000	Ordinary shares of Rs 100 each	**100,000**	100,000
	Issued, subscribed and paid-up capital		
1,000,000	Fully paid-up ordinary shares of Rs 100 each	**100,000**	100,000

The entire share capital of the Bank is owned by the Government of Pakistan except for 200 shares held by the Central Bank of India (held by Deputy Custodian Enemy Property, Banking Supervision Department, State Bank of Pakistan) and 500 shares held by the State of Hyderabad.

		2004	2003
		(Rupees in '000)	

27. CAPITAL RECEIPT

Allocation of Special Drawing Rights of the International Monetary Fund		**1,525,958**	1,525,958

28. RESERVES

Reserve Fund	*28.1*	**5,414,474**	5,414,474
Rural Credit Fund		**2,600,000**	2,600,000
Industrial Credit Fund		**1,600,000**	1,600,000
Export Credit Fund		**1,500,000**	1,500,000
Loans Guarantee Fund		**900,000**	900,000
Housing Credit Fund		**4,700,000**	4,700,000
		16,714,474	16,714,474

28.1 Reserve Fund

This represents appropriations made in the previous years out of the annual profits of the Bank and a subsidiary in accordance with the provisions of the State Bank of Pakistan Act, 1956 for the purpose of providing cover against risks relating to events which are contingent and non-foreseeable.

28.2 Other Funds

These represent appropriations made in the previous years out of the surplus profits of the Bank for certain specified purposes in accordance with the provisions of the State Bank of Pakistan Act, 1956.

29. UNREALISED APPRECIATION ON GOLD RESERVES

Opening balance		**38,883,231**	37,033,311
Appreciation on revaluation during the year:			
- held by the Bank	*3*	**6,221,047**	1,820,244
- held with the Reserve Bank of India	*11*	**101,343**	29,676
		6,322,390	1,849,920
		45,205,621	38,883,231

Gold reserves are revalued under the State Bank of Pakistan Act, 1956 and State Bank of Pakistan General Regulations at the closing market rate fixed on the last working day of the year in London.

30. CONTINGENCIES AND COMMITMENTS

30.1 Contingencies

Money for which the Bank is contingently liable:

a) Contingent liability in respect of guarantees given on behalf of:

i) Government	**32,059,794**	31,723,775
ii) Government owned/controlled bodies and authorities	**73,620,783**	103,829,076
	105,680,577	135,552,851

Guarantees amounting to Rs. 105,680.577 million (2003: Rs. 131,792.185 million) are secured by counter guarantees either from the Government of Pakistan or local financial institutions.

b) Certain employees of the Bank who had retired under the Early Retirement Incentive Scheme (ERIS) introduced in the year 2000 had filed a case against the Bank in the Federal Services Tribunal for the enhancement of their entitlement paid under the above scheme. During the year, the Tribunal has decided the case in favour of these employees and has directed that the entitlement under the above scheme should include the effect of subsequent increases in certain staff retirement and other benefits. The Bank, in response to the above decision of the Tribunal, has filed a civil petition for leave to appeal in the Supreme Court of Pakistan which is pending for hearing. The management is confident that the Bank would not have to bear any additional expenditure on this account and, accordingly, no provision has been made in this respect. As the matter is currently under litigation, the disclosure of the financial effect of this matter has not been considered appropriate by the management.

	2004	2003
	(Rupees in '000)	
c) Other claims against the Bank not acknowledged as debts	**702,624**	789,780

30.2 Commitments

Forward exchange contracts - sales	**35,140,553**	10,742,916
Forward exchange contracts - purchases	**13,253,350**	34,696,460
Repurchase and outright sale of securities	**69,740,400**	9,127,077
Import letters of credit	**82,306,585**	70,688,072

31. DISCOUNT, INTEREST / MARK-UP AND / OR RETURN EARNED

Market Treasury Bills - net	**1,727,576**	7,339,477
Other Government securities	**439,911**	603,590
Loans and advances to Government	**358,734**	406,938
Loans and advances to banks and financial institutions	**1,533,753**	3,632,247
Share of profit on finances under profit and loss sharing arrangements	**676,494**	2,591,419
Foreign currency deposits	**6,067,452**	5,567,318
Foreign currency securities	**911,286**	789,411
Adhoc Treasury Bills	**-**	211,775
Others	**18,905**	17,668
	11,734,111	21,159,843

32. INTEREST / MARK-UP EXPENSE

Deposits	**1,346,406**	2,539,255
Share of loss on finances under profit and loss sharing arrangements	**3,815,121**	-
Others	**40,564**	38,907
	5,202,091	2,578,162

33. COMMISSION INCOME

Market Treasury Bills	**50,885**	62,418
Draft / payment orders	**238,509**	46,479
Prize Bonds and National Saving Certificates	**119,171**	115,840
Management of public debts	**68,238**	63,397
Others	**19,651**	34,857
	496,454	322,991

		2004	**2003**
		(Rupees' 000)	

34. EXCHANGE GAIN / (LOSS) - net

Gain / (loss) on:

	2004	**2003**
- Foreign currency placements, deposits and other accounts - net	**3,372,849**	(12,951,336)
- Open market operations (including currency swap arrangements)	**(38,963)**	(1,730,900)
- Forward covers under Exchange Risk Coverage Scheme	**(156,485)**	1,206,876
- Payable to the International Monetary Fund (IMF)	**(3,853,758)**	(1,000,142)
- Special Drawing Rights of IMF	**669,601**	130,213
- Others	**424,750**	224,093
	417,994	(14,121,196)
Exchange risk fee income	**337,178**	2,311,731
	755,172	(11,809,465)

35. OTHER OPERATING INCOME

	2004	**2003**
Penalties levied on banks and financial institutions	**360,677**	279,472
License / Credit Information Bureau fee recovered	**1,966**	84
Others	**5,181**	171
	367,824	279,727

36. NOTE PRINTING CHARGES

Note printing charges are payable to Pakistan Security Printing Corporation (Private) Limited at agreed rates under specific arrangements.

37. AGENCY COMMISSION

Agency commission is payable to National Bank of Pakistan (NBP) under an agreement at the rate of 0.15% (2003: 0.15%) of the total amount of collection and remittances handled by NBP.

38. ESTABLISHMENT COSTS

	Note	2004	2003
		(Rupees in '000)	
Salaries and other benefits		**2,333,812**	2,364,922
Retirement benefits and employees' compensated absences		**2,376,564**	2,478,345
Daily wages staff		**6,508**	6,536
Medical allowances		**267,480**	242,829
Overtime allowance		**11,963**	10,771
Rent and taxes		**29,483**	20,535
Insurance		**4,516**	2,300
Electricity, gas and water charges		**119,527**	103,427
Depreciation	*16*	**421,187**	513,980
Repairs to Bank's property		**22,296**	21,105
Repairs to Bank's vehicles		**2,892**	2,933
Repairs to mechanical / electrical equipment		**9,594**	17,428
Directors' fee		**1,812**	1,440
Auditors' remuneration	*38.3*	**2,832**	2,770
Legal and professional charges		**58,449**	41,025
Travelling expenses		**28,482**	28,777
Daily expenses		**39,844**	37,611
Passages		**71,594**	32,890
Fuel charges		**7,475**	7,620
Conveyance charges		**6,287**	7,052
Postage		**5,437**	4,558
Telegram / telex		**14,923**	11,517
Telephone		**36,660**	32,340
Training		**10,886**	11,534
Examination/ testing services		**1,249**	443
Remittance of treasure		**31,773**	32,161
Stationery		**21,024**	23,096
Books and newspapers		**7,518**	4,869
Advertisement		**4,542**	7,273
Bank guards		**34,962**	34,244
Uniforms		**16,138**	20,901
Others		**65,525**	56,129
		6,073,234	6,183,361

38.1 Staff retirement benefits

38.1.1 As mentioned in note 2.9 (c), the Group operates the following staff retirement benefit schemes:

- an un-funded gratuity scheme for all employees other than those who opted for the new general provident fund scheme or joined the Bank after 1975 and are entitled to pension scheme benefits;
- an un-funded pension scheme;
- an un-funded contributory benevolent fund scheme; and
- an un-funded post retirement medical benefit scheme.

During the year the actuarial valuations of the above defined benefit obligations were carried out at June 30, 2004 under the Projected Unit Credit Method using following significant assumptions:

- Expected rate of increase in salary 5.94 (2003: 5.94) percent per annum
- Expected rate of discount 8.00 (2003: 8.00) percent per annum
- Medical cost increase 2.86 (2003: 2.86) percent per annum

38.1.2 Present value of the obligations

Present values of obligations under the retirement benefit schemes and liabilities recognised thereagainst for the past services of the employees at June 30, 2004 based on actuarial valuation as of that date was as follows:

(Rupees in '000)

	Present value of the defined benefit obligation	**Unrecognised actuarial gain/ (loss)**	**Provision made in respect of the staff retirement**
Gratuity	85,914	20,665	106,579
Pension	7,106,000	(126,000)	6,980,000
Benevolent	958,000	(144,000)	814,000
Post retirement medical benefits	1,434,000	(1,090,000)	344,000
	9,583,914	(1,339,335)	8,244,579

38.1.3 Amount recognised in the profit and loss account

The amounts charged in the profit and loss account during the current year in respect of the above benefits are as follows:

(Rupees in '000)

	Current service cost	**Interest cost**	**Transitional liability recognised in the current year**	**Actuarial (gain) / loss recognised**	**Employees contributions**	**Total**
Gratuity	2,339	6,556	7,000	(4,895)	-	11,000
Pension	208,000	520,000	277,000	4,000	-	1,009,000
Benevolent	32,000	69,500	13,500	-	(2,000)	113,000
Post retirement medical benefits	14,000	51,500	29,500	21,000	-	116,000
	256,339	647,556	327,000	20,105	(2,000)	1,249,000

38.2 Employees' compensated absences

As at June 30, 2004, the Bank's liability for employees' compensated absences determined through an actuarial valuation carried out under the Projected Unit Credit Method amounted to Rs. 1,739 million (2003: Rs. 1,673 million). This amount has been recognised in the financial statements of the Bank. An amount of Rs. 181 million (2003: 237 million) has been charged to the profit and loss account in the current period based on the actuarial advice.

38.3 Auditors' remuneration

(Rupees in '000)

	A. F. Ferguson & Co.	**Taseer Hadi Khalid & Co.**	**Syed Husain & Co.**	**2004**	2003
Audit fee	1,000	1,000	60	**2,060**	1,000
Special certifications / examinations and sundry advisory services	45	-	-	**45**	1,060
Out of pocket expenses	350	350	27	**727**	710
	1,395	1,350	87	**2,832**	2,770

			2004	2003
			(Rupees in '000)	

39. OTHER INCOME

Gain on disposal of fixed assets		**149,231**	85,314
Liabilities and provisions written back - net		**275**	278,190
Gain on disposal of investments	*39.1*	**6,928,678**	591,228
Amortisation of deferred income	*25*	**135,490**	135,029
Others		**28,293**	930,082
		7,241,967	2,019,843

39.1 This includes Rs. 6,086.171 million in respect of the gain realised during the year on disposal of 26% of HBL's total paid-up capital to the Aga Khan Fund for Economic Development S.A., as mentioned in detail in note 9.2.3.

40. OTHER CHARGES

Charges on allocation of Special Drawing Rights	**227,295**	263,882
Others	**320,816**	332,658
	548,111	596,540

41. PROFIT FOR THE YEAR AFTER NON-CASH ITEMS

Profit for the year	**6,108,498**	39,311
Adjustments for:		
Depreciation	**421,187**	513,980
Amortisation of deferred income	**(135,490)**	(135,029)
Provision for:		
- retirement benefits and employees' compensated absences	**2,376,564**	2,478,345
- loans and advances	**566,906**	500,000
- share of loss / (profit) under profit and loss sharing arrangements	**5,303,335**	(2,102,204)
Liabilities and provisions no longer required written back	**-**	(278,190)
Gain on disposal of fixed assets	**(149,231)**	(85,314)
Dividend income	**(1,422,058)**	(1,168,526)
Other accruals and provisions - net	**2,005,498**	1,420,912
	15,075,209	1,183,285

42. CASH AND CASH EQUIVALENTS

Local currency	**2,959,993**	2,565,308
Foreign currency reserves	**629,731,918**	562,428,084
Earmarked foreign currency balances	**3,780,277**	53,113,531
Special Drawing Rights of the International Monetary Fund	**13,826,690**	14,092,081
	650,298,878	632,199,004

43. INTEREST/ MARK-UP RATE RISK

Information about the Group's exposure to interest / mark-up rate risk based on contractual repricing and maturity dates, which ever is earlier is as follows:

(Rupees in '000)

	Interest/ mark-up bearing *			Non interest/ mark-up bearing			
	Maturity upto one year	**Maturity after one year**	**Total**	**Maturity upto one year**	**Maturity after one year**	**Total**	**Grand Total**
Financial assets							
Local currency (including rupee coins)	-	-	-	2,959,993	-	2,959,993	2,959,993
Foreign currency reserves	626,501,442	2,036,533	628,537,975	3,398,449	397,091	3,795,540	632,333,515
Earmarked foreign currency balances	3,780,277	-	3,780,277	-	-	-	3,780,277
Special Drawing Rights of the International Monetary Fund	13,826,690	-	13,826,690	-	-	-	13,826,690
Reserve tranche with the International Monetary Fund under quota arrangements	10,062	-	10,062	-	-	-	10,062
Current account of the Government of Balochistan	5,533,119	-	5,533,119	-	-	-	5,533,119
Investments	131,775,168	2,740,000	134,515,168	2,522,312	33,620,305	36,142,617	170,657,785
Loans, advances and bills of exchange	3,000,000	9,000,000	12,000,000	188,220	785,836	974,056	12,974,056
Loans, advances and bills of exchange offices	92,901,781	16,518,314	109,420,095	71,839,715	6,070,458	77,910,173	187,330,268
Balances due from Governments of India and Bangladesh (former East Pakistan)	-	2,986,117	2,986,117	-	860,377	860,377	3,846,494
Indian notes representing assets receivable from the Reserve Bank of India	-	-	-	-	543,793	543,793	543,793
Assets held with the Reserve Bank of India	-	362,897	362,897	-	3,765	3,765	366,662
Other assets	53,420	-	53,420	10,149,700	2,674,429	12,824,129	12,877,549
	877,381,959	33,643,861	911,025,820	91,058,389	44,956,054	136,014,443	1,047,040,263
Financial liabilities							
Bank notes in circulation	-	-	-	-	611,903,657 **	611,903,657	611,903,657
Bills payable	-	-	-	494,365	-	494,365	494,365
Current accounts of the Government	-	-	-	48,889,002	-	48,889,002	48,889,002
Deposits of banks and financial institutions	23,990,362	-	23,990,362	132,180,443	-	132,180,443	156,170,805
Other deposits and accounts	-	40,712,397	40,712,397	42,316,407	-	42,316,407	83,028,804
Payable to International Monetary Fund	7,303,368	95,101,866	102,405,234	-	-	-	102,405,234
Other liabilities	-	-	-	16,266,853	4,034,115	20,300,968	20,300,968
	31,293,730	135,814,263	167,107,993	240,147,070	615,937,772	856,084,842	1,023,192,835
On balance sheet gap - 2004 (a)	846,088,229	(102,170,402)	743,917,827	(149,088,681)	(570,981,718)	(720,070,399)	23,847,428
On balance sheet gap - 2003 (a)	793,650,276	(95,408,634)	698,241,642	(201,409,455)	(473,148,025)	(674,557,480)	23,684,162

(a) On-balance sheet gap represents the net amounts of on-balance sheet items.

* includes finances provided under profit and loss sharing arrangements.

** Bank notes have been assumed to have a maturity of more than one year.

43.1 Risk management policies

The Group is primarily subject to interest/mark-up rate, credit, currency and liquidity risks. The policies and procedures for managing these risks are outlined in notes 43.1.1 to 43.1.4. The Group has designed and implemented a framework of controls to identify, monitor and manage these risks. The senior management is responsible for advising the Governor on the monitoring and management of these risks.

43.1.1 Interest / mark-up rate risk management

Interest / mark-up rate risk is the risk that the value of a financial instrument will fluctuate due to changes in the market interest/ mark-up rates. The Group has adopted appropriate policies to minimise its exposure to this risk. The Group's management, the Central Board of the Bank and the investment committee has set appropriate duration limits and a separate department deals with the monitoring of the Group's interest / mark-up rate risk exposure based on these limits.

43.1.2 Credit risk management

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Credit risk in the Group's portfolio is monitored, reviewed and analysed by the appropriate officials and the exposure is controlled through counterparty and credit limits. Counterparties are allocated to a particular class based mainly on their credit rating. Foreign currency placements are made in approved currencies and government securities. Loans and advances to scheduled banks and financial institutions are usually secured either by Government guarantees or by demand promissory notes. Geographical exposures are controlled by country limits and are updated as and when necessary with all limits formally reviewed on a periodic basis. The Group's exposure to credit risk associated with foreign operations is managed by monitoring compliance with investment limits for counterparties. The Group's credit risk mainly lies with exposure towards government sector and financial institutions.

43.1.3 Currency risk management

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. Foreign currency activities result mainly from the Group's holding of foreign currency assets under its foreign reserves management function and the overall level of these assets is determined based on the prevailing extent of credit and liquidity risks. In order to avoid losses arising from adverse changes in the rates of exchange, the Group's compliance with the limits established for foreign currency positions is being regularly monitored by the management.

The Group also holds from time to time, foreign currency assets and liabilities that arise from the implementation of domestic monetary policies. Any foreign currency exposure relating to these implementation activities are hedged through the use of foreign currency forwards, swaps and other transactions.

The Group also enters into forward foreign exchange contracts with the commercial banks and financial institutions to hedge against the currency risk on foreign currency swap transactions.

43.1.4 Liquidity risk management

Liquidity risk is the risk that an entity will encounter difficulty in raising funds to meet commitments associated with the financial instruments. In order to reduce the level of liquidity risk arising out of the local currency activities, the Group manages the daily liquidity position of the banking system including advancing and withdrawal of funds from the system for smoothening out daily peaks and troughs.

The risk arising out of the Group's obligations for foreign currency balances or deposits is managed through available reserves generated mainly from borrowings and open market operations.

43.1.5 Fair value of financial assets and financial liabilities

The fair value of all financial assets and financial liabilities, except for investment accounted for at cost, is estimated to approximate their carrying values.

44. NUMBER OF EMPLOYEES

	2004	2003
Number of employees at June 30	**6,850**	6,782

45. GENERAL

Figures have been rounded off to the nearest thousand rupees.

46. DATE OF AUTHORISATION

These financial statements were authorised for issue on September 7, 2004 by the Central Board of Directors of the Bank.

Ishrat Husain **Governor**	**Tawfiq A. Husain** **Deputy Governor**	**Aftab Mustafa Khan** **Director Accounts**

13 Financial Statements of the SBP

A. F. FERGUSON & CO.
CHARTERED ACCOUNTANTS
STATE LIFE BUILDING 1-C
I. I. CHUNDRIGAR ROAD
KARACHI

TASEER HADI KHALID & CO.
CHARTERED ACCOUNTANTS
1st FLOOR, SHEIKH SULTAN TRUST
BUILDING NO. 2
BEAUMONT ROAD
KARACHI

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the annexed balance sheets of the Issue and Banking Departments of the **State Bank of Pakistan** as at June 30, 2004 and the related profit and loss account, cash flow statement and statement of changes in equity together with the notes forming part thereof (here-in-after referred to as the 'financial statements'), for the year then ended and we state that we have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purposes of our audit.

It is the responsibility of the Bank's management to establish and maintain a system of internal control, and prepare and present the financial statements in conformity with the International Accounting Standards approved for adoption by the Central Board of the Bank. Our responsibility is to express an opinion on these statements based on our audit.

Except for the matters referred to in the following paragraph, we conducted our audit in accordance with the auditing standards as applicable in Pakistan. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of any 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 policies and significant estimates made by management, as well as, evaluating the overall presentation of the above said statements. We believe that our audit provides a reasonable basis for our opinion and, after due verification, we report that:

Events have rendered impossible the verification of the assets recoverable from the Reserve Bank of India or the Government of India or pertaining to transactions in former East Pakistan included in the financial statements. Realisability of these assets amounting to Rs. 6,291.558 million is subject to final settlement between the Government of Pakistan and the Governments of India and Bangladesh respectively. Out of these, assets valuing Rs. 1,930.008 million have been included in the Issue Department as backing against the liability towards notes in circulation. Had these assets not been included in the Issue Department, foreign currency reserves or Government securities of the equivalent value would have been transferred from the Banking Department to the Issue Department as replacement. In addition, pending finalization of the restructuring process of Zarai Taraqiati Bank Limited (ZTBL) and its impact on ZTBL's future profits and cash flows and due to non-availability of any estimate of the fair value of the Bank's investment in United Bank Limited (UBL), we are unable to satisfy ourselves as to the carrying value of the Bank's investment in ZTBL and UBL.

Except for the financial effect of the matters stated in the preceding paragraph:

(a) in our opinion the balance sheets and related profit and loss account, cash flow statement and statement of changes in equity together with the notes thereon have been drawn up in conformity with the International Accounting Standards approved for adoption by the Central Board of the Bank and are further in accordance with accounting policies consistently applied; and

(b) in our opinion and to the best of our information and according to the explanations given to us, the balance sheets, profit and loss account, cash flow statement and statement of changes in equity together with the notes forming part thereof conform with the International Accounting Standards approved for adoption by the Central Board of the Bank, and, give the information required by these Standards in the manner so required, and respectively give a true and fair view of the state of the Bank's affairs as at June 30, 2004 and of the profit, its cash flows and changes in equity for the year then ended.

A. F. Ferguson & Co.	**Taseer Hadi Khalid & Co.**
Chartered Accountants	**Chartered Accountants**
Karachi	**Karachi**
Date:September 7,2004	**Date: September 7,2004**

State Bank of Pakistan - Issue Department
Balance Sheet
As at June 30, 2004

	Note	2004	2003
		(Rupees in '000)	
ASSETS			
Gold reserves held by the Bank	*3*	**47,532,115**	41,246,479
Foreign currency reserves	*4*	**500,312,132**	459,116,601
Special Drawing Rights of the International Monetary Fund	*5*	**13,826,690**	-
Notes and rupee coins:			
- Indian notes representing assets receivable from the Reserve Bank of India	*7*	**543,793**	535,162
- Rupee coins	*8*	**2,799,163**	2,351,138
		3,342,956	2,886,300
Investment in securities	*9*	**45,671,523**	18,558,695
Commercial papers	*10*	**78,500**	78,500
Assets held with the Reserve Bank of India	*11*	**1,139,741**	1,004,469
		611,903,657	522,891,044
LIABILITIES			
Bank notes issued	*12*	**611,903,657**	522,891,044

The annexed notes 1 to 47 form an integral part of these financial statements.

Ishrat Husain **Governor**	**Tawfiq A. Husain** **Deputy Governor**	**Aftab Mustafa Khan** **Director Accounts**

State Bank of Pakistan - Banking Department
Balance Sheet
As at June 30, 2004

	Note	2004 (Rupees in '000)	2003
ASSETS			
Local currency	*8*	**160,830**	214,170
Foreign currency reserves	*4*	**132,021,383**	104,384,628
Earmarked foreign currency balances	*6*	**3,780,277**	53,113,531
Special Drawing Rights of the International Monetary Fund	*5*	**-**	14,092,081
		135,962,490	171,804,410
Reserve tranche with the International Monetary Fund under quota arrangements	*13*	**10,062**	9,560
Current account of the Government of Balochistan	*19.5*	**5,533,119**	-
Investments	*9*	**125,119,093**	135,060,295
Loans, advances and bills of exchange	*14*	**196,058,152**	170,819,809
Balances due from the Governments of India and Bangladesh (former East Pakistan)	*15*	**3,846,494**	3,631,027
Fixed assets:			
- Operating fixed assets	*16*	**7,022,397**	7,385,590
- Capital work-in-progress	*17*	**348,026**	276,796
		7,370,423	7,662,386
Other assets	*18*	**12,846,989**	25,660,204
Total assets		**486,746,822**	514,647,691
LIABILITIES			
Bills payable		**494,365**	671,931
Current accounts of the Government*	*19*	**48,889,002**	81,717,903
Current account of SBP Banking Services Corporation		**3,065,457**	3,681,932
Current account of National Institute of Banking and Finance		**3,199**	10,544
Deposits of banks and financial institutions	*20*	**156,170,805**	141,665,048
Other deposits and accounts	*21*	**83,028,804**	80,968,153
Payable to the International Monetary Fund	*22*	**102,405,234**	120,933,384
Other liabilities	*23*	**18,701,441**	17,361,789
		412,758,307	447,010,684
Deferred liability - staff retirement benefits	*24*	**3,533,413**	3,262,940
Deferred income	*25*	**286,195**	415,106
Total liabilities		**416,577,915**	450,688,730
Net assets		**70,168,907**	63,958,961
Share capital	*26*	**100,000**	100,000
Capital receipt	*27*	**1,525,958**	1,525,958
Reserves	*28*	**16,700,000**	16,700,000
		18,325,958	18,325,958
Unrealised appreciation on gold reserves	*29*	**45,205,621**	38,883,231
Surplus on revaluation of fixed assets	*16.1*	**6,637,328**	6,749,772
		70,168,907	63,958,961
Contingencies and commitments	*30*		

* Government includes Federal and Provincial

The annexed notes 1 to 47 form an integral part of these financial statements.

Ishrat Husain	**Tawfiq A. Husain**	**Aftab Mustafa Khan**
Governor	**Deputy Governor**	**Director Accounts**

State Bank of Pakistan
Profit and Loss Account
For the year ended June 30, 2004

	Note	2004 (Rupees in '000)	2003 (Rupees in '000)
Discount, interest / mark-up and / or return earned	*31*	**11,708,491**	21,118,458
Interest / mark-up expense	*32*	**5,202,091**	2,578,162
		6,506,400	18,540,296
Commission	*33*	**496,454**	322,991
Exchange gain / (loss) - net	*34*	**755,172**	(11,809,465)
Dividend income		**1,422,058**	1,168,526
Profit transferred from SBP Banking Services Corporation and National Institute of Banking and Finance (Guarantee) Limited	*35*	**42,841**	49,472
Other operating income	*36*	**367,824**	279,727
		9,590,749	8,551,547
Direct operating expenses			
Note printing charges	*37*	**1,963,777**	1,845,963
Agency commission	*38*	**1,554,969**	1,398,128
Provision against loans and advances	*14.4*	**566,906**	500,000
		5,505,097	4,807,456
Establishment costs	*39*	**6,073,234**	6,183,361
OPERATING LOSS		**(568,137)**	(1,375,905)
Other income	*40*	**7,224,746**	1,997,282
		6,656,609	621,377
Other charges	*41*	**548,111**	596,540
NET PROFIT FOR THE YEAR		**6,108,498**	24,837
Surplus on revaluation of fixed assets realised on disposal	*16.1*	**112,444**	203,747
AVAILABLE FOR APPROPRIATION		**6,220,942**	228,584
Appropriation:			
Dividend to the Government of Pakistan @ Rs 10 per share (2003: Rs 10 per share)		**10,000**	10,000
BALANCE TRANSFERRED TO THE GOVERNMENT OF PAKISTAN		**6,210,942**	218,584

The annexed notes 1 to 47 form an integral part of these financial statements.

Ishrat Husain	**Tawfiq A. Husain**	**Aftab Mustafa Khan**
Governor	**Deputy Governor**	**Director Accounts**

State Bank of Pakistan

Cash Flow Statement

For the year ended June 30, 2004

	Note	**2004**	2003
		(Rupees in '000)	
Profit / (loss) for the year after non-cash items	*42*	**14,248,169**	(134,407)
(Increase)/decrease in assets			
Reserve tranche with the International Monetary Fund under quota arrangements		**(502)**	(559)
Investments		**(17,171,626)**	231,599,250
Loans, advances and bills of exchange		**(25,805,249)**	7,831,821
Foreign currency reserves not included in cash and cash equivalents		**(1,528,452)**	(41,867)
Indian notes representing assets receivable from the Reserve Bank of India		**(8,631)**	(6,522)
Assets held with the Reserve Bank of India		**(33,929)**	(13,510)
Other assets - net		**7,254,715**	850,635
		(37,293,674)	240,219,248
Increase/(decrease) in liabilities			
Notes in circulation		**89,012,613**	64,516,540
Bills payable		**(177,566)**	348,638
Current accounts of the Government*		**(38,362,020)**	25,425,280
Current account of SBP Banking Services Corporation		**(616,475)**	1,231,915
Current account of National Institute of Banking and Finance (Guarantee) Limited		**(7,345)**	10,544
Deposits of banks and financial institutions		**14,505,757**	8,714,935
Other deposits and accounts		**2,060,651**	275,752
Payable to the International Monetary Fund		**(18,528,150)**	7,880,350
Other liabilities - net		**(639,267)**	(10,270,323)
		47,248,198	98,133,631
		24,202,693	338,218,472
Payment of retirement benefits and employees' compensated absences		**(1,305,008)**	(1,094,201)
Receipt of dividend income		**1,431,808**	1,170,781
Gold purchased		**(64,589)**	(48,012)
Fixed capital expenditure		**(215,760)**	(50,475)
Proceeds from disposal of fixed assets		**271,672**	309,811
		118,123	287,904
Dividend paid to the Government of Pakistan		**(10,000)**	(10,000)
Surplus profits paid to the Government of Pakistan		**(6,210,942)**	(218,584)
		(6,220,942)	(228,584)
Increase in cash and cash equivalents during the year		**18,099,874**	338,277,792
Cash and cash equivalents at beginning of the year		**632,199,004**	293,921,212
Cash and cash equivalents at end of the year	*43*	**650,298,878**	632,199,004

* Government includes Federal and Provincial Governments of Pakistan and Government of Azad Jammu and Kashmir.

The annexed notes 1 to 47 form an integral part of these financial statements.

Ishrat Husain	**Tawfiq A. Husain**	**Aftab Mustafa Khan**
Governor	**Deputy Governor**	**Director Accounts**

State Bank of Pakistan

Statement of Changes in Equity

For the year ended June 30, 2004 **(Rupees in '000)**

	Share capital	Capital receipt	Reserves: Reserve Fund	Rural Credit Fund	Industrial Credit Fund	Export Credit Fund	Loans Guarantee Fund	Housing Credit Fund	Unrealised appreciation on gold reserves	Surplus on revaluation of fixed assets	Profit and loss account	Total
Balance at June 30, 2002	100,000	1,525,958	5,400,000	2,600,000	1,600,000	1,500,000	900,000	4,700,000	37,033,311	6,953,519	-	62,312,788
Net profit for the year ended June 30, 2003	-	-	-	-	-	-	-	-	-	-	24,837	24,837
Surplus on revaluation of fixed assets realised on disposal	-	-	-	-	-	-	-	-	-	(203,747)	203,747	-
Dividend to the Government of Pakistan	-	-	-	-	-	-	-	-	-	-	(10,000)	(10,000)
Balance profit transferred to the Government of Pakistan	-	-	-	-	-	-	-	-	-	-	(218,584)	(218,584)
Unrealised appreciation on gold reserves during the year	-	-	-	-	-	-	-	-	1,849,920	-	-	1,849,920
Balance at June 30, 2003	100,000	1,525,958	5,400,000	2,600,000	1,600,000	1,500,000	900,000	4,700,000	38,883,231	6,749,772	-	63,958,961
Net profit for the year ended June 30, 2004	-	-	-	-	-	-	-	-	-		6,108,498	6,108,498
Surplus on revaluation of fixed assets realised on disposal	-	-	-	-	-	-	-	-	-	(112,444)	112,444	-
Dividend to the Government of Pakistan	-	-	-	-	-	-	-	-	-	-	(10,000)	(10,000)
Balance profit transferred to the Government of Pakistan	-	-	-	-	-	-	-	-	-	-	(6,210,942)	(6,210,942)
Unrealised appreciation on gold reserves during the year	-	-	-	-	-	-	-	-	6,322,390	-	-	6,322,390
Balance at June 30, 2004	100,000	1,525,958	5,400,000	2,600,000	1,600,000	1,500,000	900,000	4,700,000	45,205,621	6,637,328	-	70,168,907

The annexed notes 1 to 47 form an integral part of these financial statements.

Ishrat Husain
Governor

Tawfiq A. Husain
Deputy Governor

Aftab Mustafa Khan
Director Accounts

State Bank of Pakistan

Notes to the Financial Statements

For the year ended June 30, 2004

1. Status and Nature of Operations

State Bank of Pakistan (the Bank) is the Central Bank of Pakistan and is incorporated under the State Bank of Pakistan Act, 1956. The Bank is primarily responsible for the management of credit, foreign exchange and currency in the country and also acts as the fiscal agent of the Government. The activities of the Bank mainly include:

- implementing the monetary and fiscal policies;
- issuing of currency;
- facilitation of free competition and stability in the financial system;
- licensing and supervision of credit institutions;
- organisation and management of the inter-bank settlement system and promotion of smooth functioning of payment systems;
- providing of loans and advances to the Government, banks, financial institutions and local authorities under various facilities;
- purchase, holding and sale of securities of banks and financial institutions on the directives of the Federal Government; and
- acting as depository of the Government under specific arrangements between the Government and certain institutions.

2. Summary of Significant Accounting Policies

2.1 Basis of preparation

These financial statements have been prepared in accordance with the requirements of the International Accounting Standards (IASs) approved for adoption by the Central Board of the Bank. Under the powers conferred by the State Bank of Pakistan Act, 1956, the Central Board approved IAS 1 to IAS 38 from those applicable in Pakistan for adoption by the Bank.

2.2 Accounting convention

These financial statements have been prepared under the historical cost convention, except that gold reserves and certain fixed assets, as referred to in notes 2.6 and 2.7 have been included at revalued amounts and certain employee benefits, as referred to in notes 2.9(c) and 2.10 have been stated at their present values.

2.3 Bank notes and rupee coins

The liability of the Bank towards bank notes issued as a legal tender under the State Bank of Pakistan Act, 1956 is stated at the face value and is represented by the specified assets of the Issue Department of the Bank. The cost of printing of notes is charged to the current profit and loss account. Any unissued bank notes lying with the Bank are not reflected in the books of account.

The Bank also issues coins of various denominations on behalf of the Government of Pakistan. These coins are purchased from the Government at their respective face values. The unissued coins form part of the assets of the Issue Department.

2.4 Impairment

The carrying amount of the assets is reviewed at each balance sheet date to determine whether there is any indication of impairment of any asset or a group of assets. If such indication exists, the recoverable amount of such assets is estimated and the impairment losses recognised in the profit and loss account. Balances considered bad and irrecoverable are written off from the books of accounts.

Provisions against impairment are reviewed at each balance sheet date and adjusted to reflect the current best estimates. Changes in the provisions are recognised as income / expense currently.

2.5 Investments

- Investments in debt securities are stated at cost. The cost of securities is adjusted for any amortisation of discounts or premiums on a straight-line basis over the period to maturity.
- Investments in marketable securities, other than debt securities mentioned above, are stated at the lower of cost and market value.
- Investments in unlisted securities (other than debt securities mentioned above) and subsidiaries are stated at cost less impairment losses, if any.

The Bank enters into transactions of outright sale, repurchase (Repo) and resale (Reverse Repo) of securities at contracted rates for specified periods of time. These are recorded as follows:

i) in case of outright sale or sale under repurchase (Repo) obligations, the securities are deleted from investments and the charges arising from the differential in sale and face / repurchase value are accrued on a prorata basis and recorded as discount expense which is deducted from the discount, interest / mark-up and / or return earned on these securities. On maturity, the securities are reinstated at their respective original cost.

ii) in case of purchase under resale obligations, the securities are included under investments at the contracted purchase price and the differential of the contracted purchase and resale prices is amortised over the period of the contract and recorded under discount, interest / mark-up and / or return earned on these securities.

2.6 Gold reserves

Gold reserves, including those held with the Reserve Bank of India, are stated at the revalued amounts of the fine gold content thereof in accordance with the requirements of the State Bank of Pakistan Act, 1956 and the State Bank of Pakistan General Regulations. Appreciation or depreciation, if any, on revaluation is taken to "unrealised appreciation on gold reserves" account. Appreciation realised on disposal of gold reserves is credited to the retained earnings.

2.7 Fixed assets and depreciation

Operating tangible assets except freehold land and capital work-in-progress are stated at cost or revalued amounts less accumulated depreciation and impairment losses, if any. Freehold land is stated at revalued amount less accumulated impairment losses, if any, while capital work-in-progress is valued at cost.

Depreciation is calculated using the straight-line method so as to write off the assets over their expected useful lives without taking into account any residual value.

Depreciation on additions is charged from the month in which the asset is put to use while no depreciation is charged in the month in which the assets are deleted. Normal repairs and maintenance are charged to the profit and loss account as and when incurred; major renewals and improvements are capitalised and the assets so replaced, if any, are retired. Gains and losses on disposal of fixed assets are included in income currently.

Intangible assets are carried at cost less accumulated amortisation and accumulated impairment losses, if any. Amortisation is calculated using the straight-line method so as to write off the assets over their expected useful lives without taking into account any residual value.

2.8 Deferred income

Grants received on account of capital expenditure are recorded as deferred income. These are amortised over the useful life of the relevant asset.

2.9 Staff retirement benefits

The Bank operates:

a) an un-funded contributory provident fund (old scheme) for those employees who joined prior to 1975 and have opted to remain under the old scheme;

b) an un-funded general contributory provident fund (new scheme) for all employees who joined after 1975 and those employees who had joined prior to 1975 but have opted for the new scheme;

c) following other staff retirement benefit schemes:

- an un-funded gratuity scheme for all its employees other than those who opted for the new general provident fund scheme or joined the Bank after 1975 and are entitled only to pension scheme benefits;
- an un-funded pension scheme;
- an un-funded benevolent fund scheme; and
- an un-funded post retirement medical benefit scheme.

Annual provisions are made by the Bank to cover the obligations arising under these schemes based on actuarial recommendations. The actuarial valuations are carried out under the Projected Unit Credit Method. Unrecognised actuarial gains and losses are recognised in the profit and loss account over the expected average remaining working lives of the employees.

The above staff retirement benefits are payable to staff on completion of prescribed qualifying period of service.

2.10 Compensated absences

The Bank makes annual provision in respect of liability for employees' compensated absences based on actuarial estimates.

2.11 Revenue recognition

- Discount, interest / mark-up and / or return on loans and advances and investments are recorded on accrual basis. However, income on balances pertaining to transactions in former East Pakistan (now Bangladesh), doubtful loans and advances and overdue return on investments are recognised as income on receipt basis.
- Dividend income is recognised when the Bank's right to receive dividend is established.
- Gains on disposal of securities are taken to profit and loss account currently.
- All other revenues are recognised on accrual basis.

2.12 Finances under profit and loss sharing arrangements

The Bank provides various finances to financial institutions under profit and loss sharing arrangements. Share of profit / loss under these arrangements is recognised on accrual basis.

2.13 Taxation

The income of the Bank is exempt from tax under section 49 of the State Bank of Pakistan Act, 1956.

2.14 Foreign currency translation

Transactions denominated in foreign currencies are translated to Pak Rupees at the foreign exchange rate ruling at the date of transaction. Monetary assets and liabilities in foreign currencies are translated into rupees at the rates of exchange prevailing at the balance sheet date or at contracted rates.

Exchange gains and losses are taken to the profit and loss account except for certain exchange differences on balances with the International Monetary Fund, referred to in note 2.15, which are transferred to the Government of Pakistan account.

Exchange differences arising under Exchange Risk Coverage Scheme and on currency swap transactions are recognised in the books of account on accrual basis.

2.15 Transactions and balances with International Monetary Fund

Transactions and balances with the International Monetary Fund (IMF) are recorded on the basis of International Accounting Standards and the guidelines contained in the Aide Memoire and specific arrangements entered into between the Bank and the Government. A summary of the policies followed by the Bank for recording of these transactions and balances is as follows:

- the Government's contribution for quota with the IMF is recorded by the Bank as depository of the Government and exchange differences arising under these arrangements are transferred to the Government account.
- exchange gains or losses arising on revaluation of borrowings from the IMF are recognised in the profit and loss account except for the gains or losses transferable to the Government under specific arrangements.
- the cumulative allocation of Special Drawing Rights by the IMF is treated as capital receipt and is not revalued.
- income or charges pertaining to balances with the IMF are taken to the Government account, except for the following which are taken to the profit and loss account:
    - charges on borrowings under credit schemes other than fund facilities;
    - charges on net cumulative allocation of Special Drawing Rights; and
    - return on holdings of Special Drawing Rights.

2.16 Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made.

2.17 Cash and cash equivalents

Cash and cash equivalents include cash, balances in the current and deposit accounts and securities that are realisable in known amounts of cash within three months and which are subject to insignificant changes in value.

2.18 Financial instruments

Financial assets and liabilities are recognised at the time when the Bank becomes a party to the contractual provisions of the instrument. Any gain or loss on the derecognition of the financial assets and liabilities is included in the profit and loss account currently.

Financial instruments carried on the balance sheet include foreign currency reserves, investments, loans and advances, government accounts, other deposits accounts and liabilities. The particular recognition methods adopted are disclosed in the individual policy statements associated with each financial instrument.

2.19 Offsetting

A financial asset and a financial liability is offset and the net amount is reported in the balance sheet when the Bank has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

		Net content in troy ounces	2004	2003
			(Rupees in '000)	

3. GOLD RESERVES HELD BY THE BANK

Opening balance		2,062,180	**41,246,479**	39,378,223
Additions during the year		2,730	**64,589**	48,012
Appreciation during the year due to revaluation	*29*	-	**6,221,047**	1,820,244
		2,064,910	**47,532,115**	41,246,479

4. FOREIGN CURRENCY RESERVES

Securities		**138,313,415**	55,074,419
Deposit accounts	*4.2*	**490,621,651**	489,839,438
Current accounts	*4.2*	**3,398,449**	18,587,372
		632,333,515	563,501,229

The above foreign currency reserves are held as follows:

- Issue Department	**500,312,132**	459,116,601
- Banking Department	**132,021,383**	104,384,628
	632,333,515	563,501,229

4.1 At June 30, 2004, above assets included Rs. 167.974 million (2003: Rs. 165.307 million) recoverable from the Government of India. Realisability of these assets is subject to final settlement between the Governments of Pakistan and India.

4.2 The balance in current and deposit accounts carry interest at various rates ranging between 0.97 to 4.52 (2003: 0.9 to 3.6) percent per annum.

5. SPECIAL DRAWING RIGHTS OF THE INTERNATIONAL MONETARY FUND

Special Drawing Rights (SDRs) are the foreign reserve assets which are allocated by the International Monetary Fund (IMF) to its member countries in proportion to their quota in the Fund. In addition, the member countries can purchase the SDRs from the IMF and other member countries in order to settle their obligations. The above represents the rupee value of the SDRs held by the Bank at June 30, 2004. Interest is credited by the IMF on the SDR holding of the Bank at weekly interest rates on daily products of SDRs held during each quarter.

At June 30, 2004, the SDRs were held as follows:

By the Issue Department	**13,826,690**	-
By the Banking Department	**-**	14,092,081
	13,826,690	14,092,081

6. EARMARKED FOREIGN CURRENCY BALANCES

These represent certain foreign currency balances held with the banks and financial institutions which are earmarked to meet specific foreign currency liabilities and commitments of the Bank.

7. INDIAN NOTES REPRESENTING ASSETS RECEIVABLE FROM THE RESERVE BANK OF INDIA

These represent Pak Rupee equivalent of Indian rupee notes which were in circulation in Pakistan until retirement from circulation and are to be repatriated to India under the Monetary Order from the Government of Pakistan. Realisability of these assets is subject to final settlement between the Governments of Pakistan and India.

	Note	2004	2003
		(Rupees in '000)	

8. LOCAL CURRENCY

	Note	2004	2003
Bank notes held by the Banking Department	*12*	**160,830**	214,170
Rupee coins		**2,799,163**	2,351,138
		2,959,993	2,565,308
Rupee coins held as assets of the Issue Department	*8.1*	**(2,799,163)**	(2,351,138)
		160,830	214,170

8.1 As mentioned in note 2.3, the Bank is responsible for issuing coins of various denominations on behalf of the Government. The closing balance represents the face value of unissued coins held by the Bank at June 30, 2004.

9. INVESTMENTS

	Note	2004	2003
Government securities	*9.1*		
Market Treasury Bills		**128,728,739**	104,927,028
Federal Investment Bonds		**2,150,000**	2,150,000
Federal and Provincial Government scrips		**2,740,000**	3,326,947
		133,618,739	110,403,975
Banks and other financial institutions			
Ordinary shares			
- Listed		**1,100,807**	1,147,537
- Unlisted		**35,041,806**	32,288,214
	9.2	**36,142,613**	33,435,751
Advance against issue of share capital		**-**	8,750,000
Term Finance Certificates		**282,400**	282,400
		36,425,013	42,468,151
Subsidiaries			
SBP Banking Services Corporation - wholly owned subsidiary	*9.3*	**1,000,000**	1,000,000
National Institute of Banking and Finance (Guarantee) Limited (NIBAF) - shareholding at 59.4%		**7,500**	7,500
Advance against issue of share capital (NIBAF)		**21,760**	21,760
		1,029,260	1,029,260
Other investments			
Certificates of Deposits		**112,351**	112,351
		171,185,363	154,013,737
Provision against diminution in value of investments		**(394,747)**	(394,747)
		170,790,616	153,618,990
Investment in securities held as assets of the Issue Department	*9.4*	**(45,671,523)**	(18,558,695)
		125,119,093	135,060,295

9.1 Investment in Government securities

These represent investments guaranteed / issued by the Government. The profile of return on securities during the year is as follows:

	2004	2003
	(% per annum)	
Market Treasury Bills	**1.2116 to 4.3247**	1.6389 to 6.4045
Federal Investment Bonds	**15**	15
Federal and Provincial Government scrips	**3 to 16**	3 to 16

9.2 Investment in shares of banks and other financial institutions *9.2.1*

	Holding more than 50% 2004 %	2003 %		2004 (Rupees in '000)	2003
Listed investments					
National Bank of Pakistan	**75.18**	78.39	*9.2.2*	**1,100,807**	1,147,537
Unlisted investments					
Habib Bank Limited	**73.05**	98.42	*9.2.3*	**14,739,777**	11,986,185
Zarai Taraqiati Bank Limited	**99.69**	99.69	*9.2.4*	**3,204,323**	3,204,323
Federal Bank for Cooperatives	**75.00**	75.00		**150,000**	150,000
Equity Participation Fund	**65.81**	65.81		**102,000**	102,000
				18,196,100	15,442,508
Other investments with holding less than or equal to 50%			*9.2.5*	**16,845,706**	16,845,706
				35,041,806	32,288,214
				36,142,613	33,435,751

9.2.1 Investments in above entities have been made under the specific directives of the Government in accordance with the provisions of the State Bank of Pakistan Act, 1956 and other relevant statutes. The management of the Bank does not exercise significant influence or control over these entities except for any regulatory purposes or control arising as a consequence of any statute which applies to the entire sector to which these entities belong. Accordingly, these entities have not been consolidated as subsidiaries or accounted for as investments in associates.

9.2.2 Market value of the Bank's investment in the shares of National Bank of Pakistan at June 30, 2004 amounted to Rs. 24,604.850 million (2003: Rs. 8,781.527 million).

9.2.3 During the year, the Bank alongwith the Privatisation Commission, Government of Pakistan, entered into an agreement dated February 26, 2004 with The Aga Khan Fund for Economic Development S.A. (AKFED) for the transfer of ownership of 51% shares of Habib Bank Limited's (HBL) total paid-up capital to AKFED for USD 389.929 million. Under this agreement, the Bank has transferred ownership of 26% of HBL's total paid-up capital, proceeds of which amounting to USD 198.787 million have been received by the Bank resulting in a gain of Rs. 6,086.171 million, as mentioned in note 40.1 to the financial statements. Under the terms of this agreement, the title to remaining 25% shares will be transferred to AKFED after payments due there against have been received. These payments are due by February 25, 2005 and February 25, 2006 in two equal installments of USD 95.571 million each and carry mark-up at 2.5% above London Inter Bank offer rate on the unpaid amount.

The remaining 25% shares are presently in the name of the Bank which is entitled to any dividend and/ or bonus shares declared by HBL proportionate to these shares till the time their ownership is eventually transferred to AKFED upon compliance with the above-mentioned payment and other operational covenants prescribed in the agreement. In view of the above, the management of the Bank considers that risks and rewards of the remaining 25% shares still vests with the Bank as the transfer of their ownership is subject to compliance by AKFED with the above-mentioned conditions and, accordingly, the investment in these shares has not been derecognised during the year.

The break-up value of the Bank's investment in HBL amounted to Rs. 17,154.974 million at December 31, 2003 based on the financial statements of HBL for the year then ended.

9.2.4 This represents the cost of 99.69% holding in the shares of Zarai Taraqiati Bank Limited (ZTBL - former Agricultural Development Bank of Pakistan). During the year, the Central Board of Bank approved the restructuring of the Bank's exposure in ZTBL (including the investment in the shares of former ADBP) by its conversion into a term loan on certain terms and conditions. Terms of this loan have not been finalised which has delayed the conversion process. Pending the finalisation of this process, the balance continues to be disclosed as investment.

The management is confident that the interest of the Bank will be completely safeguarded in the restructuring process of ZTBL which will result in the conversion of ZTBL into a commercially viable entity capable of generating sufficient profits and cash flows to repay its obligations towards the Bank.

9.2.5 Other investments include Rs. 14,791.674 million (2003: Rs. 14,791.674 million) representing the cost of investment in the shares of United Bank Limited (UBL). The break-up value of this investment amounted to Rs. 6,759.768 million based on the financial statements of UBL for the year ended December 31, 2003 (2003: Rs. 5,390.394 million based on the financial statements for the year ended December 31, 2002). During the year ended June 30, 2002, 51% shares in UBL were sold at Rs. 47 per share as against the carrying value per share of Rs. 59 thereby resulting in a total loss of Rs. 3,144.657 million. The current carrying value per share of UBL remains at Rs. 59. However, no provision has been made in these financial statements in respect of this investment as the management is confident that the cost of the remaining investment will be recovered in full as privatisation of UBL will enhance its value and substantial future profits are likely to be earned by UBL.

9.3 The investment in SBP Banking Services Corporation has been made in 1,000 (2003: 1,000) ordinary shares of Rs. 1 million each.

9.4 These represent Market Treasury Bills allocated to the Issue Department.

10. COMMERCIAL PAPERS

These represent face value of certain commercial papers amounting to Rs. 78.5 million (2003: Rs. 78.5 million) which are held in Bangladesh (former East Pakistan). The realisability of the underlying amount is subject to final settlement between the Governments of Pakistan and Bangladesh (Former East Pakistan).

11. ASSETS HELD WITH THE RESERVE BANK OF INDIA

		2004	2003
		(Rupees in '000)	
Gold reserves			
- Opening balance		**671,736**	642,060
- Appreciation from revaluation during the year	*29*	**101,343**	29,676
		773,079	671,736
Sterling securities		**350,140**	316,471
Government of India securities		**12,757**	12,553
Rupee coins		**3,765**	3,709
		1,139,741	1,004,469

The above assets were allocated to the Government of Pakistan as its share of the assets of Reserve Bank of India under the provisions of Pakistan (Monetary System and Reserve Bank) Order, 1947. The transfer of these assets to the Bank is subject to final settlement between the Governments of Pakistan and India.

12. BANK NOTES ISSUED

Notes held with the Banking Department	*8*	**160,830**	214,170
Notes in circulation		**611,742,827**	522,676,874
		611,903,657	522,891,044

13. RESERVE TRANCHE WITH THE INTERNATIONAL MONETARY FUND UNDER QUOTA ARRANGEMENTS

Quota allocated by the International Monetary Fund	**88,097,392**	83,716,673
Liability under quota arrangements	**(88,087,330)**	(83,707,113)
	10,062	9,560

14. LOANS, ADVANCES AND BILLS OF EXCHANGE

Government	*14.1*	**12,000,000**	12,040,000
Government owned / controlled financial institutions	*14.2*	**110,623,197**	112,729,636
Private sector financial institutions	*14.3*	**77,283,785**	49,413,274
		187,906,982	162,142,910
Employees		**891,989**	810,812
		200,798,971	174,993,722
Provision against doubtful balances	*14.4*	**(4,662,319)**	(4,095,413)
		196,136,652	170,898,309
Commercial papers	*10*	**(78,500)**	(78,500)
		196,058,152	170,819,809

	2004	2003
	(Rupees in '000)	

14.1 Loans and advances to the Government

	2004	2003
Federal Government	**12,000,000**	12,000,000
Provincial Government (of Balochistan)	**-**	40,000
	12,000,000	12,040,000

14.1.1 During the year, mark-up on above balances due from the Federal and Provincial Governments was charged at various rates ranging between 1.3795 to 1.9197 (2003: 1.7035 to 6.379) percent per annum.

14.2 Loans and advances to Government owned / controlled financial institutions

(Rupees in '000)

		Scheduled banks		Non-banking financial institutions		Total	
		2004	2003	**2004**	2003	**2004**	2003
Agricultural sector	*14.2.2*	**58,005,280**	55,686,785	**-**	-	**58,005,280**	55,686,785
Industrial sector	*14.2.2*	**2,381,409**	2,725,071	**840,261**	1,613,217	**3,221,670**	4,338,288
Export sector		**16,424,361**	14,780,711	**786,123**	3,567	**17,210,484**	14,784,278
Housing sector		**66,907**	66,907	**12,607,300**	14,157,300	**12,674,207**	14,224,207
Others		**10,629,456**	11,563,145	**8,882,100**	12,132,933	**19,511,556**	23,696,078
		87,507,413	84,822,619	**23,115,784**	27,907,017	**110,623,197**	112,729,636

14.2.1 Above balances include Rs. 515.056 million (2003: Rs. 511.306 million) which are recoverable from various financial institutions operating in former East Pakistan. The realisability of these balances is subject to final settlement between the Governments of Pakistan and Bangladesh (former East Pakistan).

14.2.2 Exposure to the agricultural and industrial sectors respectively include Rs. 50,174.089 million and Rs. 1,083.124 million representing the cumulative Government guaranteed financing of Rs. 51,257.213 million (2003: Rs. 51,257.213 million) to Zarai Taraqiati Bank Limited (ZTBL). As mentioned in note 9.2.4, the restructuring of ZTBL is in progress and detailed terms of repayment of these finances are expected to be finalised in due course.

14.3 Loans and advances to private sector financial institutions

(Rupees in '000)

	Scheduled banks		Non-banking financial institutions		Total	
	2004	2003	**2004**	2003	**2004**	2003
Industrial sector	**499,796**	153,752	**3,577,792**	3,577,792	**4,077,588**	3,731,544
Export sector	**69,409,072**	41,952,396	**587,000**	10,000	**69,996,072**	41,962,396
Others	**3,210,125**	3,719,334	**-**	-	**3,210,125**	3,719,334
	73,118,993	45,825,482	**4,164,792**	3,587,792	**77,283,785**	49,413,274

14.4 Movement of provision

	2004	2003
	(Rupees in '000)	
Opening balance	**4,095,413**	3,865,230
Provision during the year	**566,906**	500,000
Provision written back during the year	**-**	(269,817)
	4,662,319	4,095,413

14.5 The interest/mark-up rate profile of the interest/mark-up bearing loans and advances is as follows:

	2004	2003
	(% per annum)	
Government owned / controlled and private sector financial institutions	**1.5 to 12**	4 to 12
Staff loans	**10**	10

			2004	2003
			(Rupees in '000)	

15. BALANCES DUE FROM THE GOVERNMENTS OF INDIA AND BANGLADESH (FORMER EAST PAKISTAN)

		2004	2003
India			
Advance against printing of notes		**39,616**	39,616
Receivable from the Reserve Bank of India		**837**	837
		40,453	40,453
Bangladesh (former East Pakistan)			
Inter office balances		**819,924**	819,924
Loans and advances	*15.2*	**2,986,117**	2,770,650
		3,806,041	3,590,574
		3,846,494	3,631,027

15.1 The realisability of the above balances is subject to final settlement between the Government of Pakistan and Governments of Bangladesh (former East Pakistan) and India.

15.2 These represent loans and advances provided to the Government of former East Pakistan.

16. OPERATING FIXED ASSETS

(Rupees in '000)

	Cost / revalued amount at July 1, 2003	Additions / (deletions) / transfers* during the year	Cost / revalued amount at June 30, 2004	Accumulated depreciation / amortisation at July 1, 2003	Charge for the year / (accumulated depreciation on deletions) / transfers*	Accumulated depreciation/ amortisation at June 30, 2004	Net book value at June 30, 2004	Annual rate of depreciation / amortisation %
Tangible assets								
Freehold land	917,806	- (109,924)	807,882	-	-	-	807,882	-
Leasehold land	4,996,893	-	4,996,893	228,147	110,250	338,397	4,658,496	over the term of lease
Building on freehold land	787,316	210 (7,557)	779,969	197,487	45,336 (2,345)	240,478	539,491	5
Building on leasehold land	1,100,839	28,934	1,129,773	202,757	69,282	272,039	857,734	5
Furniture and fixtures	48,061	19,028 (5,564)	61,525	11,629	4,856 (3,456)	13,029	48,496	10
Office equipment	72,551	25,546 (264) 2,634 *	100,467	63,986	7,697 (231) 1,427 *	72,879	27,588	20
EDP equipment	433,261	27,652 - (2,634) *	458,279	293,743	132,429 (1,427) *	424,745	33,534	33.33
Motor vehicles	39,144	49,532 (11,051)	77,625	23,448	10,743 (5,372)	28,819	48,806	20
	8.395.871	150.902 (134.360)	8.412.413	1.021.197	380.593 (11.404)	1.390.386	7.022.027	
Intangible asset								
Computer software	32,260	207	32,467	21,344	10,753	32,097	370	33.33
2004	8,428,131	151,109 (134,360)	8,444,880	1,042,541	391,346 (11,404)	1,422,483	7,022,397	
2003	8,599,635	97,917 (269,421)	8,428,131	699,832	387,450 (44,741)	1,042,541	7,385,590	

		2004	2003
		(Rupees in '000)	

16.1 Surplus on revaluation of fixed assets

Opening balance		**6,749,772**	6,953,519
Surplus realised on disposal of fixed assets		**(112,444)**	(203,747)
		6,637,328	6,749,772

Certain items of freehold land, leasehold land, buildings on freehold and leasehold land were revalued on June 30, 2001 by Iqbal A. Nanjee & Co., Valuation and Engineering Consultants, on the basis of market value. The revaluation resulted in a surplus of Rs. 6,953.519 million at that date. Out of this surplus, Rs. 6,121.173 million remains undepreciated at June 30, 2004 (2003: Rs. 6,404.136 million) and has been included in the carrying value of the related assets.

17. CAPITAL WORK-IN-PROGRESS

Building on freehold land		**2,943**	2,943
Building on leasehold land		**44,529**	4,447
Furniture and fixtures		**6,432**	827
Office equipment		**27,346**	1,803
EDP equipment		**1,843**	1,843
Intangible assets		**264,933**	264,933
		348,026	276,796

18. OTHER ASSETS

Amounts due from financial institutions under currency swap arrangements	*18.1*	**2,674,429**	2,717,230
Accrued interest / mark-up and return		**935,986**	884,060
Exchange gain recoverable under exchange risk coverage scheme		**7,691**	41,800
Stationery and stamps on hand		**8,310**	24,790
Other advances, deposits and prepayments		**521,238**	540,829
Balance receivable from the Government of Pakistan		**5,692,379**	9,493,838
Share of profit recoverable from Zarai Taraqiati Bank Limited under profit and loss sharing arrangements - net		**-**	5,548,751
Others		**3,006,956**	6,408,906
		12,846,989	25,660,204

18.1 This represents the Bank's right to receive rupee counterpart of the foreign currency on the maturity of certain currency swap arrangements with commercial banks and non-banking financial institutions. The related obligation of the Bank to exchange foreign currency with the rupee counterpart has been disclosed in note 23.

19. CURRENT ACCOUNTS OF THE GOVERNMENT

Federal Government	*19.1*	**14,681,524**	48,841,890
Provincial Governments			
- Punjab	*19.2*	**13,913,754**	20,292,864
- Sindh	*19.3*	**13,206,367**	3,361,749
- North West Frontier Province (NWFP)	*19.4*	**4,134,839**	5,532,498
- Balochistan	*19.5*	**-**	1,198,843
		31,254,960	30,385,954
Government of Azad Jammu and Kashmir		**2,952,518**	2,490,059
		48,889,002	81,717,903

		2004	2003
		(Rupees in '000)	

19.1 Federal Government

Non-food account		**484,991**	34,630,083
Food account		**20,693**	63,972
Zakat fund account		**15,857,448**	18,565,798
Railways - ways and means advances	*19.6*	**(2,798,603)**	(4,939,204)
Fertilizer account		**44,137**	(216,577)
Saudi Arab special loan account		**4,124**	4,124
Pakistan Baitul Mal fund account		**85**	85
Pakistan Railways special account		**1,063,373**	728,333
Government deposit account no. XII		**5,276**	5,276
		14,681,524	48,841,890

19.2 Provincial Government - Punjab

Non-food account	**(4,365,339)**	(6,239,821)
Food account	**1,254,266**	1,057,546
Zakat fund account	**50,117**	7,772
District Government account no. IV	**16,974,710**	13,177,552
Social action program	**-**	12,289,815
	13,913,754	20,292,864

19.3 Provincial Government - Sindh

Non-food account	**9,483,511**	(154,058)
Food account	**108,558**	211,914
Zakat fund account	**75,083**	144,917
District Government account no. IV	**3,539,215**	3,158,976
	13,206,367	3,361,749

19.4 Provincial Government - NWFP

Non-food account	**3,054,159**	3,885,304
Food account	**203,073**	389,095
Zakat fund account	**2,007**	611
District Government account no. IV	**875,600**	1,257,488
	4,134,839	5,532,498

19.5 Provincial Government - Balochistan

Non-food account		**(9,865,206)**	(2,526,162)
Food account		**463,836**	1,950
Zakat fund account		**5**	302,171
District Government account no. IV		**3,868,246**	3,420,884
		(5,533,119)	1,198,843
Classified as a receivable balance	*19.6*	**5,533,119**	-
Net credit balance		**-**	1,198,843

19.6 At the year end, these balances carried mark-up at 1.92 (2003: 1.7035) percent per annum.

	Note	2004	2003
		(Rupees in '000)	

20. DEPOSITS OF BANKS AND FINANCIAL INSTITUTIONS

	2004	2003
Foreign currency		
Scheduled banks	**14,212,278**	19,885,202
Held under Capital Reserve Requirement scheme	**32,020,008**	27,083,275
	46,232,286	46,968,477
Local currency		
Scheduled banks	**108,946,952**	94,076,143
Non-banking financial institutions	**991,567**	620,428
	109,938,519	94,696,571
	156,170,805	141,665,048

20.1 The interest / mark-up rate profile of the interest / mark-up bearing deposits is as follows:

	2004	2003
	(% per annum)	
Foreign currency	**0.59 to 0.67**	0.80 to1.34
Local currency	**0.99 to 1.70**	10.67 to 14.79

	Note	2004	2003
		(Rupees in '000)	

21. OTHER DEPOSITS AND ACCOUNTS

	Note	2004	2003
Foreign currency			
Foreign central banks		**26,172,872**	26,015,103
International organisation		**14,539,525**	14,451,875
		40,712,397	40,466,978
Local currency			
Special debt repayment	*21.2*	**22,108,042**	18,802,147
Government	*21.3*	**17,952,963**	19,817,965
Others		**2,255,402**	1,881,063
		42,316,407	40,501,175
		83,028,804	80,968,153

21.1 The interest rate profile of the interest bearing deposits is as follows:

	2004	2003
	(% per annum)	
Foreign central banks	**1.36 to 1.79**	1.39 to 2.21
International organisation	**2.96 to 3.1**	3.10 to 4.50

21.2 These represent amounts kept in separate special accounts to meet forthcoming foreign currency debt repayment obligations of the Government of Pakistan.

21.3 These represent rupee counterpart of the foreign currency loan disbursements received from various international financial institutions on behalf of the Government and credited to separate deposit accounts in accordance with the instructions of the Government.

		2004	2003
		(Rupees in '000)	
22. PAYABLE TO INTERNATIONAL MONETARY FUND			
Borrowings under:			
- Fund facilities	*22.1*	**25,041,465**	54,409,694
- Other credit schemes	*22.2*	**77,363,692**	66,523,617
		102,405,157	120,933,311
Current account for administrative charges		**77**	73
		102,405,234	120,933,384

22.1 These facilities are secured by demand promissory notes issued by the Government of Pakistan.

22.2 This includes Rs. 255.676 million (2003: Rs.728.887 million) in respect of the finance provided by the Saudi Fund for Development (SFD) under Enhanced Structural Adjustment Facility programme of the International Monetary Fund (IMF). The amount has been paid through IMF in its capacity as a Trustee for SFD in respect of this arrangement.

23. OTHER LIABILITIES

Foreign currency			
Amounts due to financial institutions under currency swap arrangements	*18.1*	**2,617,115**	2,601,338
Accrued interest and discount on deposits		**243,021**	256,799
Charges on allocation of Special Drawing Rights of IMF		**42,000**	38,000
Others		**4,603**	2,888
		2,906,739	2,899,025
Local currency			
Overdue mark-up and return		**3,444,098**	3,223,263
Unearned exchange risk fee		**12,183**	67,030
Remittance clearance account		**607,501**	246
Exchange loss payable under exchange risk coverage scheme		**45,721**	-
Share of loss under profit and loss sharing arrangements		**3,274,752**	3,543,166
Dividend payable to the Government		**10,000**	10,000
Payable to Government in respect of privatisation proceeds		**2,929,066**	2,929,066
Other accruals and provisions	*23.1*	**2,324,340**	1,646,714
Others		**3,147,041**	3,043,279
		15,794,702	14,462,764
		18,701,441	17,361,789

		2004	2003
		(Rupees in '000)	

23.1 Other accruals and provisions

Interest, mark-up and discount		**18,451**	20,806
Printing charges		**10,064**	147,187
Agency commission		**362,115**	326,514
Provision for employees' compensated absences	*39.5*	**322,000**	304,000
Others		**1,611,710**	848,207
		2,324,340	1,646,714

24. DEFERRED LIABILITY - STAFF RETIREMENT BENEFITS

Provident fund scheme		**148,942**	137,469
Gratuity		**22,471**	19,471
Pension		**2,991,000**	2,765,000
Benevolent fund scheme		**247,000**	253,000
Post retirement medical benefits		**124,000**	88,000
	24.1	**3,533,413**	3,262,940

24.1 The following is a movement in the net recognised liability in respect of the defined benefit schemes mentioned above:

					(Rupees in '000)
	Net recognised liability at July 1, 2003	**Charge for the year (note 39.4.3)**	**Payments during the year**	**Employees contribution**	**Net liability at June 30, 2004**
Gratuity	19,471	5,000	(2,000)	-	22,471
Pension	2,765,000	545,000	(319,000)	-	2,991,000
Benevolent	253,000	53,000	(61,000)	2,000	247,000
Post retirement medical benefits	88,000	87,000	(51,000)	-	124,000
	3,125,471	690,000	(433,000)	2,000	3,384,471

	2004	2003
	(Rupees in '000)	

25. DEFERRED INCOME

Opening balance	**415,106**	480,754
Grants received during the year	**6,579**	69,381
Amortisation during the year	**(135,490)**	(135,029)
Closing balance	**286,195**	415,106

This represents grant received for capital expenditure and, as indicated in note 2.8 to these financial statements, is being amortised over the useful lives of the related assets.

26. SHARE CAPITAL

Number of shares			
	Authorised share capital		
1,000,000	Ordinary shares of Rs 100 each	**100,000**	100,000
	Issued, subscribed and paid-up capital		
1,000,000	Fully paid-up ordinary shares of Rs 100 each	**100,000**	100,000

The entire share capital of the Bank is owned by the Government of Pakistan except for 200 shares held by the Central Bank of India (held by Deputy Custodian Enemy Property, Banking Supervision Department, State Bank of Pakistan) and 500 shares held by the State of Hyderabad.

		2004	2003
		(Rupees in '000)	

27. CAPITAL RECEIPT

Allocation of Special Drawing Rights of the International Monetary Fund		**1,525,958**	1,525,958

28. RESERVES

Reserve Fund	*28.1*	**5,400,000**	5,400,000
Rural Credit Fund		**2,600,000**	2,600,000
Industrial Credit Fund		**1,600,000**	1,600,000
Export Credit Fund		**1,500,000**	1,500,000
Loans Guarantee Fund		**900,000**	900,000
Housing Credit Fund		**4,700,000**	4,700,000
		16,700,000	16,700,000

28.1 Reserve Fund

This represents appropriations made in the previous years out of the annual profits of the Bank in accordance with the provisions of the State Bank of Pakistan Act, 1956 for the purpose of provision of cover against risks relating to events which are contingent and non-foreseeable.

28.2 Other Funds

These represent appropriations made in the previous years out of the surplus profits of the Bank for certain specified purposes in accordance with the provisions of the State Bank of Pakistan Act, 1956.

29. UNREALISED APPRECIATION ON GOLD RESERVES

Opening balance		**38,883,231**	37,033,311
Appreciation on revaluation during the year:			
- held by the Bank	*3*	**6,221,047**	1,820,244
- held with the Reserve Bank of India	*11*	**101,343**	29,676
		6,322,390	1,849,920
		45,205,621	38,883,231

Gold reserves are revalued under the State Bank of Pakistan Act, 1956 and State Bank of Pakistan General Regulations at the closing market rate fixed on the last working day of the year in London.

30. CONTINGENCIES AND COMMITMENTS

30.1 Contingencies

Money for which the Bank is contingently liable:

a) Contingent liability in respect of guarantees given on behalf of:

i) Government	**32,059,794**	31,723,775
ii) Government owned / controlled bodies and authorities	**73,620,783**	103,829,076
	105,680,577	135,552,851

Guarantees amounting to Rs. 105,680.577 million (2003: Rs. 131,792.185 million) are secured by counter guarantees either from the Government of Pakistan or local financial institutions.

b) Certain employees of the Bank who had retired under the Early Retirement Incentive Scheme (ERIS) introduced in the year 2000 had filed a case against the Bank in the Federal Services Tribunal for the enhancement of their entitlement paid under the above scheme. During the year, the Tribunal has decided the case in favour of these employees and has directed that the entitlement under the above scheme should include the effect of subsequent increases in certain staff retirement and other benefits. The Bank, in response to the above decision of the Tribunal, has filed a civil petition for leave to appeal in the Supreme Court of Pakistan which is pending for hearing. The management is confident that the Bank would not have to bear any additional expenditure on this account and, accordingly, no provision has been made in this respect. As the matter is currently under litigation, the disclosure of the financial effect of this matter has not been considered appropriate by the management.

	2004	2003
	(Rupees in '000)	
c) Other claims against the Bank not acknowledged as debts	**702,624**	789,780

30.2 Commitments

Forward exchange contracts - sales	**35,140,553**	10,742,916
Forward exchange contracts - purchases	**13,253,350**	34,696,460
Repurchase and outright sale of securities	**69,740,400**	9,127,077
Import letters of credit	**82,306,585**	70,688,072

31. DISCOUNT, INTEREST / MARK-UP AND / OR RETURN EARNED

Market Treasury Bills - net	**1,714,976**	7,310,225
Other Government securities	**439,911**	603,590
Loans and advances to Government	**358,734**	406,938
Loans and advances to banks and financial institutions	**1,533,753**	3,632,247
Share of profit on finances under profit and loss sharing arrangements	**676,494**	2,591,419
Foreign currency deposits	**6,067,452**	5,567,318
Foreign currency securities	**911,286**	789,411
Adhoc Treasury Bills	**-**	211,775
Others	**5,885**	5,535
	11,708,491	21,118,458

32. INTEREST / MARK-UP EXPENSE

Deposits	**1,346,406**	2,539,255
Share of loss on finances under profit and loss sharing arrangements	**3,815,121**	-
Others	**40,564**	38,907
	5,202,091	2,578,162

33. COMMISSION INCOME

Market Treasury Bills	**50,885**	62,418
Draft / payment orders	**238,509**	46,479
Prize Bonds and National Saving Certificates	**119,171**	115,840
Management of public debts	**68,238**	63,397
Others	**19,651**	34,857
	496,454	322,991

	2004	2003
	(Rupees' 000)	

34. EXCHANGE GAIN / (LOSS) - net

Gain / (loss) on:

	2004	2003
- Foreign currency placements, deposits and other accounts - net	**3,372,849**	(12,951,336)
- Open market operations (including currency swap arrangements)	**(38,963)**	(1,730,900)
- Forward covers under Exchange Risk Coverage Scheme	**(156,485)**	1,206,876
- Payable to the International Monetary Fund (IMF)	**(3,853,758)**	(1,000,142)
- Special Drawing Rights of IMF	**669,601**	130,213
- Others	**424,750**	224,093
	417,994	(14,121,196)
Exchange risk fee income	**337,178**	2,311,731
	755,172	(11,809,465)

35. PROFIT TRANSFERRED FROM SBP BANKING SERVICES CORPORATION AND NATIONAL INSTITUTE OF BANKING AND FINANCE (GUARANTEE) LIMITED

	2004	2003
SBP Banking Services Corporation	**26,135**	41,568
National Institute of Banking and Finance (Guarantee) Limited	**16,706**	7,904
	42,841	49,472

The above represents the net profit of subsidiaries for the year ended June 30, 2004 transferred to the Bank in accordance with the arrangements mentioned in note 39.3.

36. OTHER OPERATING INCOME

	2004	2003
Penalties levied on banks and financial institutions	**360,677**	279,472
License / Credit Information Bureau fee recovered	**1,966**	84
Others	**5,181**	171
	367,824	279,727

37. NOTE PRINTING CHARGES

Note printing charges are payable to Pakistan Security Printing Corporation (Private) Limited at agreed rates under specific arrangements.

38. AGENCY COMMISSION

Agency commission is payable to National Bank of Pakistan (NBP) under an agreement at the rate of 0.15% (2003: 0.15%) of the total amount of collection and remittances handled by NBP.

39. ESTABLISHMENT COSTS

	Note	2004	2003
		(Rupees in '000)	
Salaries and other benefits		**531,728**	498,857
Retirement benefits and employees' compensated absences		**1,582,008**	1,379,672
Daily wages staff		**145**	317
Medical allowances		**38,777**	35,472
Overtime allowance		**8,006**	6,565
Rent and taxes		**23,621**	12,869
Insurance		**3,285**	1,567
Electricity, gas and water charges		**15,323**	693
Depreciation	*16*	**391,346**	387,450
Repairs to Bank's property		**17,888**	14,458
Repairs to Bank's vehicles		**1,653**	1,215
Repairs to mechanical / electrical equipment		**4,865**	13,636
Directors' fee		**1,812**	1,440
Auditors' remuneration	*39.6*	**1,245**	1,200
Legal and professional charges		**55,844**	39,364
Travelling expenses		**21,020**	15,822
Daily expenses		**29,825**	20,321
Passages		**14,572**	9,510
Fuel charges		**5,281**	5,205
Conveyance charges		**3,039**	2,861
Postages		**2,090**	1,718
Telegram / telex		**14,923**	11,517
Telephone		**26,483**	19,911
Training		**7,179**	5,331
Examination/ testing services		**1,249**	443
Remittance of treasure		**1,001**	3,680
Stationery		**12,594**	13,429
Books and newspapers		**5,062**	3,873
Advertisement		**2,930**	5,305
Uniforms		**1,987**	1,993
Others		**38,775**	30,652
		2,865,556	2,546,346
Expenses allocated by:			
SBP Banking Services Corporation	*39.1*	**821,202**	1,216,882
National Institute of Banking and Finance (Guarantee) Limited		**3,196**	49,821
		824,398	1,266,703
Expenses reimbursed to:			
SBP Banking Services Corporation	*39.2*	**2,340,526**	2,361,991
National Institute of Banking and Finance (Guarantee) Limited		**42,754**	8,321
		2,383,280	2,370,312
		6,073,234	6,183,361

		2004	2003
		(Rupees in '000)	
39.1	**Expenses allocated by SBP Banking Services Corporation**		
	Retirement benefits and employees' compensated absences	**794,556**	1,098,673
	Depreciation	**26,646**	118,209
		821,202	1,216,882

39.2	**Expenses reimbursed to SBP Banking Services Corporation**		
	Salaries and other benefits	**1,784,542**	1,844,254
	Daily wages staff	**6,363**	6,219
	Medical allowances	**227,767**	206,544
	Overtime allowance	**3,957**	4,206
	Rent and taxes	**5,857**	7,653
	Insurance	**1,142**	674
	Electricity, gas and water charges	**96,099**	95,328
	Repairs to Bank's property	**4,408**	2,498
	Repairs to Bank's vehicles	**1,239**	1,130
	Repairs to mechanical / electrical equipment	**819**	3,792
	Auditors' remuneration	**1,500**	1,500
	Legal and professional charges	**2,237**	1,370
	Travelling expenses	**6,154**	11,410
	Daily expenses	**10,019**	13,495
	Recreation allowance	**57,022**	23,380
	Fuel charges	**2,194**	2,415
	Conveyance charges	**3,145**	4,191
	Postage	**2,450**	2,787
	Telephone	**10,177**	11,561
	Remittance of treasure	**30,772**	28,481
	Stationery	**8,430**	8,202
	Books and newspapers	**2,340**	859
	Advertisement	**1,612**	1,968
	Bank guards	**34,733**	34,244
	Uniforms	**14,151**	18,908
	Others	**21,397**	24,922
		2,340,526	2,361,991

39.3 SBP Banking Services Corporation, a wholly owned subsidiary of the Bank, carries out certain functions and activities principally relating to public dealing on behalf of the Bank and incurs administrative costs in this respect. Accordingly, under mutually agreed arrangements, all of the above costs have been reimbursed to or allocated by the Corporation while net profit of the Corporation for the year ended June 30, 2004, as mentioned in note 35, has also been transferred to the Bank. Similar treatment is also followed by the other subsidiary, National Institute of Banking and Finance (Guarantee) Limited, under arrangements mutually agreed with the Bank.

39.4 Staff retirement benefits

39.4.1 As mentioned in note 2.9 (c), the Bank operates the following staff retirement benefit schemes:

- an un-funded gratuity scheme for all employees other than those who opted for the new general provident fund scheme or joined the Bank after 1975 and are entitled to pension scheme benefits;
- an un-funded pension scheme;
- an un-funded contributory benevolent fund scheme; and
- an un-funded post retirement medical benefit scheme.

During the year the actuarial valuations of the above defined benefit obligations were carried out at June 30, 2004 under the projected Unit Credit Method using following significant assumptions:

- Expected rate of increase in salary 5.94 (2003: 5.94) percent per annum
- Expected rate of discount 8.00 (2003: 8.00) percent per annum
- Medical cost increase 2.86 (2003: 2.86) percent per annum

39.4.2 Present value of the obligations

Present values of obligations under the retirement benefit schemes and liabilities recognised thereagainst for the past services of the employees at June 30, 2004 based on actuarial valuation as of that date was as follows:

			(Rupees in '000)
	Present value of the defined benefit obligation	**Unrecognised actuarial gain/ (loss)**	**Provision made in respect of the staff retirement benefits**
Gratuity	17,471	5,000	22,471
Pension	3,065,000	(74,000)	2,991,000
Benevolent	384,000	(137,000)	247,000
Post retirement medical benefits	945,000	(821,000)	124,000
	4,411,471	(1,027,000)	3,384,471

39.4.3 Amount recognised in the profit and loss account

The amounts charged in the profit and loss account during the current year in respect of the above benefits are as follows:

						(Rupees in '000)
	Current service cost	**Interest cost**	**Transitional liability recognised in the current year**	**Actuarial (gain) / loss recognised**	**Employees contributions**	**Total**
Gratuity	-	1,000	7,000	(3,000)	-	5,000
Pension	40,000	229,000	277,000	(1,000)	-	545,000
Benevolent	5,000	28,500	13,500	8,000	(2,000)	53,000
Post retirement medical benefits	2,000	34,500	29,500	21,000	-	87,000
	47,000	293,000	327,000	25,000	(2,000)	690,000

39.5 Employees' compensated absences

As at June 30, 2004, the Bank's liability for employees' compensated absences determined through an actuarial valuation carried out under the projected unit credit method amounted to Rs. 322 million (2003: Rs. 304 million). This amount has been recognised in the financial statements of the Bank. An amount of Rs. 40 million (2003: 61 million) has been charged to the profit and loss account in the current period based on the actuarial advice.

39.6 Auditors' remuneration

				(Rupees in '000)
	A.F. Ferguson & Co.	**Taseer Hadi Khalid & Co.**	**2004**	2003
Audit fee	500	500	**1,000**	1,000
Special certifications/ examinations and sundry advisory services	45	-	**45**	-
Out of pocket expenses	100	100	**200**	200
	645	600	**1,245**	1,200

		2004	2003
		(Rupees in '000)	

40. OTHER INCOME

	Note	2004	2003
Gain on disposal of fixed assets		**148,716**	85,131
Liabilities and provisions written back - net		**275**	278,190
Gain on disposal of investments	*40.1*	**6,928,678**	591,228
Amortisation of deferred income	*25*	**135,490**	135,029
Others		**11,587**	907,704
		7,224,746	1,997,282

40.1 This includes Rs. 6,086.171 million in respect of the gain realised during the year on disposal of 26% of HBL's total paid-up capital to the Aga Khan Fund for Economic Development S.A., as mentioned in detail in note 9.2.3.

41. OTHER CHARGES

	2004	2003
Charges on allocation of Special Drawing Rights	**227,295**	263,882
Others	**320,816**	332,658
	548,111	596,540

42. PROFIT / (LOSS) FOR THE YEAR AFTER NON-CASH ITEMS

	2004	2003
Profit for the year	**6,108,498**	24,837
Adjustments for:		
Depreciation	**391,346**	387,450
Amortisation of deferred income	**(135,490)**	(135,029)
Provision for:		
- retirement benefits and employees' compensated absences	**1,582,008**	1,379,672
- loans and advances	**566,906**	500,000
- share of loss / (profit) under profit and loss sharing arrangements	**5,303,335**	(2,102,204)
Liabilities and provisions written back	**-**	(278,190)
Gain on disposal of fixed assets	**(148,716)**	(85,131)
Dividend income	**(1,422,058)**	(1,168,526)
Other accruals and provisions - net	**2,002,340**	1,342,714
	14,248,169	(134,407)

43. CASH AND CASH EQUIVALENTS

	2004	2003
Local currency	**2,959,993**	2,565,308
Foreign currency reserves	**629,731,918**	562,428,084
Earmarked foreign currency balances	**3,780,277**	53,113,531
Special Drawing Rights of International Monetary Fund	**13,826,690**	14,092,081
	650,298,878	632,199,004

44. **INTEREST/ MARK-UP RATE RISK**

Information about the Bank's exposure to interest / mark-up rate risk based on contractual repricing and maturity dates, which ever is earlier is as follows:

(Rupees in '000)

	Interest/ mark-up bearing *			Non interest/ mark-up bearing			
	Maturity upto one year	**Maturity after one year**	**Total**	**Maturity upto one year**	**Maturity after one year**	**Total**	**Grand Total**
Financial assets							
Local currency (including rupee coins)	-	-	-	2,959,993	-	2,959,993	2,959,993
Foreign currency reserves	626,501,442	2,036,533	628,537,975	3,398,449	397,091	3,795,540	632,333,515
Earmarked foreign currency balances	3,780,277	-	3,780,277	-	-	-	3,780,277
Special Drawing Rights of International Monetary Fund	13,826,690	-	13,826,690	-	-	-	13,826,690
Reserve tranche with the International Monetary Fund under quota arrangements	10,062	-	10,062	-	-	-	10,062
Current account of the Government of Balochistan	5,533,119	-	5,533,119	-	-	-	5,533,119
Investments	130,878,739	2,740,000	133,618,739	2,522,312	33,620,305	36,142,617	169,761,356
Loans, advances and bills of exchange	3,000,000	9,000,000	12,000,000	188,220	785,836	974,056	12,974,056
Loans, advances and bills of exchange offices	92,874,173	16,264,693	109,138,866	71,511,009	2,512,721	74,023,730	183,162,596
Balances due from Governments of India and Bangladesh (former East Pakistan)	-	2,986,117	2,986,117	-	860,377	860,377	3,846,494
Indian notes representing assets receivable from the Reserve Bank of India	-	-	-	-	543,793	543,793	543,793
Assets held with the Reserve Bank of India	-	362,897	362,897	-	3,765	3,765	366,662
Other assets	-	-	-	10,144,220	2,674,429	12,818,649	12,818,649
	876,404,502	33,390,240	909,794,742	90,724,203	41,398,317	132,122,520	1,041,917,262
Financial liabilities							
Bank notes in circulation	-	-	-	-	611,903,657 **	611,903,657	611,903,657
Bills payable	-	-	-	494,365	-	494,365	494,365
Current accounts of the Government	-	-	-	48,889,002	-	48,889,002	48,889,002
Current account of SBP Banking Services Corporation	-	-	-	3,065,457	-	3,065,457	3,065,457
Current account of National Institute of Banking and Finance (Guarantee) Limited	-	-	-	3,199	-	3,199	3,199
Deposits of banks and financial institutions	23,990,362	-	23,990,362	132,180,443	-	132,180,443	156,170,805
Other deposits and accounts	-	40,712,397	40,712,397	42,316,407	-	42,316,407	83,028,804
Payable to International Monetary Fund	7,303,368	95,101,866	102,405,234	-	-	-	102,405,234
Other liabilities	-	-	-	16,072,143	2,617,115	18,689,258	18,689,258
	31,293,730	135,814,263	167,107,993	243,021,016	614,520,772	857,541,788	1,024,649,781
On balance sheet gap - 2004 (a)	845,110,772	(102,424,023)	742,686,749	(152,296,813)	(573,122,455)	(725,419,268)	17,267,481
On balance sheet gap - 2003 (a)	792,809,969	(95,367,128)	697,442,841	(205,151,931)	(475,238,591)	(680,390,522)	17,052,319

(a) On-balance sheet gap represents the net amounts of on-balance sheet items.

* includes finances provided under profit and loss sharing arrangements.

** Bank notes have been assumed to have a maturity of more than one year.

44.1 Risk management policies

The Bank is primarily subject to interest/mark-up rate, credit, currency and liquidity risks. The policies and procedures for managing these risks are outlined in notes 44.1.1 to 44.1.4. The Bank has designed and implemented a framework of controls to identify, monitor and manage these risks. The senior management is responsible for advising the Governor on the monitoring and management of these risks.

44.1.1 Interest / mark-up rate risk management

Interest / mark-up rate risk is the risk that the value of a financial instrument will fluctuate due to changes in the market interest/ mark-up rates. The Bank has adopted appropriate policies to minimise its exposure to this risk. The Bank's management, the Central Board and the investment committee has set appropriate duration limits and a separate department deals with the monitoring of the Bank's interest/ mark-up rate risk exposure based on these limits.

44.1.2 Credit risk management

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Credit risk in the Bank's portfolio is monitored, reviewed and analysed by the appropriate officials and the exposure is controlled through counterparty and credit limits. Counterparties are allocated to a particular class based mainly on their credit rating. Foreign currency placements are made in approved currencies and government securities. Loans and advances to scheduled banks and financial institutions are usually secured either by Government guarantees or by demand promissory notes. Geographical exposures are controlled by country limits and are updated as and when necessary with all limits formally reviewed on a periodic basis. The Bank's exposure to credit risk associated with foreign operations is managed by monitoring compliance with investment limits for counterparties. The Bank's credit risk mainly lies with exposure towards government sector and financial institutions.

44.1.3 Currency risk management

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. Foreign currency activities result mainly from the Bank's holding of foreign currency assets under its foreign reserves management function and the overall level of these assets is determined based on the prevailing extent of credit and liquidity risks. In order to avoid losses arising from adverse changes in the rates of exchange, the Bank's compliance with the limits established for foreign currency positions is being regularly monitored by the management.

The Bank also holds from time to time, foreign currency assets and liabilities that arise from the implementation of domestic monetary policies. Any foreign currency exposure relating to these implementation activities are hedged through the use of foreign currency forwards, swaps and other transactions.

The Bank also enters into forward foreign exchange contracts with the commercial banks and financial institutions to hedge against the currency risk on foreign currency swap transactions.

44.1.4 Liquidity risk management

Liquidity risk is the risk that an entity will encounter difficulty in raising funds to meet commitments associated with the financial instruments. In order to reduce the level of liquidity risk arising out of the local currency activities, the Bank manages the daily liquidity position of the banking system including advancing and withdrawal of funds from the system for smoothening out daily peaks and troughs.

The risk arising out of the Bank's obligations for foreign currency balances or deposits is managed through available reserves generated mainly from borrowings and open market operations.

44.1.5 Fair value of financial assets and financial liabilities

The fair value of all financial assets and financial liabilities, except for investment accounted for at cost, is estimated to approximate their carrying values.

		2004	2003
45.	**NUMBER OF EMPLOYEES**		
	Number of employees at June 30	**1,275**	1,201

46. GENERAL

Figures have been rounded off to the nearest thousand rupees.

47. DATE OF AUTHORISATION

These financial statements were authorised for issue on September 7, 2004 by the Central Board of Directors of the Bank.

______________	______________	________________
Ishrat Husain	**Tawfiq A. Husain**	**Aftab Mustafa Khan**
Governor	**Deputy Governor**	**Director Accounts**

14 Financial Statements of the SBP BSC

A. F. FERGUSON & CO.
CHARTERED ACCOUNTANTS
STATE LIFE BUILDING 1-C
I. I. CHUNDRIGAR ROAD
KARACHI

TASEER HADI KHALID & CO.
CHARTERED ACCOUNTANTS
1st FLOOR, SHEIKH SULTAN TRUST
BUILDING NO. 2
BEAUMONT ROAD
KARACHI

AUDITORS' REPORT TO THE SHAREHOLDER

We have audited the annexed balance sheet of the **SBP Banking Services Corporation** as at June 30, 2004 and the related profit and loss account, cash flow statement and statement of changes in equity together with the notes forming part thereof, for the year then ended and we state that we have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purposes of our audit.

It is the responsibility of the Corporation's management to establish and maintain a system of internal control, and prepare and present the above said statements in conformity with the International Accounting Standards approved for adoption by the Board of Directors of the Corporation. Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with the auditing standards as applicable in Pakistan. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the above said statements are free of any material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the above said statements. An audit also includes assessing the accounting policies and significant estimates made by management, as well as, evaluating the overall presentation of the above said statements. We believe that our audit provides a reasonable basis for our opinion and, after due verification, we report that:

(a) in our opinion the balance sheet and related profit and loss account, cash flow statement and statement of changes in equity together with the notes thereon have been drawn up in conformity with the International Accounting Standards approved for adoption by the Board of Directors of the Corporation; and

(b) in our opinion and to the best of our information and according to the explanations given to us, the balance sheet, profit and loss account, cash flow statement and statement of changes in equity together with the notes forming part thereof conform with the International Accounting Standards approved for adoption by the Board of Directors of the Corporation, and, give the information required by these Standards in the manner so required, and respectively give a true and fair view of the state of the Corporation's affairs as at June 30, 2004 and of the profit, its cash flows and changes in equity for the year then ended.

Chartered Accountants
Karachi
Date: September 7,2004

Chartered Accountants
Karachi
Date: September 7,2004

SBP BANKING SERVICES CORPORATION
BALANCE SHEET
AS AT JUNE 30, 2004

	Note	2004	2003
		(Rupees'000)	
ASSETS			
Investments	3	896,429	512,819
Employee loans and advances		4,167,674	3,914,944
Prepaid expenses		5,682	2,429
Balance in current account with the State Bank of Pakistan		3,065,457	3,681,932
Tangible assets:			
- Operating fixed assets	4	74,933	70,785
- Capital work-in-progress	5	17,176	2,103
		92,109	72,888
Total assets		8,227,351	8,185,012
LIABILITIES			
Other liabilities	6	1,609,443	1,537,689
Deferred liabilities - staff retirement benefits	7	5,617,908	5,647,323
Total liabilities		7,227,351	7,185,012
Net assets		1,000,000	1,000,000
REPRESENTED BY			
Share capital	8	1,000,000	1,000,000

The annexed notes 1 to 14 form an integral part of these financial statements.

Liaquat Durrani	**Taslim Kazi**
Managing Director	**Director Accounts**

SBP BANKING SERVICES CORPORATION
PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED JUNE 30, 2004

	Note	2004	2003
		(Rupees' 000)	
Discount and interest earned	9	25,620	41,385
Net operating expenses - establishment costs	10		
Total expenses		3,161,728	3,578,873
Less: Reimbursed by the State Bank of Pakistan		2,340,526	2,361,991
Less: Allocated to the State Bank of Pakistan		821,202	1,216,882
		-	-
OPERATING PROFIT		25,620	41,385
Profit on disposal of fixed assets		515	183
BALANCE PROFIT TRANSFERRED TO THE STATE BANK OF PAKISTAN		26,135	41,568

The annexed notes 1 to 14 form an integral part of these financial statements.

Liaquat Durrani
Managing Director

Taslim Kazi
Director Accounts

SBP BANKING SERVICES CORPORATION
CASH FLOW STATEMENT
FOR THE YEAR ENDED JUNE 30, 2004

	Note	2004	2003
		(Rupees' 000)	
Cash flow from operating activities			
Loss after non-cash items	11	(1,506,304)	(1,132,976)
Expenses reimbursed by the State Bank of Pakistan		2,340,526	2,361,991
Balance profit transferred to the State Bank of Pakistan		(26,135)	(41,568)
Retirement benefits and employees' compensated absences paid		(775,975)	(233,244)
Discount income received		13,497	35,297
		45,609	989,500
Decrease / (increase) in assets			
- Loans to employees		(252,730)	228,233
- Other assets - net		(3,253)	10,780
Increase in liabilities			
- Other liabilities - net		23,758	36,459
Net cash (outflow) / inflow from operating activities		(186,616)	1,264,972
Cash flow from investing activities			
Fixed capital expenditure		(46,603)	(33,439)
Investment made		(384,507)	-
Proceeds from disposal of fixed assets		1,251	382
Net cash outflow on investing activities		(429,859)	(33,057)
Net (decrease) / increase in cash and cash equivalents		(616,475)	1,231,915
Cash and cash equivalents at beginning of the year		3,681,932	2,450,017
Cash and cash equivalents at end of the year		3,065,457	3,681,932

The annexed notes 1 to 14 form an integral part of these financial statements.

Liaquat Durrani
Managing Director

Taslim Kazi
Director Accounts

SBP BANKING SERVICES CORPORATION
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED JUNE 30, 2004

	Share capital	Profit and loss account	Total
	---------------------- (Rupees '000) ----------------------		
Balance as at June 30, 2002	1,000,000	-	1,000,000
Profit for the year ended June 30, 2003	-	41,568	41,568
Balance profit transferred to the State Bank of Pakistan	-	(41,568)	(41,568)
Balance as at June 30, 2003	1,000,000	-	1,000,000
Profit for the year ended June 30, 2004	-	26,135	26,135
Balance profit transferred to the State Bank of Pakistan	-	(26,135)	(26,135)
Balance as at June 30, 2004	1,000,000	-	1,000,000

The annexed notes 1 to 14 form an integral part of these financial statements.

Liaquat Durrani
Managing Director

Taslim Kazi
Director Accounts

SBP BANKING SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004

1. STATUS AND NATURE OF OPERATIONS

SBP Banking Services Corporation (the Corporation) was constituted under the SBP Banking Services Corporation Ordinance, 2001 (the Ordinance) as a wholly owned subsidiary of the State Bank of Pakistan (SBP) and commenced its operations with effect from January 2, 2002. The Corporation is responsible for carrying out certain statutory and administrative functions and activities on behalf of SBP, as transferred or delegated by SBP under the provisions of the Ordinance mainly including:

- disbursing of loans and advances to the Government, banks, financial institutions and local authorities and facilitating in inter-bank settlement system;
- collecting revenue and making payments for and on behalf of and maintaining accounts of the Government, local bodies, authorities, companies, banks and other financial institutions;
- receipt, supply and exchange of bank notes and coins;
- dealing in prize bonds and other savings instruments of the Government; and
- operational work relating to management of debt and foreign exchange.

Any assets, liabilities, income and expenditure directly relating to the above activities are accounted for in the books of SBP while the cost incurred by the Corporation in carrying out the above activities are either reimbursed from or allocated to SBP and are accounted for as deduction from the expenditure while net profit / loss, if any, of the Corporation is transferred to / recovered from SBP.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation

These financial statements have been prepared in accordance with the requirements of the International Accounting Standards (IASs) approved for adoption by the Board of Directors of the Corporation, being consistent with the accounting framework approved by the Central Board of SBP for the preparation of the financial statements of SBP.

2.2 Accounting convention

These financial statements have been prepared under the historical cost convention except that certain employee benefits, as referred to in notes 2.6 (c) and 2.7 have been stated at their present values.

2.3 Investments

Investment in Government securities are stated at cost. The cost of securities is adjusted for any amortisation of premiums on a straight-line basis over the period of maturity.

2.4 Fixed assets and depreciation

Operating fixed assets are stated at cost less accumulated depreciation and any accumulated impairment losses while capital work-in-progress is stated at cost.

Depreciation is calculated using the straight-line method so as to write off the assets over their expected useful lives without taking into account any residual value.

Depreciation on additions is charged from the month in which the asset is put to use while no depreciation is charged in the month in which the assets are deleted. Normal repairs and maintenance are charged to the profit and loss account as and when incurred; major renewals and improvements are capitalised and the assets so replaced, if any, are retired. Gains and losses on disposal of fixed assets are included in income currently.

2.5 Provisions

Provisions are recognised when the Corporation has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made.

2.6 Staff retirement benefits

The Corporation operates the following staff retirement benefits for employees transferred from SBP (transferred employees) and other employees:

a) an un-funded contributory provident fund (old scheme) for transferred employees who joined SBP prior to 1975 and opted to remain under the old scheme;

b) an un-funded general contributory provident fund (new scheme) for transferred employees who joined SBP after 1975 or who had joined SBP prior to 1975 but have opted for the new scheme and other employees;

c) the following other staff retirement benefit schemes:

- an un-funded gratuity scheme for all employees other than the employees who opted for the new general provident fund scheme or transferred employees who joined SBP after 1975 and are entitled only to pension scheme benefits;
- an un-funded pension scheme;
- an un-funded contributory benevolent fund scheme; and
- an un-funded post retirement medical benefit scheme.

Annual provisions are made by the Corporation to cover the obligations arising under these schemes based on actuarial recommendations. The actuarial valuations are carried out using the Projected Unit Credit Method. Actuarial gains and losses arising at the valuation date are recognised as income / expense in the following year based on actuarial recommendations.

The above staff retirement benefits are payable to staff on completion of prescribed qualifying period of service.

2.7 Compensated absences

The Corporation makes annual provision in respect of liability for employees' compensated absences based on actuarial estimates.

2.8 Revenue recognition

Revenue is recognised on an accrual basis.

2.9 Taxation

The income of the Corporation is exempt from Tax under section 25 of the SBP Banking Services Corporation Ordinance, 2001.

2.10 Cash and cash equivalents

Cash comprise of cash on hand and balance in current account with the State Bank of Pakistan. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to insignificant changes in value.

2.11 Financial instruments

Financial assets and liabilities are recognised at the time when the Corporation becomes a party to the contractual provisions of the instrument. Any gain or loss on the derecognition of the financial assets and liabilities is included in the profit and loss account currently.

Financial instruments carried on the balance sheet include investments, loans and advances, balance in the current account with the State Bank of Pakistan and other liabilities. The particular recognition methods adopted are disclosed in the individual policy statements associated with each financial instrument.

2.12 Offsetting

A financial asset and a financial liability is offset and the net amount is reported in the balance sheet when the Corporation has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

2.13 Impairment

The carrying amount of the assets is reviewed at each balance sheet date to determine whether there is any indication of impairment of any asset or a group of assets. If such indication exists, the recoverable amount of such assets is estimated and the impairment losses are recognized in the profit and loss account.

Provisions for impairment are reviewed at each balance sheet date and adjusted to reflect the current best estimates. Changes in the provisions are recognized as income / expense currently.

	2004	2003
	(Rupees'000)	
3. Investments		
Government securities		
Market Treasury Bills	511,923	512,819
Pakistan Investment Bonds	384,506	-
	896,429	512,819

Market Treasury Bills carry mark-up at the rate of 2.0 percent per annum (2003: 2.7 percent per annum) while the Pakistan Investment Bonds carry mark-up at the rate of 8.0 percent per annum.

4. Operating fixed assets

The following is a statement of operating assets:

	Cost at July 1, 2003	Additions/ (deletions) during the year	Cost at June 30, 2004	Accumulated depreciation at July 1, 2003	Charge for the year/ (accumulated depreciation on deletions)	Accumulated depreciation at June 30, 2004	Net book value at June 30, 2004	Annual rate of depreciation %
	(Rupees '000)							
Furniture and fixtures	25.592	2.070 (296)	27.366	5.920	4.132 (402)	9.650	17.716	10
Office equipment	179.333	16.900 (870)	195.363	144.929	13.618 (484)	158.063	37.300	20
EDP equipment	35.591	1.360 (64)	36.887	20.524	7.129 -	27.653	9.234	33.33
Motor vehicles	2.805	11.200 (653)	13.352	1.163	1.767 (261)	2.669	10.683	20
2004	243,321	31,530 (1,883)	272,968	172,536	26,646 (1,147)	198,035	74,933	
2003	211,606	33,536 (1,821)	243,321	55,949	118,209 (1,622)	172,536	70,785	

	Note	2004	2003
		(Rupees'000)	
5. Capital work-in-progress			
Furniture and fixtures		9,398	1,073
Office equipment		7,598	968
EDP equipment		180	62
		17,176	2,103
6. Other liabilities			
Accruals and provisions	6.1	1,419,834	1,447,202
Others		189,609	90,487
		1,609,443	1,537,689
6.1 Accruals and provisions			
Provision for employees' compensated absences		1,417,000	1,369,004
Others		2,834	78,198
		1,419,834	1,447,202
7. Deferred liabilities - staff retirement benefits			
Provident fund scheme		757,800	715,189
Gratuity		84,108	81,565
Pension		3,989,000	3,979,560
Benevolent fund scheme		567,000	595,184
Post retirement medical benefits		220,000	275,825
		5,617,908	5,647,323

7.1 The following is the movement of the net recognised liability in respect of the defined benefit schemes mentioned above:

	Recognised liability as at June 30, 2003	Charge for the year	Payments during the year	Recognised liability as at June 30, 2004
	------------------------ (Rupees '000)--------------------------			
Gratuity	81,565	6,000	3,457	84,108
Pension	3,979,560	464,000	454,560	3,989,000
Benevolent fund scheme	595,184	60,000	88,184	567,000
Post retirement medical benefits	275,825	29,000	84,825	220,000
	4,932,134	559,000	631,026	4,860,108

8. Share capital

Number of shares 2004	Number of shares 2003		2004	2003
			(Rupees'000)	
		Authorised share capital		
1,000	1,000	Ordinary shares of Rs 1,000,000 each	1,000,000	1,000,000
		Issued, subscribed and paid-up capital		
1,000	1,000	Fully paid-up ordinary shares of Rs 1,000,000 each	1,000,000	1,000,000

	Note	2004	2003
		(Rupees' 000)	

9. Discount and interest earned

Discount on Government securities		12,600	29,252
Interest on staff loans		13,020	12,133
		25,620	41,385

10. Establishment costs

Reimbursable from the State Bank of Pakistan

	Note	2004	2003
Salaries and other benefits		1,784,542	1,844,254
Daily wages staff		6,363	6,219
Medical allowance		227,767	206,544
Overtime allowance		3,957	4,206
Rent and taxes		5,857	7,653
Insurance		1,142	674
Electricity, gas and water charges		96,099	95,328
Repairs to office property		4,408	2,498
Repairs to office vehicles		1,239	1,130
Repairs to mechanical / electrical equipment		819	3,792
Auditors' remuneration	10.3	1,500	1,500
Legal and professional charges		2,237	1,370
Travelling expenses		6,154	11,410
Daily expenses		10,019	13,495
Passages		57,022	23,380
Fuel charges		2,194	2,415
Conveyance charges		3,145	4,191
Postages		2,450	2,787
Telephone		10,177	11,561
Remittance of treasure		30,772	28,481
Stationery		8,430	8,202
Books and newspapers		2,340	859
Advertisement		1,612	1,968
Bank guards		34,733	34,244
Uniforms		14,151	18,908
Others		21,397	24,922
		2,340,526	2,361,991
Allocable to the State Bank of Pakistan			
Retirement benefits and employees' compensated absences		794,556	1,098,673
Depreciation	4	26,646	118,209
		821,202	1,216,882
		3,161,728	3,578,873

10.1 As mentioned in note 2.6, the Corporation operates the following staff retirement benefit schemes:

- an un-funded gratuity scheme for all employees other than the employees who opted for the new general provident fund scheme or transferred employees who joined the SBP after 1975 and are entitled only to pension scheme benefits;

- an un-funded pension scheme;

- an un-funded contributory benevolent fund scheme; and

- an un-funded post retirement medical benefit scheme.

During the year the Corporation has had actuarial valuations carried out for all the above schemes. Projected Unit Credit Method using the following significant assumptions was used for the valuations of these schemes as at June 30, 2004:

	Percent per annum
- Expected rate of increase in salary level	5.94%
- Expected rate of discount	8.00%
- Medical cost trend	2.86%

The following are the fair values of the obligations under the schemes and liabilities recognised thereagainst for the past services of the employees at the latest valuation dates:

	Present value of the defined benefit obligation	**Provision made in respect of retirement benefits**	**Unrecognised actuarial gain / (loss)**
	-----------------------(Rupees '000)		**-----------------------**
Gratuity	68,443	84,108	15,665
Pension	4,041,000	3,989,000	(52,000)
Benevolent fund scheme	574,000	567,000	(7,000)
Post retirement medical benefits	489,000	220,000	(269,000)
	5,172,443	4,860,108	(312,335)

The following amounts have been charged to the profit and loss account in respect of the above benefits:

	Current service cost	Actuarial gain	Interest cost	Total
	-----(Rupees '000)-----			
Gratuity	2,339	(1,895)	5,556	6,000
Pension	168,000	5,000	291,000	464,000
Benevolent fund scheme	27,000	(8,000)	41,000	60,000
Post retirement medical benefits	12,000	-	17,000	29,000
	209,339	(4,895)	354,556	559,000

10.2 Employees' compensated absences

During the year, actuarial valuation of employees' compensated absences has been carried out as at June 30, 2004 using the Projected Unit Credit Method. An amount of Rs 141 million (2003: Rs 176 million) has been charged to the profit and loss account in this respect based on actuarial recommendations.

	A.F.Ferguson & Co.	Taseer Hadi Khalid & Co.	2004	2003
	-----(Rupees' 000)-----			
10.3 Auditors' remuneration				
Audit fee	500	500	1,000	1,000
Out of pocket expenses	250	250	500	500
	750	750	1,500	1,500

11. Loss after non-cash items

	2004	2003
Net profit for the year	26,135	41,568
Expenses reimbursed by the State Bank of Pakistan	(2,340,526)	(2,361,991)
Expenses allocated to the State Bank of Pakistan	(821,202)	(1,216,882)
	(3,135,593)	(3,537,305)
Adjustments for:		
Depreciation	26,646	118,209
Provision for retirement benefits and employees' compensated absences	794,556	1,098,673
Expenses allocated to the State Bank of Pakistan	821,202	1,216,882
Discount on Government securities	(12,600)	(29,252)
Profit on disposal of fixed assets	(515)	(183)
	1,629,289	2,404,329
	(1,506,304)	(1,132,976)

Financial assets and liabilities

	Interest / mark-up bearing			Non interest / mark-up bearing			
	Maturity upto one year	Maturity after one year	Sub total	Maturity upto one year	Maturity after one year	Sub total	Total
	----- (Rupees '000) -----						
Financial assets							
Investments	896,429	-	896,429	-	-	-	896,429
Employee loans and advances	27,608	253,621	281,229	328,706	3,557,737	3,886,443	4,167,672
Balance in current account with the State Bank of Pakistan	-	-	-	3,065,457	-	3,065,457	3,065,457
	924,037	253,621	1,177,658	3,394,163	3,557,737	6,951,900	8,129,558
Financial liabilities							
Other liabilities	-	-	-	192,443	1,417,000	1,609,443	1,609,443
	-	-	-	192,443	1,417,000	1,609,443	1,609,443

Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The management of the Corporation believes that it is not exposed to any significant level of credit risk. Loans to employees are secured by deposit of title documents with the Corporation and by insurance policies covering any loss arising from the death of the employees. The remaining balances are recoverable from the State Bank of Pakistan and accordingly are not subject to any significant level of credit risk.

Liquidity risk

Liquidity risk is the risk that an enterprise will encounter difficulties in raising funds to meet commitments associated with financial instruments. The Corporation believes that it is not exposed to any significant level of liquidity risk.

Fair value of financial assets and liabilities

The fair value of all financial assets and financial liabilities is estimated to approximate their carrying values.

Number of employees	**2004**	**2003**
Number of employees as at June 30	5,510	5,581

Date of authorisation for issue

These financial statements were authorised for issue on September 7,2004 by the Board of Directors of the Corporation.

Liaquat Durrani
Managing Director

Taslim Kazi
Director Accounts

15 Financial Statements of NIBAF

AUDITORS' REPORT TO THE MEMBERS

We have audited the annexed balance sheet of **National Institute of Banking and Finance (Guarantee) Limited** as at June 30, 2004, and the related income and expenditure account, cash flow statement and statement of changes in equity together with the notes forming part thereof, for the year then ended and we state that we have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purposes of our audit.

It is the responsibility of the company's management to establish and maintain a system of internal control, and prepare and present the above said statements in conformity with the approved accounting standards and the requirements of the Companies Ordinance, 1984. Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with the auditing standards as applicable in Pakistan. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the above said statements are free of any material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the above said statements. An audit also includes assessing the accounting policies and significant estimates made by management, as well as evaluating the overall presentation of the above said statements. We believe that our audit provides a reasonable basis for our opinion and, after due verification, we report that:

(a) in our opinion, proper books of account have been kept by the company as required by the Companies Ordinance, 1984;

(b) in our opinion:

   (i) the balance sheet and income and expenditure account together with the notes thereon have been drawn up in conformity with the Companies Ordinance, 1984, and are in agreement with the books of account and are further in accordance with accounting policies consistently applied;

   (ii) the expenditure incurred during the year was for the purpose of the company's business; and

   (iii) the business conducted, investments made and the expenditure incurred during the year were in accordance with the objects of the company;

(c) in our opinion and to the best of our information and according to the explanations given to us, the balance sheet, income and expenditure account, cash flow statement and statement of changes in equity, together with the notes forming part thereof conform with approved accounting standards as applicable in Pakistan, and, give the information required by the Companies Ordinance, 1984, in the manner so required and respectively give a true and fair view of the state of the company's affairs as at June 30, 2004 and of the surplus and its cash flows and changes in equity for the year then ended; and

(d) in our opinion, no Zakat was deductible at source under the Zakat and Ushr Ordinance, 1980.

Islamabad : September 7, 2004

SYED HUSAIN & CO.
Chartered Accountants

NATIONAL INSTITUTE OF BANKING AND FINANCE (GUARANTEE) LIMITED
BALANCE SHEET
AS AT JUNE 30, 2004

	Note	2004 Rupees	2003 Rupees
ASSETS			
NON CURRENT ASSETS			
Tangible operating fixed assets - at cost less accumulated depreciation	3	13,505,168	15,035,842
Balance in current account with State Bank of Pakistan		3,199,083	10,544,898
		16,704,251	25,580,740
CURRENT ASSETS			
Stocks - Stationary and other consumables		370,738	245,619
Advances, deposits, prepayments and other receivables	4	5,401,719	900,150
Cash and bank balances	5	53,420,346	52,888,383
		59,192,803	54,034,152
TOTAL ASSETS		**75,897,054**	**79,614,892**
EQUITY AND LIABILITIES			
EQUITY			
Authorized share capital			
20,000,000 (2003: 20,000,000) ordinary shares of Rupees 10 each		200,000,000	200,000,000
Issued, subscribed and paid up share capital			
07 (2003: 07) ordinary shares of Rupees 10 each fully paid up in cash		70	70
Accumulated surplus		24,367,267	24,367,267
		24,367,337	24,367,337
NON-CURRENT LIABILITIES			
Advance for issue of shares	6	49,260,760	49,260,760
CURRENT LIABILITIES			
Creditors, accrued and other liabilities	7	2,268,957	4,486,795
Advance fee received		-	1,500,000
		2,268,957	5,986,795
CONTINGENCIES AND COMMITMENTS		-	-
TOTAL EQUITY AND LIABILITIES		**75,897,054**	**79,614,892**

The annexed notes form an integral part of these financial statements.

MANAGING DIRECTOR **DIRECTOR**

NATIONAL INSTITUTE OF BANKING AND FINANCE (GUARANTEE) LIMITED

INCOME AND EXPENDITURE ACCOUNT

FOR THE YEAR ENDED JUNE 30, 2004

	Notes	2004 Rupees	2003 Rupees
INCOME	8	16,705,586	7,903,770
EXPENDITURE	9	45,949,758	58,142,656
DEFICIT BEFORE ALLOCATION TO STATE BANK OF PAKISTAN		(29,244,172)	(50,238,886)
EXPENSES REIMBURSABLE FROM / ALLOCATED TO STATE BANK OF PAKISTAN		45,949,758	58,142,656
LESS: INCOME ALLOCATED TO STATE BANK OF PAKISTAN		16,705,586	7,903,770
		29,244,172	50,238,886
DEFICIT FOR THE YEAR- BEFORE TAX		-	-
TAXATION:			
Current		-	-
Prior		-	-
		-	-
DEFICIT FOR THE YEAR - AFTER TAX		-	-
ACCUMULATED SURPLUS BROUGHT FORWARD		24,367,267	24,367,267
ACCUMULATED SURPLUS CARRIED FORWARD		**24,367,267**	**24,367,267**
BASIC EARNING PER SHARE	12	-	-

The annexed notes form an integral part of these financial statements.

MANAGING DIRECTOR **DIRECTOR**

NATIONAL INSTITUTE OF BANKING AND FINANCE (GUARANTEE) LIMITED
CASH FLOW STATEMENT
FOR THE YEAR ENDED JUNE 30, 2004

	2004 Rupees	2003 Rupees
CASH FLOW FROM OPERATING ACTIVITIES		
Surplus before tax	-	-
Adjustments for non-cash items and other charges		
Expenses allocated to State Bank of Pakistan	3,195,921	8,321,198
(Gain)/Loss on disposal of fixed assets	-	(60)
Cash flow from operating activities before working capital changes	3,195,921	8,321,138
Cash flow from working capital changes		
Increase/(Decrease) in Current Liabilities:		
Creditors, accrued and other liabilities	(2,217,838)	(218,451,786)
Advance fee received	(1,500,000)	1,500,000
(Increase)/Decrease in Current Assets:		
Stocks	(125,119)	(245,619)
Advances, deposits, prepayments and other receivables	(4,501,569)	77,779
	(8,344,526)	(217,119,626)
Income tax paid	-	-
NET CASH OUTFLOW FROM OPERATING ACTIVITIES	(5,148,605)	(208,798,488)
CASH FLOW FROM INVESTING ACTIVITIES		
Addition/transfer of fixed assets	(1,665,247)	(23,358,180)
Proceeds from disposal of fixed assets	-	1,200
NET CASH OUTFLOW FROM INVESTING ACTIVITIES	(1,665,247)	(23,356,980)
CASH FLOW FROM FINANCING ACTIVITIES		
Current accounts with State Bank of Pakistan	7,345,815	(10,544,898)
Advance against issue of shares	-	21,760,790
NET CASH INFLOW FROM FINANCING ACTIVITIES	7,345,815	11,215,892
NET INCREASE/(DECREASE) IN CASH AND CASH AND CASH EQUIVALENTS	531,963	(220,939,576)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR	52,888,383	273,827,959
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	53,420,346	52,888,383

The annexed notes form an integral part of these financial statements.

MANAGING DIRECTOR **DIRECTOR**

NATIONAL INSTITUTE OF BANKING AND FINANCE (GUARANTEE) LIMITED
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED JUNE 30, 2004

	Advance for Issue of Shares	Share Capital	Accumulated Surplus	Total
	Rupees	Rupees	Rupees	Rupees
Balance as at June 30, 2002	27,499,970	70	24,367,267	51,867,307
Consideration received during the year	21,760,790	-	-	21,760,790
Net profit for the year	-	-	-	-
Balance as at June 30, 2003	49,260,760	70	24,367,267	73,628,097
Net profit for the year	-	-	-	-
Balance as at June 30, 2004	**49,260,760**	**70**	**24,367,267**	**73,628,097**

The annexed notes form an integral part of these financial statements.

MANAGING DIRECTOR **DIRECTOR**

NATIONAL INSTITUTE OF BANKING AND FINANCE (GUARANTEE) LIMITED
NOTES TO THE ACCOUNTS
FOR THE YEAR ENDED JUNE 30, 2004

1. STATUS AND NATURE OF BUSINESS

National Institute of Banking and Finance (Guarantee) Limited (the Institute) was incorporated under the Companies Ordinance, 1984 on March 21, 1993 in Pakistan, as a Private Company Limited by Guarantee. The Institute is engaged in providing education an

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Accounting Convention

These accounts have been prepared under the historical cost convention without any adjustment of the effect of inflation.

2.2 Basis of Preparation of Financial Statements

These financial statements have been prepared in compliance with requirements of the Companies Ordinance, 1984, circulars, notifications and orders issued by the regulatory authorities and International Accounting Standards as applicable in Pakistan.

Income generated by the Institute is allocated to State Bank of Pakistan. The expenses incurred by the Institute are also allocated to or reimbursed from State Bank of Pakistan.

2.3 Tangible Operating Fixed Assets

Fixed assets are stated at cost less accumulated depreciation. Depreciation on these assets is charged on the straight line method at rates specified in Note 3 of these accounts whereby the cost of assets is written off over their estimated useful lives.

Depreciation on additions and disposals is charged for the number of months for which assets remained in use in the year of addition/disposal.

Repair and maintenance costs are charged to income as and when incurred, whereas major renewals and improvements are capitalized. Gain/Loss on disposal of fixed assets is recognized in the income and expenditure account in the year of disposal.

2.4 Stationery and Computer Stock

These are valued at cost determined on first in first out basis.

2.5 Taxation

Income of the Institute, being a subsidiary of State Bank of Pakistan is exempted from tax under Section 49 of the State Bank of Pakistan Act, 1956. Further, income of the Institute is also exempted from income tax as per Clause 92 of Part-I of Schedule 2

2.6 Revenue Recognition

Education and training fee is recognized on completion of courses. Hostel income is recognized on providing of hostel accommodation and ancillary facilities.

Profit on PLS accounts and income from rent is recognized on accrual basis.

3 TANGIBLE OPERATING FIXED ASSETS

PARTICULARS	COST					Rate per Annum	DEPRECIATION					Written Down
	As at July 1, 2003	Transfers	Additions	(Disposals)	As at June 30, 2004		As at July 1, 2003	Transfers	Adjustment for disposals	Depreciation for the year	As at June 30, 2004	Value as on June 30, 2004
Furniture and fixtures	18,822,814	-	71,750	-	18,894,564	10%	7,120,498	-	-	1,885,446	9,005,944	9,888,620
EDP equipment	1,127,403	-	261,690	-	1,389,093	33.33%	800,427	-	-	269,919	1,070,346	318,747
Office equipment	29,646,906	-	1,318,053	-	30,964,959	20%	27,285,498	-	-	857,309	28,142,807	2,822,152
Vehicles	3,041,902	-	-	-	3,041,902	20%	2,396,760	-	-	169,493	2,566,253	475,649
Library books	711,997	-	13,754	-	725,751	100%	711,997	-	-	13,754	725,751	-
2004	**53,351,022**	**-**	**1,665,247**	**-**	**55,016,269**		**38,315,180**	**-**	**-**	**3,195,921**	**41,511,101**	**13,505,168**
2003	**-**	**51,754,832**	**1,597,390**	**(1,200)**	**53,351,022**		**-**	**29,994,042**	**(60)**	**8,321,198**	**38,315,180**	**15,035,842**

3.1 During the year ended June 30, 2003, cost (Rs. 51,754,832) and accumulated depreciation (Rs. 29,994,042) of the assets in use of the Institute (except land and buildings), were transferred by State Bank of Pakistan.

3.2 State Bank of Pakistan owns land and building of the Institute. No amount, for its use, has been charged by State Bank of Pakistan to the Institute.

		2004 Rupees	2003 Rupees
4.	**ADVANCES, DEPOSITS, PREPAYMENTS AND OTHER RECEIVABLES**		
	These are unsecured but considered good:		
	Receivable against training programmes	5,007,542	437,118
	Accrued profit on PLS accounts	233,663	395,863
	Prepayments	114,699	38,055
	Advances to staff against expenses	41,815	29,114
	Security Depisits	4,000	-
		5,401,719	900,150
5.	**CASH AND BANK BALANCES**		
	Cash in hand	-	106,146
	Cash with banks on deposit accounts	53,420,346	52,782,237
		53,420,346	52,888,383
6.	**ADVANCE FOR ISSUE OF SHARES**		
	State Bank of Pakistan	29,260,770	29,260,770
	National Bank of Pakistan	19,999,990	19,999,990
		49,260,760	49,260,760
7.	**CREDITORS, ACCRUED AND OTHER LIABILITIES**		
	Creditors	1,139,243	2,870,533
	Traveling and training costs payable	316,040	578,366
	Payable to training institutions	-	356,785
	Accrued charges	324,041	288,160
	Salaries/stipends payable	243,211	182,008
	Auditor's remuneration	70,000	70,000
	Withholding tax payable	2,252	29,307
	Other liabilities	174,170	111,636
		2,268,957	4,486,795
8.	**INCOME**		
	Hostel income	12,447,408	6,192,359
	Education and training fee	3,066,060	557,841
	Other income (Note 8.1)	1,192,118	1,153,570
		16,705,586	7,903,770

	2004 Rupees	2003 Rupees
8.1 OTHER INCOME		
Profit on PLS accounts	475,909	1,024,718
Gain on disposal of fixed assets	-	60
Miscellaneous income	716,209	128,792
	1,192,118	1,153,570
9. EXPENDITURE		
Reimbursable from State Bank of Pakistan:		
Salaries, wages and other benefits	17,542,070	21,811,175
Electricity, gas and water	8,105,191	7,406,414
Training costs	3,706,864	6,203,140
Repair and maintenance	3,910,189	4,148,810
Boarding/lodging catering and allied expenses	3,146,103	3,794,810
Printing and stationery	1,160,537	1,464,581
Traveling and conveyance	1,308,478	1,544,533
Medical expenses	936,204	813,440
Telecommunication	896,917	868,493
Vehicle running expenses	626,823	587,682
Legal and professional charges	367,800	290,804
Disinfectants and general consumables	160,577	177,996
Security services/charges	229,219	225,482
Newspapers and periodicals	116,320	136,806
Insurance expense	88,883	59,224
Auditors' remuneration		
Audit fee	60,000	60,000
Out of pocket expenses	27,060	10,000
	87,060	70,000
Postage and courier	103,063	52,889
Entertainment	136,750	42,977
Rent, rates and taxes	5,198	12,707
Others	119,591	109,495
	42,753,837	49,821,458
Allocated to the State Bank of Pakistan:		
Depreciation (Note: 3)	3,195,921	8,321,198
	45,949,758	58,142,656

9.1 Number of employees of the Institute at the end of the year was 65 (2003: 70).

10. TRANSACTIONS WITH HOLDING UNDERTAKING

	2004 Rupees	2003 Rupees
Expenses incurred on behalf of holding undertaking	6,530,749	4,263,939
Amount disbursed by holding company on behalf of the company	42,753,837	49,821,458

Maximum aggregate amount due from holding undertaking at the end of any month during the year was Rupees 3,199,083 (2003: 10,544,898)

11. FINANCIAL INSTRUMENTS AND RELATED DISCLOSURES

11.1 Financial assets and liabilities of the Institute are as under:

	2004							2003
	Interest bearing			Non Interest Bearing			Total	
	With in one year	One year to five year	Subtotal	With in one year	One year to five year	Subtotal		
	Rupees	Rupees	Rupees	Rupees	Rupees	Rupees	Rupees	Rupees
Financial Assets								
Advances and other receivables	-	-	-	5,245,205	-	5,245,205	5,245,205	862,095
Due from SBP	-	-	-	-	3,199,083	3,199,083	3,199,083	10,544,898
Cash and Bank balance	53,420,346	-	53,420,346	-	-	-	53,420,346	52,888,383
	53,420,346		53,420,346	5,245,205	3,199,083	8,444,288	61,864,634	64,295,376
Financial Liabilities								
Creditors accrued and other liabilities	-	-	-	2,266,705	-	2,266,705	2,266,705	4,457,488
	-	-	-	2,266,705		2,266,705	2,266,705	4,457,488
Net financial assets (liabilities)	53,420,346		53,420,346	2,978,500	3,199,083	6,177,583	59,597,929	59,837,888

11.2 Effective Markup Rate

Effective markup rate for the current year for financial assets is 0.75% to 1.00% per annum. Financial liabilities are not subjected to any mark up rate.

11.3 Exposure to Credit Risk and Mark up Rate Risk

Credit risk represents the accounting loss that would be recognized at the reporting date if counter parties failed completely to perform as contracted. The Institute believes that it is not exposed to major concentration of credit risk and significant ma

11.4 Fair Value of Financial Instruments

The estimated fair values of financial instruments are not significantly different from their book values as shown in these financial statements.

		2004 Rupees	2003 Rupees
12. EARNING PER SHARE -BASIC			
There is no dilutive effect on the basic earning per share, which is as under:			
Profit for the year - After Tax	(Rupees)	-	-
Shares in issue	(Numbers)	7	7
Basic earning per share	(Rupees)	-	-

13. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the board of directors of the Institute and authorized for issue on September 7, 2004.

14. CORRESPONDING FIGURES

14.1 The corresponding figures have been re-arranged and re-classified for comparison,

14.2 Figures have been rounded off to the nearest rupees.

MANAGING DIRECTOR	**DIRECTOR**

Annexure

1. Chronology of Major Policy Announcements
2. Governance Structure
3. Organizational Chart
4. Management Directory
5. List of Publications
6. List of Acronyms

1 Chronology of Major Policy Announcements

1.1 Financial Sector

Date of Announcement		Policy Announcements
2003		
July	4	All terms and conditions of operation of an account were required to be made known to the opener of an account at the time of opening of the account. Further, the accounts maintained by (i) Students (ii) Mustahiqueen of Zakat (iii) employees of Government/Semi-Government institutions for salary and pension purposes were exempted from levy of service charges in any manner whatsoever.
	4	On the basis of complaints received from borrowers of different banks wherein it had been pointed out that banks are compounding markup, in violation of guidelines issued by SBP for elimination of 'riba' from the Banking System. In order to resolve such issues promptly, SBP, decided to constitute a "Resolution Committee" (RC) under the chairmanship of Director, Banking Policy Department, and comprising members from Banking Inspection Department of SBP who will be a Chartered Accountant – (Permanent Member), A representative of the concerned bank–(Revolving Member), a Chartered Accountant from the Chartered Accountancy firm listed on the panel of SBP to represent the borrower –(Revolving Member) and Joint Director Complaints Cell, SBP Member/Secretary. The Committee will examine the complaints falling in its purview and shall decide the issues in terms of guidelines issued by SBP from time to time.
	4	To encourage private sector investment in infrastructure sector, which are capital intensive and require heavy capital outlay, the prescribed maximum debt equity was relaxed to 80:20 for the following infrastructure projects: i. A road, including toll road, a bridge, mass transit or a rail system; ii. Telecommunication services, whether basic or cellular; iii. Generation and distribution of power; iv. Transmission or distribution of power by laying a network of new transmission or distribution lines; v. A natural gas exploration and distribution project, Liquefied Petroleum Gas extraction project; vi. A water supply project, irrigation project, water treatment system, sanitation and sewerage system or solid waste management system; vii. Dams and canals; viii. Port, shipping, container terminals, airport, aviation project, inland waterway or inland port; ix. A refinery project; x. A pipeline project; xi. Any other infrastructure facility of similar nature.

2003		
August	15	The SBP issued guidelines on risk management and a detailed elaboration of major risks that financial institutions may be exposed to. The basic principles relating to risk management that would be applicable to every financial institution, irrespective of its size and complexity include: - The overall responsibility of risk management vests in the Board of Directors, which shall formulate policies in various areas of operations of the bank. The senior management is, *interalia*, responsible for devising risk management strategy and well-defined policies and procedures for mitigating/controlling risks, which should be duly approved by the Board and is also responsible for the dissemination, implementation, and compliance of approved policies and procedures. - At operational level, risk assessment may be made on portfolio or business line basis, however, at the top level the management need to adopt a holistic approach in assessing and managing risk profile of the bank. - Irrespective of a separate risk review or management function, individuals heading various business lines or units are also accountable for the risk they are taking. - Wherever possible risks should be quantitatively measured, reported, and mitigated. Banks were encouraged to put in place an effective risk management strategy based on these guidelines that will also facilitate the banks in their preparation for the implementation of New Basel Capital Accord.
	23	In order to facilitate the development and growth of Commercial Paper (CP) in Pakistan and to encourage active participation of banks/DFIs in this area, SBP formulated certain guidelines, which were framed in consultation with all stakeholders to facilitate the development of CP's primary and secondary markets in Pakistan. Banks/DFIs shall not deal in any manner and in any capacity in CPs of denomination below Rs1 million. All the endorsements made by the banks/DFIs to the subsequent purchasers of their holding of CPs shall be strictly on "without recourse basis". While underwriting the issue, banks/DFIs shall ensure that their total exposure including underwriting does not exceed their per party exposure limits prescribed in these guidelines and under Prudential Regulations. It was also decided that underwriting commitment was assigned a weightage of 50 percent for the purpose of calculating per party exposure limit.
October	22	It was decided to allow commercial banks to establish subsidiaries for the purpose of Asset Management and Financial & Investment Advisory Services. Guidelines were issued for commercial banks desirous of establishing a subsidiary for any activity mentioned in the Non-Banking Finance Companies (Establishment and Regulation) Rules, 2003.

2003		
October	24	The banks were required to submit the Minimum Capital Requirement (MCR) statements on a quarterly basis. These four quarterly MCR statements may be un-audited and will have to be submitted on the prescribed format within one month of the close of respective quarter throughout the year.
November	12	New guidelines were issued for banks/DFIs for recording/ reporting of loans / advances, accrued mark-up and NPLs in their books of accounts and various returns.
	17	Credit rating was made mandatory for Microfinance Institutions, for which a new Prudential Regulation 29, for Microfinance Institutions regarding credit rating of MFIs was been issued.
December	30	The SBP revised the format of the Quarterly Report of Condition. The Quarterly Statement on MCR was merged with the Quarterly Report of Condition as Part-C. The Annual MCR Statement, duly certified by the external auditors would, however, continue to be submitted by the banks within three months of the close of their accounting year. The DFIs, however, are not required to submit information on MCR (Part-C and Annual MCR Statement). The banks and DFIs were required to report on their exposure to connected parties like subsidiaries, controlled firms, managed modarabas and other related parties to the SBP in the revised Quarterly Report of Condition.
2004		
January	7	In order to facilitate banks/DFIs to ensure compliance of statutory/regulatory requirements regarding financial disclosure, a Master Circular was issued containing consolidated instructions on financial disclosure. All banks/DFIs were required to prepare their annual financial statements in the prescribed manner, as on the last working day of that year. These financial statements together with the auditor's report, as passed in the Annual General Meeting, shall be published and circulated as well as furnished, as returns, to the SBP. For 1st and 3rd quarter, quarterly un-audited financial statements, along with directors' review, shall be prepared by all banks/DFIs, including the branches of foreign banks, within 45 days of the close of the quarter to which they relate. Half yearly (2nd quarter) financial statements, with limited scope review by the statutory auditors, shall be prepared by all banks/DFIs, including the branches of foreign banks, within two months of the close of the half-year (2nd quarter).

2004		
January	14	It was made mandatory for all banks/DFIs to inform the SBP promptly about any substantive changes in their activities or any material adverse development, including breach of legal and prudential requirements. During the course of regular inspections, Banking Inspection Department would check, on test basis, that the banks/DFIs have followed these instructions. Additionally, the SBP will also enhance direct interaction with the Board of Directors and Senior Management, as well as the External Auditors, of the banks/DFIs. Accordingly, it will hold regular high-level meetings with them; at least once during each calendar year, with banks/DFIs having satisfactory rating but more frequently with banks/DFIs having unsatisfactory ratings.
	21	From January 1, 2004 all the commercial banks were required to link their lending rates with one, three, six months & any other longer period tenors of Karachi Inter-Bank Offered Rate (KIBOR), if available. The rate over & above KIBOR should be decided with mutual consent between borrower & a bank. All the floating & fixed rate time loans/TFCs/Commercial Papers with reset dates, overdrafts & running finances obtained after January 31, 2004 were required to be benchmarked against KIBOR.
	29	The President, Chairman and members of the Board of all banks/DFIs were required to sign a declaration of fidelity and secrecy before assuming their office. In case of foreign banks, who were represented in Pakistan by their branch offices only, the declaration should be signed by the Country Managers.
February	10	Regulations were issued for banks/DFIs to conduct brokerage business through their separately set up subsidiaries.
March	8	Guidelines on establishment of subsidiaries by banks/DFIs were issued. The Banks/DFIs desiring to establish any subsidiary should obtain prior approval of SBP. ✍ The subsidiary should be a public limited company. ✍ The Board of Directors of the subsidiary should be completely independent and different from the Board of Directors of the banks/DFIs. The banks/DFIs may nominate its employees on the Board of Directors of the subsidiary up to 25 percent of the total directors, and the remaining directors nominated by the banks/DFIs should be independent individuals. ✍ The banks/DFIs will fulfill all the other legal and regulatory requirements needed for the establishment of proposed subsidiary. In case of banks, it should be ensured that the subsidiaries are established only for activities as are admissible under Section 23 of the Banking Companies Ordinance, 1962. ✍ Before increasing its investment in the equity of the subsidiary, the banks/DFIs will seek prior approval of the SBP. ✍ Per party exposure limit proposed by regulation R-1 of

2004		Prudential Regulations for Corporate/Commercial Banking will be applicable on exposure to the subsidiary and any type of placement in the form of deposit, purchase of COI, certificates, units, etc. shall be considered part of the exposure of the banks/DFIs. Further, the exposure of the banks/DFIs on mutual funds launched/administered by the subsidiary shall also be considered exposure on the subsidiary. The Banks/DFIs shall take sufficient measures to ensure that the banks/DFIs is not exposed to risks, especially reputation and legal risks, on account of its subsidiary. The Non-Bank Finance Companies set up as subsidiaries will be regulated by the SECP.
April	24	Instructions on margin requirements were issued. Banks were made free to fix/determine the margin requirements on facilities provided by them to their clients for Corporate, SME and Consumer Financing products, taking into account the risk profile of the borrower(s). However banks were advised to follow: a) Margin restrictions on shares/TFCs as per existing instructions b) Existing cash margin requirement of 100 percent on Caustic Soda (PCT heading 2815.12) for opening Import Letter of Credit as advised by Federal Government and notified earlier. The SBP would continue to exercise its powers for fixation/reinstatement of margin requirements on financing facilities being provided by banks for various purposes including Import Letter of Credit on a particular item(s), as and when required.
	26	The financial institutions were advised not to enter into any agreement with the borrowers in cases, which had already been referred to NAB by Governor SBP under Section 31-D of NAB Ordinance without obtaining prior written permission/clearance from NAB. In cases, which had been forwarded to the SBP and were in the process of reference to NAB, the financial institutions had to first withdraw their request/cases from the SBP before entering into settlement agreements with borrowers.
May	17	Guidelines on Country Risk Management were issued for banks/DFIs, having cross border exposures both on and off balance sheets. All banks/DFIs were required to put in place their respective Country Risk Management policies and procedures duly approved by their BoD within three months. The SBP inspectors, during the course of their regular inspection of the banks/DFIs, would check the policies and procedures on Country Risk Management of the concerned banks/DFIs.

2004		
May	22	DFIs were advised to maintain Statutory Liquidity Requirement (SLR) at 15 percent of their total Time & Demand Liabilities (TDL) in the form of liquid assets (excluding Cash Reserve maintained at 1 percent of their TDL). In addition, they were to continue maintaining Cash Reserve (CRR) with the SBP at 1 percent of their Demand & Time Liabilities. The DFIs were given until December 31, 2004 to comply with the new requirements.
	22	Revised minimum capital requirements for all DFIs were issued. The DFIs were required to meet minimum paid-up capital requirement of Rs1 billion free of losses and maintain capital adequacy ratio not less than 8 percent of their risk weighted assets as envisaged in the above with effect from July 1, 2004.
	24	The banks/DFIs were allowed to invest in subordinated/unsecured TFCs issued by other banks/DFIs to raise Tier-II Capital. However, i) The banks/DFIs investments in such TFCs would be assigned a risk weight of 100 percent and will not be deducted from Tier-I capital for the purpose of calculating the Capital Adequacy Ratio, provided the Banks/DFIs' investment in such TFCs will not exceed 10 percent of their equity (in the case of DFIs not mobilizing deposits/ Certificate of Investments from general public the investment in such TFCs will not exceed 25 percent of their equity). ii) The investments of the banks/DFIs in such TFCs in excess of the limits prescribed at Para 2(i) above will be assigned a risk weight of 0 percent for Capital Adequacy Purpose and will be deducted from Tier-I Capital of the investing banks/DFIs. iii) A banks/DFIs investment in a single issue of such TFCs of any other banks/DFIs will not at any time exceed 5 percent of its own equity or 15 percent of the total size of the issue, whichever is less.
	27	The SBP issued Guidelines on Internal Controls as a part of its ongoing efforts to encourage banks/DFIs to adopt robust risk management practices. These guidelines required all banks/DFIs to ensure existence of an effective system of internal controls which is commensurate with the nature, size and complexity of their business; minimizes the risk inherent in their activities.

1.2 Foreign Exchange Management

Date of Announcement		**Policy Announcements**
2003		
August	15	To further liberalize the foreign exchange regime, certain amendments /additions were made in the Foreign Exchange Manual (Eighth Edition-2002) after incorporation of the facilities extended to importers and exporters under Trade Policy 2003-04.
September	10	In order to save the beneficiaries of small inward remittances from the requirement of filling forms, which were required exclusively for statistical purposes, it was decided to exempt such remittances up to US$10,000 (or equivalent in other currencies).
	13	The rate of refinance under the Foreign Currency Export Finance (FCEF) Facility was fixed at 1.93 percent, which would continue to be applicable from September 15, 2003 until next review due on March 15, 2004.
October	10	The functions of the Exchange Policy Department were bifurcated between the SBP and the SBP BSC under the following lines: i) All policy and investment related issues would be dealt with by the Exchange Policy Department, SBP. ii) All operational matters pertaining to foreign exchange would be directly handled by the respective Area Field Offices of the SBP BSC. iii) Foreign Exchange issues other than those mentioned in paras (i) and (ii) above including general matters may be referred to the respective Area field offices of the SBP BSC or Director, Exchange Policy Department, SBP BSC.
2004		
January	29	The FCEF was terminated because the Federal Government had decided to repay the loan availed from ADB for this scheme ahead of its scheduled repayment since the scheme was utilized only nominally by the exporters. All the Authorized Dealers were advised not to entertain any fresh request from exporters for financing under FCEF
February	12	Franchise Arrangements were allowed in order to facilitate the Exchange Companies.
	19	The SBP introduced “Local US Dollar Instruments Collection and Settlement System” with effect from March 11, 2004, to facilitate operations for maintaining Foreign Currency Accounts under FE-25 in Pakistan. Under the previous system, the clearing process was routed through New York, which took a long time in settlement and resulted in high cost to the account holders

2004		
May	4	Exemption was granted from Form-E procedure for the export of Literary, Religious, Educational and General books subject to the condition that the value of the individual shipment/export does not exceed US$10,000.
June	7	In order to ensure smooth transition of their existing business, the Authorized money changers were allowed to establish Exchange Companies of 'B' Category. The procedure for establishing the Exchange Companies (B) is given below: (a) The applicants (Minimum 5 Licenced Authorized Money Changers) interested in formation of Exchange Companies of 'B' Category would, in the first instance, apply on prescribed form to SBP for obtaining a No Objection Certificate (NOC) which shall be processed within 3 working days by the SBP. (b) On receipt of the NOC from the SBP, the applicant will submit an application to SECP for incorporation under the Companies Ordinance. (c) After the Exchange Company of 'B' Category is registered by SECP, the applicant would apply to the SBP for issuance of Licence against surrender of at least 5 money changers licences and for commencement of operations.
	22	It was decided to issue Restricted Authorization to deal in foreign currencies to 3, 4 and 5 Star Hotels. The Hotels desirous of obtaining this authorization were required to make an application to the SBP through the Pakistan Hotels Association, who would ascertain the status of the hotel and then forward the application to SBP.
	22	It was decided to delegate powers to ADs for effecting remittances of aircraft lease rental by Airlines Incorporated in Pakistan upto the guaranteed hours. However, if the amount exceeds the guaranteed hours, the case may be referred to FEOD, SBP BSC.

2 Governance Structure

The governance framework of the SBP is specified in the SBP Act of 1956. The Act has been amended over the years to give more autonomy and independence to the central bank to enable it to discharge its functions more effectively. The Act provides for an independent Central Board of Directors to oversee the affairs of the SBP

2.1 The Central Board of Directors

Under the provisions of the SBP Act 1956, the "general superintendence and direction of the affairs and business of the bank" rests with the Central Board of Directors. Through an amendment in the SBP Act in February 1994, the Central Board of Directors was enlarged which now consists of the Governor; Secretary Finance, Government of Pakistan and seven directors nominated by the Federal Government. From these seven Directors, one Director from each province is nominated while ensuring representation to agriculture, banking and industrial sectors.

The Governor is the Chairman of the Central Board and all decisions are taken by majority of the members present and voting with the provision that in the event of equality of votes, the Governor may exercise a casting vote.

Given the nature of SBP's statutory objectives, and the complexity and breadth of the role it is expected to play in the development of the country, it is essential that members of the Central Board represent the major sectors of the economy. The Directors bring a wide range of experience ranging from the agriculture, banking and industrial sectors to the deliberations of the Board. The range of experience provides for an appropriate balance of expertise and views to be brought to the deliberations on the range of issues affecting the strategic direction of the SBP.

The Director CMAD, who acts as the Secretary to the Board ensures that the Board is provided information and updates on a regular basis. The Secretary attends and minutes all meetings of the Board and provides a link with the Directors in case of any query on any issue. The Board met ten times during the FY04 at different centers to hold deliberations on important matters.

2.1.1 Members of the Board as on 30th June, 2004

Mr. Nawid Ahsan

Mr. Ahsan is Secretary Finance, Finance Division, GoP and represents the government on the Central Board of Directors of the SBP. He has around 36 years of experience with the Civil Service of Pakistan, which he joined in October 1968. During his tenure, he has worked in various ministries and departments of the Government of Pakistan as well as the Government of Punjab and Government of Sindh. He was appointed member of the Central Board of Directors of the SBP on July 27, 2002.

Mr. Khair Mohamed Junejo

Mr. Junejo hails from the province of Sindh. He is an agriculturist and has extensive experience of managing family agricultural farms in District Sanghar of Sindh. He has also held various appointments: Member of Agricultural Advisory Committee, Member of Agricultural Price Commission, Member of Pakistan Central Cotton Committee, Member of Board of Governors, Pakistan Agricultural Research Council and Director, Cotton Trading Corporation of Pakistan. He held the office of Federal Minister for Food, Agriculture and Livestock between 2000-2003. He was appointed member of the Central Board of Directors of the SBP on August 21, 2003.

Mr. Abdul Razzak Dawood

Mr. Abdul Razzak Dawood has enjoyed a distinguishing career as an industrialist. He has served in senior positions in leading industrial concerns of the country, like Lawrencepur Woollen & Textile Mills, Dawood Hercules Chemicals, Descon Engineering, Delta Industries, ICI Pakistan and KSB Pumps. He has held the position of Federal Minister for Commerce, Industries & Production between November 1999 and November 2002. He was visiting Professor at the Department of Business Administration, Punjab University for seven years and later served as Member Syndicate/Senate of the same University. He has also held membership on the Board of Directors of Pakistan International Airlines Corporation, Shaukat Khanum Cancer Hospital and Engineering Development Board. Currently, he is serving as Rector, Lahore University of Management Sciences and Vice Chairman, Board of Governors, National Management Foundation. He was appointed member of the Central Board of Directors of the SBP on August 21, 2003.

Mr. M. Yaqoob Vardag

Mr. Vardag hails from the province of Balochistan. He has a distinguished career in banking of over 32 years. He started his career in banking with the HBL in 1964 as Probation Officer. During the span of 32 years he has served in various positions in HBL, Commerce Bank, NBP (both domestic and international operations), ABL and PBC. He has also held membership on the Board of Directors of ABL, NBP and Bank Al-Jazira Bank, Saudi Arabia and held directorship in various other organizations. He was appointed member of the Central Board of Directors of the SBP on August 21, 2003.

Mr. Azhar Hamid

Mr. Azhar Hamid is a seasoned banker. He has enjoyed a career in banking spanning over four decades. He started his career from ANZ Grindlays Bank in 1962 as an Executive Trainee. Later on, he assumed positions of higher responsibility within ANZ Grindlays Bank Pakistan and also served the bank in its overseas operations. His career with the bank came to an end in 2003 when he retired as Chief Executive of Standard Chartered Bank, Pakistan. In addition to his duties with the bank, he has also served as Director Khushali Bank; Vice Chairman, Council of the Institute of Bankers Pakistan; member of Board, Grindlays Bahrain Bank; Director, ANZ Capital Management and Chairman, First Grindlays Modaraba and Chairman, Banking Sub-Committee of the Pakistan Overseas Investors Chamber. He was appointed member of the Central Board of Directors of the SBP on August 21, 2003.

Mr. Mohsin Aziz

Mr. Mohsin Aziz belongs to the Frontier province. He has been affiliated with the industrial sector of the country for a considerable time. During the course of his professional life, he has served as Director Mohsin Enterprises; Chief Executive of A.J. Spinning Mills; Managing Director of Premier Formica Industries and Chairman Mohsin Match Factory. In addition, he has been President Sarhad Chamber of Commerce & Industry; Chairman All Pakistan Textile Mills Association; Director, Peshawar Electric Supply Company and Director Board of HBL. He has also held the office of Provincial Minister for Industries, Commerce, Labour, Mineral Development, and Technical Education & Manpower with the Government of NWFP. He is also Life Member of Federation of Pakistan Chamber of Commerce and Industry. He was appointed member of the Central Board of Directors of the SBP on December 6, 2003.

Dr. Wasim Azhar

Dr. Azhar enjoys a distinguishing career as an academic. He has taught in various universities in the United States and has worked as Marketing Analyst for Exxon Corporation in the USA. He has also served as the Dean of Lahore University of Management Sciences. In addition to his academic credentials, Dr. Azhar also has membership of a number of professional bodies, which includes Institute of Electrical and Electronic Engineering, American Marketing Association, American Production Inventory Control Society and American Mathematical Association. He was appointed member of the Central Board of Directors of the SBP on December 6, 2003.

2.1.2 Main Decisions of the Board

The Board held ten meetings during the FY 2004 at different centers, where the following issues came up for discussion/ deliberation:

Accounts

a) Actual Accounts for the period of July 2002 to May 2003 and the estimates of the Profit and Loss for the period of June 2003.
b) Revenue and Capital Budget for FY04.
c) Change in accounting policy – foreign currency transactions.
d) New Bank Fund.
e) Audited Annual Accounts of the SBP for the year ended 30 June 2003.
f) Presentation on Business Plan of the SBP for fiscal year 2003 and 2004.
g) Actual Profit and Loss for the period July to October 2003 and the estimates of Profit and Loss for the period November 2003 to June 2004.
h) Actual Profit and Loss for the period July to December 2003 and the estimates of Profit and Loss for the period January to June 2004.
i) Review of the Revenue and Capital Budget *vis-à-vis* Expenditure for the period July to December 2003.
j) Actual Profit and Loss for the period July 2003 to April 2004.
k) Review of the Revenue and Capital Budget *vis-à-vis* Expenditure for the period July to March 2004.
l) Appointment of Auditors and Fixation of their Fee – Accounting year 2003-2004.
m) Revision of the SBP Expenditure Regulations.

Agriculture Credit

a) Restructuring/ repricing of SBP debt against ZTBL as on 30 June 2002.

Banking Policy

a) Payment of additional full membership fees to IFSB.
b) Appointment of Financial Adviser for disinvestments of government's remaining 49 percent shareholding in ABL.
c) Review of Islamic Export Refinance Scheme of Meezan Bank Ltd.
d) New Guidelines on Write-off of irrecoverable loans and advances.
e) Membership of International Islamic Financial Market.
f) Panel of professional bankers – Banks (Nationalization) Act 1974.
g) Revamping of scheme for financing Locally Manufactured Machinery.
h) Scheme for long term financing of export oriented projects.

Banking Supervision

a) Capacity building for shariah compliance inspection of Islamic banks.
b) Shariah Board in the SBP.
c) Performance Review of the Banking System for the quarter ended March 31, 2003.
d) Banking System Review for the year ended June 30, 2003.
e) Performance Review of the Banking System for the quarter ended June 30, 2003.
f) Performance Review of the Banking System for the quarter ended September 30, 2003.
g) Banking System Reviews for the year ended December 31, 2003 and quarter ended March 2004.

Corporate and Media Affairs

a) Nomination of Directors on the Central Board of the SBP.
b) Reconstitution of Board Sub-committees.
c) Compilation of the History of the SBP.
d) Governor's participation in the Board of Governors of Shaukat Khanam Memorial Trust Hospital, Karachi.
e) Nomination of two Members on the Board of NIBAF.
f) Nomination of two Directors of the Central Board as administrators of the SBP Employees' Provident Fund.

Exchange and Debt Management

a) Introduction of SBP's Certificate of Deposit (SBP-CD).

Exchange Policy

a) Inclusion/ exclusion of different currencies from the list of Approved foreign Exchange for the purpose of SBP Act 1956.
b) Restructuring of Monetary and Exchange Rate Committee (MERPC).

Human Resources

a) Employee recognition and Reward Program.
b) Appointment of Director IBD.
c) Grant of scholarship/ leave for study.
d) Extension of medical facilities to dependents of serving/ retied/ deceased employees of the Bank.
e) Delegation of power in respect of No Objection Certificate (NOC).
f) Promotion Policy and Broad Banding.
g) Revision of Leave Policy.
h) Appointments in the SBP.
i) Amendment in Staff Regulations 2001 – Legal Framework for protection of Banking Supervisors.
j) Comprehensive health insurance scheme for the SBP employees.
k) Creation of the SBP Employees Fund.
l) Annual merit increase in salaries.
m) Discontinuation of Early Retirement Scheme.
n) Regularization of some contractual employees.
o) Career position of OG-5 in the SBP and the SBP BSC.
p) Revised Promotion Policy for OG-1.

Payment System

a) Procurement of CASmf (Common Application Server) Software from M/s SWIFT.
b) SWIFT migration to IP Network.

Property Management

a) Out of court settlement of suit against SBP in New York court filed by liquidators of BCCI (Overseas) Ltd.
b) Sale of Bank's Officers Colony at Gulberg, Lahore.

Research and Economic Policy

a) Monetary and Credit Developments 2002-2003, Credit Plan for 2003-2004 and Review of Pakistan Financial Sector Assessment 2001-02.
b) Annual Report on the working of the SBP for the year ended June 30, 2003.
c) Review of Monetary Policy statement – 1st and 2nd Half FY04.
d) The State of Pakistan's Economy – 1st, 2nd and 3rd Quarterly Report for FY 2002-03.
e) Appointment of outside consultant to conduct consumer confidence and business tendency surveys on quarterly basis.
f) Publication of books on economic management in Pakistan

Reserve Management

a) Presentation by M/s Mercer on development of investment policy and strategy.
b) Final selection of Fund managers and Custodians for Reserve Management.
c) Hiring of law firm – Allen and Overy to review agreement with Fund Managers and Custodians; revised fee structure for Fund managers and approval of tracking error.

Risk Management

a) Risk Management Cell Plan.
b) Acquisition of Bloomberg Professional License.

2.1.3 Sub-Committees of the Board

The Board has constituted seven Sub-Committees with the objective of enabling meaningful deliberations and comprehensive analysis of the matters / issues relating to the respective areas assigned, so that credible basis / reasoning is established in respect of proposals put up for final decision by the Board.

The Sub-Committees of the Board were reconstituted in the meeting of the Board held on 20th December 2003. The current setup of each sub-committee is discussed in more detail below.

Audit

The members of the Audit Sub-Committee are Mr. M. Yaqoob Vardag, the President of Institute of Chartered Accountants of Pakistan (ICAP) and the Director Audit. The Committee is chaired by Mr. M. Yaqoob Vardag with the Director Audit acting as the Secretary to the Sub-Committee.

The Audit Sub-Committee is responsible for the review of Audit department's organization and structure; to devise a rating system for various departments based on internal audit reports and to oversee development of a system of internal audit on modern lines. The Sub-Committee met six times during the year. During the year under review the following issues came up for discussion:

- Review of Annual Accounts for the year ended 30-06-2003
- Presentation on current practices in Auditing and Audit Plan of Audit Department by Director, Audit.
- Review of half yearly Accounts for the period from 1 July, 2003 to 31 December, 2003
- Review of Audit Report of Research Department & Agricultural Credit Department.

- Accounts & Audit Department's Plan for matters to be taken up by Audit Committee.
- Review of quarterly Account.
- Review of Audit Report on IBSD.
- Updating of Reconciliation issues by the Accounts Department.

Monetary and Credit Policies

The Monetary and Credit Policies Sub-Committee consists of Mr. Abdul Razzak Dawood, Mr. Azhar Hamid and the Director Research. Mr. Abdul Razzak Dawood is the Chairman of the Sub-Committee while the Director Research is the Secretary of the Committee.

The Sub-Committee has the mandate to deal with all matters relating to the formulation and implementation of monetary & credit policies. The Sub-Committee met once during the year and deliberated on the following issues:

- Monetary Policy statement for July to December 2003.
- Credit Plan for FY 04.
- Monetary Policy statement for January to June, 2004.

Budget and Expenditure

The members of the Budget and Expenditure Sub-Committee are Mr. Mohsin Aziz and the Executive Director Financial Resources Management (ED FRM). The ED FRM acts as the Secretary of the Sub-Committee.

The Sub-Committee is responsible for reviewing the budget and expenditure of the SBP. It also examines proposals for write off and re-scheduling, concessions and waivers in respect of SBP's loans/Investments outstanding against banks/DFIs etc. In addition, the committee evaluates and gives recommendations on any other matter referred to it by the Governor. The Sub-Committee met two times during the year during which the following issues came up for discussion:

- Review of the Revenue & Capital Budget *vis-à-vis* Expenditure for the period from July 2003 to December 2003.
- Review of the revenue & Capital Budget *vis-à-vis* Expenditure for the period from July 2003 to March 2004.

Human Resources

This Sub-Committee comprises of Mr. Azhar Hamid, Mr. Khair Mohamad Junejo and the Director Human Resources. The Director Human Resources acts as the Secretary of the Sub-Committee.

The Sub-Committee deals with matters pertaining to the human resource policies regarding recruitment, promotion, compensation, performance evaluation and retirement; oversees the Human Resource Audit and acts as the Interview Committee for promotion of OG-6 Officers to the next grade as well as dealing with all matters relating to training policies, their implementation and monetary sanctions, etc. The committee met three times during FY04.

Automation

The members of the Automation Sub-Committee include Mr. Mohsin Aziz, Dr. Wasim Azhar; Deputy Governor (Management), and the Director ISD. Mr. Mohsin Aziz chairs the Sub-committee while the Director ISD acts as the Secretary to the Sub-Committee.

The Sub-Committee is empowered to deal with all matters relating to implementation of Information System Strategy Plan, Procurement of IT related items outside the Information Systems Strategy Plan and may also undertake any other assignment if referred by the Governor.

Building Projects

The Building Projects Sub-Committee comprises of Mr. Khair Mohamad Junejo (Chairman) and Mr. M. Yaqoob Vardag. The Director Engineering Department acts as the Secretary of the Sub-Committee.

The Sub-Committee is empowered to sanction /approve expenditure in respect of construction of SBP's buildings and their maintenance as well as matters pertaining to the acquisition and disposal of moveable and immovable assets. In addition, the Sub-Committee may also oversee other works/projects as may be referred to it by the Governor. Nine meetings of the Sub-Committee were held during FY 2004 for decisions and recommendations on the following:

- Sale of SBP's Staff Colony at Multan Road, Lahore.
- Appointment of consultants for provision of additional space for training programme as well as office accommodation at NIBAF, Islamabad.
- Award of work for Renovation and Refurnishing work at 2nd Floor for Housing of Payment Systems Department, SBP Main Building, Karachi.
- Award of Cleansing/Janitorial Services for SBP Office Building, Quetta.
- Approval of construction of SBP BSC New Office Building Complex at Sialkot.
- Award of Electrical Work for Remodeling and Renovation of Annexe Building for Housing SBP Library in the premises of Main Building at I.I. Chundrigar Road, Karachi.
- Supply and Installation of CCTV System at the SBP, SBP BSC Office Building, Hyderabad, Quetta and Peshawar.
- Payment of Final Bill for electrical work of SBP BSC, Multan Office Building.
- Award of work for Renovation and Refurnishing of 8th Floor of SBP Main Bank Building Karachi.
- Award of work for addition/alteration and renovation work of "C" Type flats at the SBP Staff Colony, G-7/1, Islamabad.
- Award of work for Furnishing/Furniture of the Auditorium at the SBP and SBP BSC Multan.
- Approval of additional amount for construction of Mosque at Peshawar.
- Disposal of SBP's Colony, Gulberg Lahore.
- Award of work for supply of exercise equipments/machines for the Gymnasium at the SBP, Main Building, Karachi.
- Approval of updated/revised procedure for tendering.

Investment

The Sub-Committee on Investment consists of Mr. Nawid Ahsan, Mr. Azhar Hamid, Mr. Abdul Razzak Dawood; Deputy Governor (Banking) and ED FRM. Mr. Nawid Ahsan is the Chairman while ED FRM acts as Secretary of the Sub-Committee.

The Sub-Committee is responsible for providing guidance to streamline Foreign Exchange Reserves Management; ensure optimal placement/investment of Foreign Exchange Reserves of the country and to periodically review the mechanism of investment of Foreign Exchange Reserves. The Sub-Committee met once for deliberations during the year in review, where the following issues were dealt with:

- Presentation by M/s. MERCER, the Investment Consultant.
- Appointment of Fund Managers & Custodian.

2.2 Management

In line with the change initiatives being undertaken at the SBP, the decision-making processes are also being streamlined by decentralization and delegation of administrative and financial powers. This is being done to increase accountability and consequently transparency at all levels of the decision making process. In parallel to this decentralization and delegation, internal control, accounting and audit system are also being strengthened.

The management within the SBP is now carried out at three tiers. The powers and responsibilities have been distributed to these three levels of management corresponding to various levels in the organizational hierarchy. The three points of management decision-making are:

a) Corporate Management Team
b) Group Management Team
c) Departmental Management Team

The CMT is headed by the Governor and consists of Deputy Governors, Executive Directors, Economic Advisor, M.D. SBP BSC, Chief Spokesman and Director CMAD who acts as the Secretary of the team. The CMT acts as the principal forum for debate and decision on critical operational issues affecting the quality of work at the institutional level.

Six Policy Groups assist the CMT in its work. Three Policy groups on HR, IT and Payment System are headed by Deputy Governor (Management) and three groups on Banking, Monetary & Exchange Rate Policy and Exchange and Debt Management are headed by Deputy Governor (Banking).

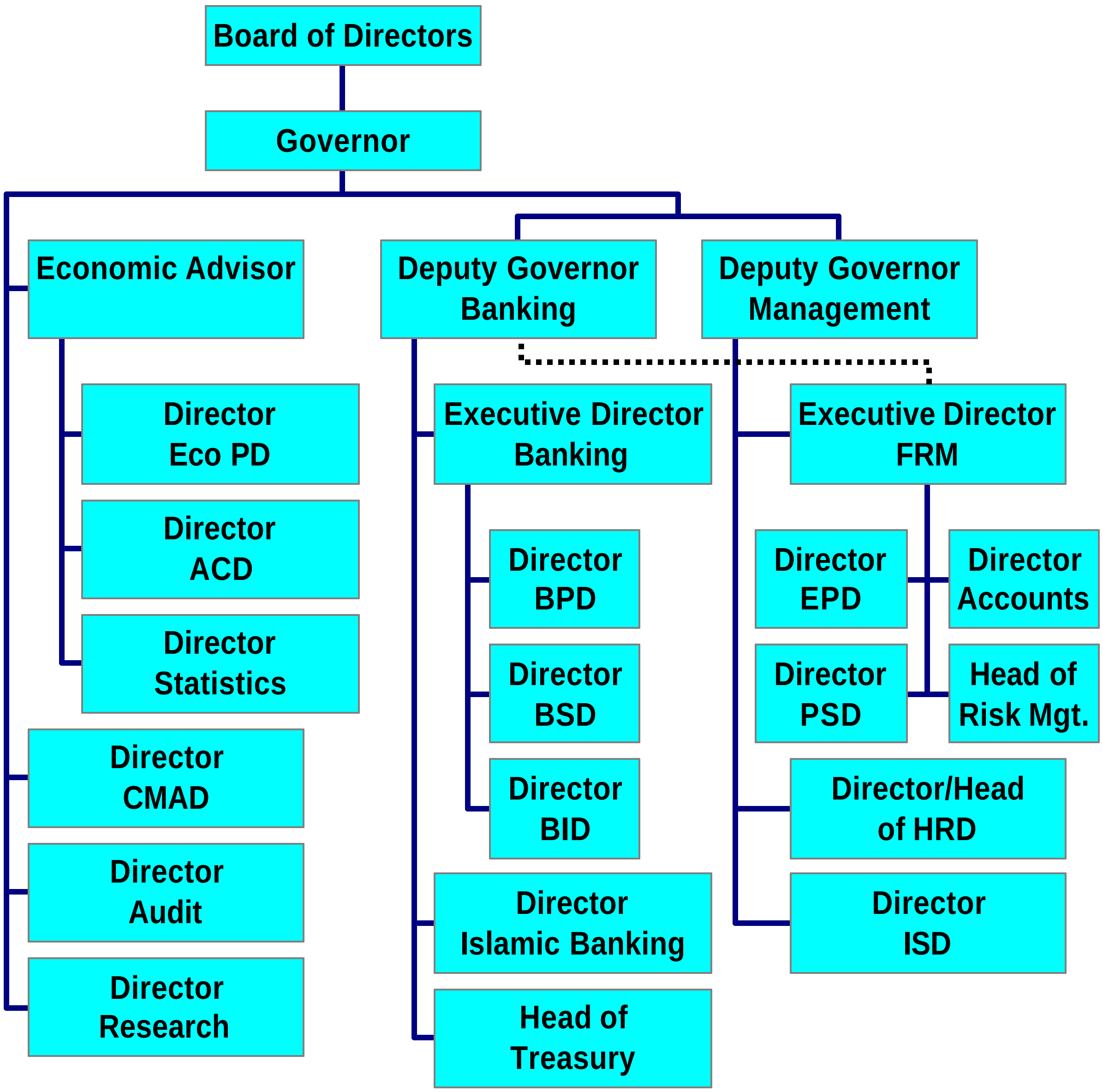
The Group Management Teams (GMTs), headed by the respective Executive Directors are responsible for decision making in respect of administrative, financial, monitoring and organizational functions relating to the cluster of departments working under each Executive Director.

The Departmental Management Team (DMT) headed by the Director and consisting of all the Divisional Chiefs reporting to him addresses department specific issues.

In order to increase accountability and transparency in decision-making at all three levels of management, the minutes of all meetings of the CMT, GMT and DMT are made available to all the stakeholders. The minutes of the CMT are disseminated bank wide, while those of the GMT are circulated within each group consisting of functional clusters of departments. Minutes of the DMT are made available to members of the relevant department.

It is pertinent to point out that by design, there is a two-way flow of information and a clear focus on a bottom-up approach, with policy proposals flowing from the departmental levels to the GMT and CMT. Likewise, the directions and guidelines framed by the CMT trickle down to the other decision-making forums described above and reach the relevant Division and the individual workers entrusted with the job of ensuring compliance. The same channel is used for monitoring progress achievement and identification of bottlenecks in implementation, if any.

3 Organizational Chart



4 Management Directory

Name	Designation	E-mail	Phone
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Syed Basit Aly	PSO to Governor	basit.aly@sbp.org.pk	+92-21-244503326
Mrs. Flaxy Elizabeth Pereira	E.S. to Governor	governor.office@sbp.org.pk	+92-21-244503301
Mr. Tawfiq A.Husain	Deputy Governor (Banking)	tawfiq.husain@sbp.org.pk	+92-21-244503302
Mr. Farhat Saeed	Executive Director	farhat.saeed@sbp.org.pk	+92-21-244503414
Mr. Mansur -ur-Rehman	Executive Director	mansur.rehman@sbp.org.pk	+92-21-244503404
Dr. Abdul Naseer	Economic Adviser	abdul.naseer@sbp.org.pk	+92-21-244503402
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5 List of Publications

Name of Publication	Frequency	Price List
1. Statistical Bulletin	Monthly	Rs160.00
2. Export Receipts	Monthly	Rs260.00
3. The State of Pakistan's Economy	Quarterly	Rs320.00
4. Quarterly Performance Review of the Banking System	Quarterly	Rs50.00
5. Statistics on Scheduled Banks in Pakistan	Half Yearly	Rs180.00
6. Index Numbers of Stock Exchange Securities	Annual	Rs150.00
7. Balance Sheet Analysis of Joint Stock Companies	Annual	Rs600.00
8. Banking Statistics of Pakistan	Annual	Rs435.00
9. Pakistan's Balance of Payments	Annual	Rs150.00
10. Export Receipts	Annual	Rs240.00
11. Equity Yields on Ordinary Shares	Annual	Rs140.00
12. Foreign Liabilities and Assets and Foreign Investment in Pakistan	Annual	Rs145.00
13. Pakistan Financial Sector Assessment	Annual	Rs395.00
14. Banking System Review (BSR)	Annual	Rs230.00
15. SBP Annual Report (Vol-I) Review of the Economy	Annual	Rs450.00
16. SBP Annual Report (Vol-II) Performance Review	Annual	Rs375.00
17. Pakistan Financial Sector Assessment (1990-2000)	Occasional	Rs195.00
18. Foreign Exchange Manual, 2002 (Vol I&II)	Occasional	Rs950.00
19. History of the SBP Vol. I (1948-1960)	Occasional	Rs650.00
20. History of the SBP Vol. II (1961-1977)	Occasional	Rs550.00
21. History of the SBP Vol. III (1977-1988)	Occasional	Rs925.00
22. History of the SBP Vol. IV (1988-2003)	Occasional	Rs1200.00
23. Islamic Banking & Finance-Theory & Practice	Occasional	Rs480.00
24. Prudential Regulations for Consumer Financing	Occasional	Rs50.00
25. Prudential Regulations for Corporate / Commercial Banking	Occasional	Rs100.00
26. Prudential Regulations for Small and Medium Enterprise Financing	Occasional	Rs60.00
27. Minimum Capital Requirements for Banks/DFIs	Occasional	Rs100.00
28. An Overview of Performance since its inception (SBP BSC)	Occasional	Rs250.00
29. Leading Issues Facing Pakistan Economy (Governor's speeches)	Occasional	Rs170.00

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6 List of Acronyms

A

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ABL	Allied Bank Limited
ADB	Asian Developmental Bank
ADs	Authorized Dealers
AGP	Auditor General Pakistan
AKFED	Agha Khan Fund for Economic Development
AMCs	Authorized Money Changers
AMI	Annual Merit Increase
AML	Anti Money Laundering
APGML	Asia Pacific Group on Money Laundering
ATM	Automated Teller Machine

B

BCO	Banking Companies Ordinance
BID	Banking Inspection Department
BIS	Bank of International Settlement
BoD	Board of Director
BoP	Balance of Payment
BPD	Banking Policy Department
BPR	Business Process Re-engineering
BSD	Banking Supervision Department

C

CAELS	Offsite surveillance framework, which gauges the Capital adequacy, Asset quality, Earnings and profitability, Liquidity and Sensitivity to market risk
CAMELS-S	Onsite inspection framework, which gauges the Capital adequacy, Asset quality, Management soundness, Earnings and profitability, Liquidity, Sensitivity to market risk and System and controls
CAR	Capital Adequacy Ratio
CBR	Central Board of Revenue
CI	Currency Issue
CIB	Credit Information Bureau
CMAD	Corporate & Media Affairs Department
CMT	Corporate Management Team
CobiT	Control Objectives for Information and related Technology
COD	Certificate of Deposit
CRR	Cash Reserve Requirement
CY	Calendar Year

D

DFIs	Development Finance Institutions
DGs	Deputy Governors
DIS	Deposit Insurance Scheme
DMT	Departmental Management Team

DTCs	Departmental Training Coordinators
DXX	Digital Cross Connect
E	
EAD	Economic Affairs Division
EBB	Electronic Bulletin Board
ECC	Economic Coordination Committee
EcoPD	Economic Policy Department
e-Commerce	Electronic Commerce
EDMD	Exchange and Debt Management Department
EDs	Executive Directors
EDW	Enterprise Data Warehouse
EFS	Export Finance Scheme
EoI	Expression of Interest
EPD	Exchange Policy Department
ERP	Enterprise Resource Planning
F	
FE	Foreign Exchange
FEBC	Foreign Exchange Bearer Certificate
FCEF	Foreign Currency Export Finance
FEOD	Foreign Exchange Operations Department
FMAP	Financial Markets Association of Pakistan
FPT	Fit and Proper Test
FRA	Forward Rate Agreement
FRM	Financial Resources Management
FSAP	Financial Sector Assessment Programme
FY	Fiscal Year
G	
GDDS	General Data Dissemination System
GL	General Ledger
GMT	Group Management Team
GoP	Government of Pakistan
H	
HBL	Habib Bank Limited
HIT	Hyundai Information Technologies
HR	Human Resources
HRD	Human Resources Department
HRMS	Human Resource Management System
I	
IAS	International Accounting Standards
IBA	Institute of Business Administration
IBBs	Islamic Banking Branches
IBD	Islamic Banking Department
IBIs	Islamic Banking Institutions
IBP	Institute of Bankers Pakistan
IBSD	Internal Bank Security Department
ICAP	Institute of Chartered Accountants of Pakistan
ICMAP	Institute of Cost and Management Accountants of Pakistan

IDB	Islamic Development Bank
IDD	In-house Development Division
IFIs	International Financial Institutions
IFSB	Islamic Financial Services Board
IIFM	International Islamic Financial Market
IIRA	Islamic International Rating Agency
IMF	International Monetary Fund
IP	Internet Protocol
IRAF	Institutional Risk Assessment Framework
IRTI	Islamic Research and Training Institute
IS	Information Systems
ISD	Information Systems Department
IT	Information Technology

K

kbps	Kilobytes per seconds
KIBOR	Karachi Inter-bank Offered Rate
KYC	Know Your Customer

L

LAN	Local Area Networking
LMC	Liquidity Management Centre
LTF-EOP	Scheme for Long Term Financing for Export Oriented Projects

M

MAG	Mindscape data Acquisition Gateway
MAN	Metropolitan Area Networking
MCB	Muslim Commercial Bank
MFIs	Microfinance Institutions
MFPCB	Monetary and Fiscal Policy Coordination Board
MIS	Management Information System
MoU	Memorandum of Understanding
MSD	Medical Services Department
MSDP	Micro Finance Sector Development Programme
MTBs	Market Treasury Bills

N

NAB	National Accountability Bureau
NBFCs	Non-Bank Finance Companies
NBFIs	Non-Bank Finance Institutions
NBP	National Bank of Pakistan
NCBs	Nationalized Commercial Banks
NCCC	National Credit Consultative Council
NGOs	Non-Government Organizations
NIB	NDLC-IFIC Bank
NIBAF	National Institute of Banking and Finance
NIFT	National Institutional Facilitation Technologies (Pvt.) Ltd.
NIPA	National Institute of Public Administration
NPLs	Non Performing Loans
NSS	National Saving Schemes

O

OG	Officer Grade
OMOs	Open Market Operations

P

PBA	Pakistan Bankers Association
PCC	Project Coordination Committee
PCs	Personal Computers
PDOs	Public Debt Offices
PER	Performance Evaluation Report
PIBs	Pakistan Investment Bonds
PIM	Pakistan Institute of Management
PKI	Public-Key Infrastructure
PMO	Project Management Office
PMS	Performance Management System
PSD	Payment System Department

R

Rs	Rupees
RTGS	Real Time Gross Settlement

S

SAI	Supreme Audit Institution
SBOTS	State Bank Officials Training Scheme
SBP	State Bank of Pakistan
SBP BSC	State Bank of Pakistan Banking Services Corporation
SDC	Swiss Agency for Development and Cooperation
SDDS	Special Data Dissemination Standard
SDP	Sector Development Programme
SDRs	Special Drawing Rights
SEANZA	South East Asia, New Zealand & Australian Association of Central Bankers
SECP	Securities and Exchange Commission of Pakistan
SEPR	System Enabled Process Re-alignment
SLR	Statutory Liquidity Requirement
SME Bank	Small and Medium Enterprise Bank
SMEDA	Small and Medium Enterprise Development Authority
SMEs	Small and Medium Enterprises
SoQ	Statement of Qualification
SPU	Strategic Planning Unit
SSC	Special Saving Certificate
SWIFT	Society for Worldwide Inter-bank Financial Telecommunication

T

TABS	Technical Assistance for Banking Sector
T-Bills	Treasury Bills

U

UAT	User Acceptance Testing
UBL	United Bank Limited
UN	United Nations
US$	US Dollar
USDB	US Dollar Bond

V

VSAT	Very Small Aperture Terminal

W

WAN	Wide Area Networking
WB	World Bank

Z

ZTBL	Zarai Taraqiati Bank Limited