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Governor’s Message

I am pleased to present State Bank of Pakistan’s (SBP) performance report for the fiscal year 2005. The year remained eventful in many aspects including record high economic growth fueled by unprecedented rise in credit off-take by private sector, remarkable performance by banking industry, record high oil prices, and highest inflation in last 6-7 years. While the extraordinary performance of the economy that owes overwhelmingly to the sounder and more efficient financial system epitomizes the success of reforms pursued over the last few years, the build-up of inflationary pressures particularly in the second half of the year shadowed the achievements on economic front to some extent.

SBP while keeping vigilance on developments on various fronts, vigorously pursued its strategic objectives and continued to enhance and improve its institutional capacity to align it with the strategic direction. This report reviews and examines the progress on strategic objectives as well as the management strategies adopted during the year.

The key strategic objectives include:
- Ensuring soundness of the financial system;
- Broadening of access of financial services to all segments of society;
- Maintaining price stability with growth;
- Exchange rate stability and reserve management and
- Strengthening of the payment system

The fiscal year witnessed phenomenal rise in profitability of the banking system, which reached an impressive Rs22.8 billion in the first six month ending June 2005 after touching record Rs32.9 billion in the calendar year 2004. The year also witnessed a handsome growth of more than 20 percent in the balance sheet footing; substantial improvement in capital base and thus enhanced solvency levels, and increased focus on developing necessary risk management systems. The Financial Sector Assessment Program (FSAP), initiated by World Bank and International Monetary Fund to assess the resilience and stability of financial systems of the member countries, assessed the overall condition of the financial sector of Pakistan as sound and satisfactory. It also assessed Pakistan as fully/largely compliant with 26 of the 30 Basel core principles on banking supervision; compliance with 2 more principles regarding market and country risks was achieved subsequent to the FSAP report, and the remaining 2 principles concerning consolidated supervision are likely to be complied during FY06.

These achievements owe largely to the financial sector reforms pursued vigorously over the last few years and give us the confidence to initiate second generation reforms to consolidate the gains of the recent years. SBP strategic plan for 2005-2010, unveiled during the year gives the blue print of SBP reforms agenda in the medium term. The plan among others envisages increasing the minimum capital for banks gradually to US$100 million by 2009 from the existing US$35 million to bring it at par with international standards. This will promote further consolidation and mergers in the financial sector and weed out the remaining weak and under capitalized banks, and thus will further improve the stability of the banking system. A road map for implementation of Basel II has also been announced that will prepare the banking system to evolve appropriate risk management culture in their respective spheres to meet the future challenges. The continuously improving performance of the banking industry and the direction of the future reforms give me the optimism to foresee further strength, stability and robustness in the banking system in future.

The year also proved significant in terms of our efforts to promote Small and Medium Enterprises (SMEs), agriculture, micro, housing and Islamic finance sectors, which remained less served till recently. While a large portion of the 33 percent growth in total loans of the banking system went to finance the needs of the corporate sector, a substantial portion also flowed to consumer, SME and agriculture sectors. The consumer finance almost doubled during the year to Rs206 billion; the SME portfolio rose to Rs284 billion; the disbursements to agriculture sector reached record Rs108.6 billion with commercial banks accounting for two third of the total disbursements; the outreach of microfinance banks extended to 213,000 borrowers in 66 districts across the country and Islamic banking branches increased threefold to 62. This growing interest of banks and financial institutions in these sectors provides a win-win situation for all the players; for the banks, to diversify and increase their earning potential, for the sectors, to avail themselves of the hitherto less or non-existent banking services, and for the government and regulators, the achievement of the objectives of financial sector broadening and deepening, equitable growth & alleviation of poverty.

While these developments are encouraging and provide optimism for broadening and deepening of financial sector at an even faster pace in the medium term, significant improvement in banks' capacity in these specialized areas, both in terms of human resources and risk management and information systems will be required to sustain this momentum. SBP is actively engaged in sensitizing the banks about these largely untapped areas and building and upgrading their capacity and skills through trainings, seminars and promotional activities. The two international conferences on Micro and SME finance organized by SBP during the year proved extremely useful in creating national and international awareness about policy, regulatory and business environment for Micro and SME finance, identifying key issues and challenges faced by the sectors and possible approaches to address the issues. A separate SME Department has also been established to focus on all SME, micro and housing finance issues.

The regulatory measures also remained afoot to minimize the risks associated with the banks' forays into these sectors and to remove the legal and regulatory impediment in their growth. These included formulation of Prudential Regulations for agriculture finance, introduction of fit & proper criteria for board members and president of microfinance banks, restructuring of SME bank along with issuance of commercial banking license, amendments in micro finance institutions' ordinance, comprehensive NGO's transformation guidelines, relaxation of limits on commercial banks for extending housing loans etc. The initiatives are likely to spur further growth and activity in these sectors; however concerted and coordinated efforts by all stakeholders should continue to build upon theses gains and enlarge outreach of financial services to all segments of society.

This year proved testing for SBP monetary policy management that targets price stability with adequate growth in the economy. We started the year with the first Monetary Policy Statement (MPS) for FY05 (July-December 2004) that hinted at continuation of gradual and measured increases in the interest rates to check the inflation while maintaining the growth momentum. The Market Treasury Bills (MTBs) rates were thus allowed to increase gradually in each successive auction. However, our efforts to maintain the price stability received a setback due to shortage of essential commodities, the super spike in oil prices and unabated rise in demand for private sector credit, which grew by Rs428 billion during the year. This started translating into further mounting of inflationary pressures in the third quarter of the year requiring more aggressive fiscal and monetary measures.

The second MPS for FY05 (January-June 2005) thus highlighted SBP intentions to more aggressively pursue monetary tightening to reign in the soaring inflation. Consequently the discount rate was increased by 150 basis points to 9 percent in April 2005 followed by more pronounced ascent in the MTBs' yields in the subsequent auctions. This together with fiscal and administrative measures to address the supply side weaknesses checked and reversed the rising inflationary trend in the last two months enabling us to close the year with a single digit inflation of 9.28 percent. The MPS for July-December 2005 has again signaled continuation of tight monetary policy stance; however the pace of tightening and interest rate rises will depend on the behavior of inflation and its attributes.

The year also proved challenging in terms of exchange rate and reserves management due to record high oil prices, hefty rise in non-oil import bill and some speculative sentiments that engulfed the market in the first quarter of the year. SBP closely monitored the developments and intervened at appropriate times to lend stability to the exchange rate. Since November 2004, we started financing oil import bill directly from our reserves that proved extremely useful in releasing the pressure on exchange rate, which stabilized at Rs59.60/US$ after touching Rs61.30/US$ in November 2004 and compared to Rs58.16/US$ as at end June 2004. The decision to finance imports directly from reserves also left the inter bank forex market fairly liquid, enabling SBP to buy back a significant proportion of the total oil support provided to the market. However, on overall basis, SBP remained a net supplier of foreign exchange to the market and its foreign exchange reserves were reduced by US$629 million to US$10.482 billion. This is, however, inline with our policy to build reserves in easy times to lend stability to exchange rate in difficult periods.

The measures to liberalize the foreign exchange market also remained afoot. The local mutual funds were allowed to invest abroad up to 30 percent of the aggregate funds in permissible categories subject to a cap of US$15 million. This will open up investment avenues for investors and enable Mutual Funds to diversify their portfolio of investments and secure better returns for their unit/certificate holders. Other major steps include permission to authorized dealers to remit funds for IT transactions and facility to sell their surplus cash foreign currency notes to SBP.

After transformation of more than 95 percent of the money changers network into Exchange Companies (ECs), the major challenge now is to ensure effective regulatory and supervisory oversight of the new born ECs and building their capacity, both human and systems, to facilitate their transition from an unregulated to a regulated environment. We therefore further strengthened our capacity for effective supervision of ECs and arranged training and capacity building programs for ECs. The ECs' supervisory units were established at 16 SBP Banking Services Corporation (SBP BSC) field offices and a manual for on-site examination for ECs was developed. Further, a number of meetings were held with the ECs' managements to sensitize them about the regulatory environment and challenges ahead. The efforts in this direction will continue to bring discipline, adequate documentation and corporate governance standards in ECs.

The year also witnessed further strengthening of on-line and e-banking infrastructure in the country. The growing number of ATMs as well as interconnectivity of two major switches (MNet & 1-Link) has yielded increasing benefits to the customers. The permeating e-culture into the financial system is expected to promote efficiency and resilience in the payment system of the country. The implementation of Real Time Gross Settlement (RTGS) system is also at a very advanced stage and is likely to be operative by the second quarter of FY06. The "*Payment System and Electronic Funds Transfer Act, 2005*" was drafted during the year and sent to Ministry of Finance for necessary approval and enactment. This is a comprehensive document that will address a number of issues and allow smooth functioning of RTGS. It will also help us become compliant with the Bank of International Settlement Core Principles of Systematically Important Payment Systems.

The progress achieved towards strategic objectives would not have been possible without building adequate institutional capacity. We continued to strengthen our human resource base through regular inductions & trainings, improving and expanding our information technology base by employing state-of-the-art techniques, strengthening our research and analytical skills and promoting transparency, openness and accountability.

During the year, we made further headway towards the completion of the information technology up-gradation project; presently the roll out of Globus in SBP BSC field offices is in progress that is most likely to be completed by second quarter of FY06, whereas most of the automation and electronic communication work at SBP and SBP BSC head office has already been completed. The Data

Warehouse project is also finally on track with its first phase completing in December 2005. The successful completion of the IT up gradation project will give fillip to the process of decision-making, as management will have quick access to a variety of data and reports. Moreover, it will also enable to implement business process reengineering, which is being employed in SBP to increase efficiency, reduce cost and meet stakeholders' satisfaction through value added services.

With continuous influx of young and mid career professionals at entry and middle management level, extensive focus on training & development and a performance based reward & recognition culture, SBP now enjoys the services of a professional and efficient human resource base. While this improvement in the human resource base is satisfying, it poses a new challenge of retaining the skilled and well trained officers who are in great demand in the growing banking industry. We have taken quite a few steps to improve the retention ratio including upward revision of the compensation package, promotions at accelerated pace, improvement in Annual Merit Increase and enhanced training and development opportunities etc.

In addition fresh recruitments at entry and middle management level are continuing to replenish the resigning and retiring employees. During the year 44 entry level officers were hired under SBOTS and process for hiring of 17 officers at middle management (Joint Director) level was completed. We have also decided to hire two regular batches of entry level officers under SBOTS from FY06 to minimize the time lag in hiring, post induction training and deployment of officers in various departments. While the steps taken to address the relatively higher turn over in young professionals are likely to improve the position, we will keep on reviewing our internal policies and practices to attract, train, develop and retain high caliber professionals in SBP.

Last year, we had created a Strategic Planning Unit to develop a medium term (2005-2010) strategic plan for the central bank to build upon the gains of the financial sector reforms, pursued vigorously over the last 5 years. It gives me real satisfaction that the plan has been developed through a rigorous consultative process that defines the SBP reforms agenda for the next five years. The plan has identified specific actions along with time lines for each of the strategic objectives, to be initiated and completed during next five years. It covers both functional and management strategies and will ensure that SBP remains on course in pursuing its key objectives.

Lastly, I will like to express my satisfaction that both the financial sector and SBP as the central bank are in a much better shape than they were six years back. While the financial sector is sound and stable and fully poised to efficiently and effectively serve the real sector, SBP is far better equipped to manage its responsibilities in a more effective manner. Most of the reform initiatives have been completed and a comprehensive Strategic Plan for the next five years is in place to build on the gains of the recent years. This provides optimism for further strength, stability, maturity and robustness in the financial sector in future and its positive impact on the real sector. This will, however, require continuation of the reforms agenda with at least similar vigor and zeal and enhanced coordination and cooperation amongst all the key stakeholders.

Ishrat Husain
Governor

Strategic Objectives of SBP

1. Broadening Access of Financial Services
2. Ensuring Soundness of the Financial Sector
3. Maintaining Price Stability with Growth
4. Exchange and Reserve Management
5. Strengthening of Payment Systems

1 Broadening Access of Financial Services

1.1 Overview

State Bank of Pakistan (SBP) has been pursuing broadening of access of financial services to all segments of the society as an important strategic objective considering its direct and indirect benefits to the economy. Learning from past experience, both within the country and elsewhere, a market based approach has been adopted to broaden and deepen the country's financial markets with focus on mainstreaming of Agriculture, Micro, Small and Medium Enterprise (SME), Consumer and Islamic finance services. A number of initiatives have been taken to help develop these sub sectors of the financial system including extensive promotion, awareness and capacity building campaigns, rationalization of the regulatory framework to remove regulatory impediments, development of legal and regulatory framework for Microfinance Institutions to allow private sector entry into banking with the poor and establishment of SME and Islamic Banking Departments to focus on all SME finance and Islamic finance issues respectively.

The initiatives have led to significant improvement in growth and activity in these largely untapped sectors. The total number of borrowers of the banking industry has doubled in the last two years to about 4.1 million at the end of June 2005 (**Table 1.1**). The Consumer finance, which had a limited presence in the country just a few years back and caters mainly to the middle class, has grown exponentially during last few years reaching Rs206 billion as at end June 2005, and played a much needed role in returning the economy to positive real growth mode from negligible or negative real growth since mid 90s. The annual agrifinance disbursements have reached record Rs108.6 billion in FY05 compared to Rs73.4 billion in FY04 and Rs45 billion in FY01.

Table 1.1: Sector-wise Number of Borrowers

Sector	December 2002	December 2003	December 2004	June 2005
Agriculture	1,339,961	1,411,508	1,503,827	1,572,202
Microfinance Banks	57,037	96,420	177,742	212,647
SME Sector	67,520	91,663	106,248	160,977
Consumer Finance	252,156	721,201	1,619,207	1,992,912
Commodity Operation	1,458	2,069	3,207	5,945
Staff Loans	72,570	69,796	72,633	73,317
Others	56,683	63,696	73,735	58,200
Corporate Sector	14,256	17,743	19,333	19,399
Total	**1,861,641**	**2,474,096**	**3,575,932**	**4,095,599**

The private sector interest in establishing Microfinance Banks has started picking up; so far licenses for 5 Microfinance Banks have been issued and quite a few more are likely to be licensed in the near future. The commercial banks are now fully geared to build their capacities in SME finance to tap this highly profitable but largely untapped sector that will translate into substantial growth in this sector in the medium to long term. Islamic banking has started firming roots in the country's financial market as is evident by its fast expanding branch network that reached to 62 at the end of June 2005. This will enable a significant segment of the population, which shies away from conventional banking system, to access the financial services and contribute in economic development of the country.

This, however, is just a modest beginning towards broadening access of financial services to all segments of the society and still a long distance is to be covered to achieve significant progress in that direction. The SBP Strategic Plan, unveiled during the year, has accordingly identified various developmental plans for these sectors and categorized them as high priority areas to be pursued during next five years.

1.2 Agricultural Credit

Efforts to mainstream agrifinance continued during the year with more vigor and a number of activities were initiated and completed during the year including awareness building and information dissemination programs for farmers, training and capacity building programs for banks, finalization of agrifinance prudential regulations and initiation of Agribusiness Development Project. The efforts translated into phenomenal growth in agrifinance disbursements that exceeded the target for the year by 28 percent and last fiscal year disbursements by 48 percent. The commercial banks, which used to shy away from this sector, have made a very strong entry with more than two third share in the current year's disbursements.

1.2.1 Prudential Regulations for Agricultural Financing

The distinct nature of agrifinance necessitates a separate regulatory framework responsive to its peculiar dynamics. Accordingly, a project to develop separate Prudential Regulations for Agricultural finance was initiated during the fiscal year and the draft Prudential Regulations were finalized through rigorous consultation with stakeholders. The draft agrifinance Prudential Regulations were also placed on SBP website for comments and suggestions from the general public. The comments and suggestions received are being compiled and the amended regulations will be issued shortly.

1.2.2 Special Training and Awareness Programs

The third phase of the specialized training and awareness programs initiated in fiscal year 2002-03 (FY03) to build banks' and financial institutions' agrifinance capacity and disseminate information about agrifinance products among small farmers, continued during this fiscal year. Accordingly Special Training Programs on Agricultural Credit including one-day field visits were held at nine different Districts[1]. The training programs and field visits have been extremely useful in attracting commercial banks' interest in agrifinance resulting in manifold increase in their agrifinance portfolio over the last three years. The process of bringing the agricultural/rural finance in the fore will continue in FY06 also, and the fourth phase of Special Training Program will be initiated, to cover 11 new districts[2].

1.2.3 Agricultural Credit Takeoff

The policy advocacy and promotional initiatives have started bearing fruits in the form of substantially increased activity in the agrifinance sector, led by a strong entry of commercial banks. The total agriculture credit disbursements during the year reached Rs108.6 billion, thus widely surpassing the target of Rs85 billion and the actual disbursements of Rs73.4 billion last year (**Table 1.2**). The commercial banks, which traditionally shied away from agriculture sector, perceiving it laborious, risky and costly affair, have been leading the way in growth of agrifinance since the last five years. During FY05 they disbursed Rs63.7 billion compared to Rs37.4 billion disbursed by Zarai Taraqiati Bank Limited (ZTBL), the specialized agrifinance institution (**Figure 1.1**). The five big commercial banks with Rs51.3 billion disbursements, accounted for 81 percent of agrifinance disbursements by commercial banks whereas the remaining 19 percent was shared by Domestic Private Commercial Banks (DPCBs) with total disbursements of Rs12.4 billion.

The disbursements, however, are still about 42 percent of the total estimated credit requirements of Rs252 billion and outreach in terms of number of borrowers at 1.6 million is still hovering around 24 percent of the 6.6 million rural households. The Agricultural Advisory Credit Committee (ACAC) accordingly, in its meeting held in July 2005, while appreciating the record disbursements made during the year, envisioned increasing the outreach to 50 percent of the rural households during next 3 to 5 years.

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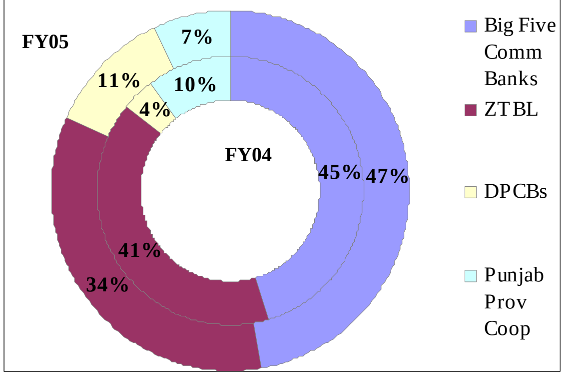
[1] Sahiwal, Mardan, D.G. Khan, Abbottabad, Larkana, Kasur, Naseerabad, Mirpur Khas and Sargodha.

[2] Vehari, Rahimyar Khan, Bhalwal (Distt. Khushab), Gujrat, Nawabshah, Shikarpur, Kohat, Haripur, Gawadar / Turbat, Loralai and Rawla Kot.

Table 1.2: Growth in Agricredit
(Billion Rupee)

	FY04		FY05	
	Targets	**Disbursed**	**Targets**	**Disbursed**
Big Five Comm Banks	22.4	33.2	38	51.3
ZTBL	33	29.9	34	37.4
DPCBs	2.6	2.7	5	12.4
Punjab Prov Coop	7.5	7.6	8	7.6
Total	**65.5**	**73.4**	**85**	**108.7**

Figure 1.1: Share in Agricredit during FY04 and FY05 (Percentage)



Box 1.1: Agricultural Credit Advisory Committee

ACAC is a consultative body to review and monitor activities in agri/rural finance sector. It has representation of Central Bank, Federal and Provincial Governments, Banks and Chambers of Agriculture/Farmers Associations. The Committee meets twice a year to undertake following business:

- To assess credit requirements of the agricultural sector and assist National Credit Consultative Council in formulation of the Annual Credit Plan
- To review periodically and report on the flow of credit to Agriculture sector
- To consider ways and means for improving the disbursement and recovery of agricultural credit and to suggest measures for strengthening institutional framework flow of agricultural credit

The committee in its meeting held in July 2005, reviewed the agrifinance disbursements during FY05 and expressed satisfaction on surpassing the target by wide margin and substantially improved presence of commercial banks in the sector since last couple of years. While setting the voluntary targets for FY06, it emphasized the banks and financial institutions to focus on the three sub-sectors in the non-farm sector viz. livestock, orchards and fisheries –as they have huge potential to raise income levels in poverty reduction and earning handsome returns for the banking industry. Further to make the task of the Committee more meaningful and result-oriented, the Committee resolved to focus on the following three areas during the next 3 to 5 years:

- The outreach of the institutional agrifinance should be increased to 50 percent or 3.3 million rural households from the existing level of 15 percent or 1.1 million rural households.
- The level of financing to livestock, orchards, fisheries, etc particularly in North West Frontier Province (NWFP), Balochistan and Sindh shall be increased substantially and the banks will be encouraged to employ qualified experts in these fields and develop new products for these important sub sectors.
- The level of agrifinance disbursements in NWFP, Sindh and Balochistan shall be increased and banks will be encouraged to expand their presence in the rural areas of these provinces through multi-delivery channels.

1.2.4 Agricultural Credit Targets for FY06

The ACAC has set a target of Rs130 billion for agriculture credit disbursements during the FY06, which is 53 percent and 20 percent higher than the target and actual disbursements respectively of the outgoing year. The targets however are totally voluntary and indicative in nature as the mandatory targets allocations policy has been totally phased out from FY06, and the targets for the five big commercial banks[3] has also been made voluntary and indicative in line with DPCBs. The elimination of Mandatory Credit Targets coupled with active involvement of commercial banks in agrifinance is a major milestone achieved towards mainstreaming of agrifinance in the country's financial system. The flow of necessary funding to the sector will now be ensured through ensuring a conducive policy and regulatory environment, policy advocacy and promotional initiatives and monitoring of agri-

[3] National Bank of Pakistan (NBP), Habib Bank, MCB Bank, United Bank Limited (UBL) and Allied Bank.

disbursements and portfolio build-up plans. With the discontinuation of the mandatory agricredit schemes, the scheme for reimbursement of bonafide losses/sharing of losses with banks by SBP under Supervised Agricultural Credit Scheme shall automatically be discontinued from July 1, 2005. However the losses already incurred by the banks during the year ended June 30, 2005 will be reimbursed as per previous policy.

1.3 Microfinance

The paradigm shift in Microfinance from supply-led, interventionist policies towards more liberal market-oriented approaches has led to a growing emphasis on provision of conducive environment by the governments and regulatory authorities rather than intervening directly in the allocation of financial resources. The government adopting a similar policy had enacted a separate legal framework for Microfinance Institutions (MFIs) in 2001 that encouraged institutional diversity and allowed both unregulated NGO-MFIs and formal Microfinance Banks (MFBs) to extend financial services to the low income population while remaining in their respective domains. SBP in consonance with the government policy has assumed a dual role for the sector viz. regulatory and promotional, to ensure development of a sound and self sustainable Microfinance sector in the country. Like agrifinance, the focus here again, is the mainstreaming of Microfinance through necessary regulatory, policy and promotional initiatives in consultation and collaboration with the stakeholders.

1.3.1 Amendments in MFIs Ordinance

The enactment of separate legal framework for MFIs in 2001 was the most significant government initiative, which led and steered most of the microfinance activity in the country since the recent past. However, considering the substantial developments in domestic and international microfinance business in last 3-4 years, certain provisions of the ordinance were required to be reviewed to align them with market dynamics. A sub-group of Microfinance Consultative Group was formed to review the ordinance and suggest necessary amendments. The sub-group accordingly finalized a set of amendments, which after discussion and clearance by the Consultative Group were forwarded to the Ministry of Finance for necessary approvals. A brief summary of the proposed amendments has been given in the **Box 1.2**.

1.3.2 Fit and Proper Criteria

The regulatory framework, evolved through a rigorous consultative process during the last couple of years, has been under continuous review to ensure its responsiveness to the sector dynamics. The fit and proper criteria for the Board Members, Presidents and Chief Executive Officers (CEOs) of MFBs were issued during the year to ensure that the Board Members and President are not only the persons of established integrity and track record, but also have necessary capacity, qualification and experience to effectively undertake their respective responsibilities, and steer the MFB as a pro poor but commercially viable financial institution. SBP even before the issuance of the criteria had been reviewing the credentials and making background checks etc of the proposed directors and presidents/CEOs of MFBs, the criteria however give objective parameters to be used by SBP to assess the suitability of the incumbent directors and Presidents/CEOs for their respective positions.

Box 1.2: Proposed Amendments in MFI Ordinance 2001

A sub-group of the Micro Finance Consultative Group reviewed the MFI Ordinance 2001 to make it more responsive to the sector's requirements and remove legal hurdles in the sector's growth. The important amendments proposed include:

Title of the Ordinance- The name of the Ordinance has been proposed to be changed as Microfinance Banks Ordinance from existing MFIs Ordinance along with insertion of separate definitions for MFIs and MFBs; the MFBs have been defined as institutions licensed by SBP to undertake the microfinance business including deposits mobilization, and the MFIs as the institutions extending micro credit and allied services to the poor through sources other than public savings. This will provide explicit distinction between MFBs and NGO-MFIs and enable the NGO-MFIs to use the word MFI in their name, which the existing ordinance prohibits.

Definitions of Poor- The existing definition, which allows all persons with income below the taxable limit to avail financial services from MFBs has been considered restrictive. The amendments proposed to empower SBP to prescribe the maximum income limit from time to time in consultation with stakeholders. This will enlarge the scope of MFBs' market, enable the MFBs to continue serving their clients even if their income level increases over time, increase business viability of MFBs and would be instrumental in attracting further investment in the sector.

Regional MFBs- The amendments propose to allow establishment of Regional Micro Finance Banks comprising 3-5 adjacent districts within same province with a capital base of Rs150 million. It is aimed at increasing the business viability of District based Micro Finance Banks and encouraging prospective sponsors/investors to extend coverage to relatively smaller districts.

Licensing of new MFBs - The existing sections /clauses on licensing of new MFBs has certain ambiguities, which would be removed with the proposed separate sections on licensing of new/startup MFBs and those transforming from NGO-MFIs and suspension /cancellation of the license.

Regulatory powers of SBP- The amendments in regulatory powers are aimed at equipping SBP with necessary powers to ensure effective regulatory and supervisory oversight of MFBs and deal with problem MFBs.

1.3.3 NGO Transformation Guidelines

SBP though doesn't regulate and supervise NGO-MFIs, it recognizes and appreciates their role in the country's microfinance sector and has been encouraging the NGO-MFIs having requisite capacity to transform into MFBs. Last year guidelines for reviewing credit portfolio of NGO-MFIs interested in transformation into MFBs were issued, which covered just one aspect of the transformation. Comprehensive NGO transformation guidelines covering all areas and facets of the transformation were issued during FY05 to facilitate the NGOs in the transformation process. The guidelines discuss in detail the transformation process, the pre-requisites of transformation and its costs and benefits and require the NGO-MFIs to take the transformation decision based on independent institutional assessment[4] and clear understanding of the transformation objectives. The guidelines complements the legal and regulatory framework, which now provides a continuum whereby the NGO-MFIs could gradually build their capacity, grow and mature over time into deposit taking MFBs, provided they meet the requisite criteria.

1.3.4 Microfinance Consultative Group

The Partnership and collaboration with practitioners and stakeholders has been the hallmark of SBP policy formulation process for the banking sector in general and microfinance sector in particular since the initiation of strategic reforms programs in 2000. The Microfinance Consultative Group constituted in 2001 with representation from SBP, relevant government ministries, regulated MFBs, NGOs-MFIs and donor agencies, to work as an advisory body for SBP in microfinance policy

[4] To be undertaken by chartered accountancy firms along with microfinance experts/practitioners having minimum five years experience with reputed MFIs/Microfinance rating agencies etc.

formulation process, has been a great success in building trust amongst the policy makers and practitioners, enabling the central bank to develop sector friendly policies and regulations. The group meets on quarterly basis to discuss microfinance policy issues and no policy or regulation is issued unless discussed extensively by the group. The group during the year expanded with the induction of a representative from European Commission and presidents of two MFBs, licensed during the year. All the policy and regulatory initiatives taken by SBP during the year including amendments proposed in MFIs ordinance 2001, fit and proper criteria for board members and president/Chief Executive Officers of MFBs and NGO transformation guidelines were discussed and approved by the Group.

1.3.5 Promotional Initiatives

SBP, considering the evolving stage of the sector, has also assumed promotional role to catalyze growth and activity in the sector. It frequently interacts with the stakeholders to create greater awareness and understanding of microfinance policy environment and encourage private sector investment in the sector. In this respect a very important event, the two-day International Microfinance Conference, '*Microfinance in Pakistan-Innovating and Mainstreaming*' was organized in December 2004 at Islamabad in collaboration with the Pakistan Poverty Alleviation Fund (PPAF), Pakistan Microfinance Network (PMN) and Khushhali Bank. The conference attended by about 400 microfinance practitioners, donor representatives, bankers and academia including more than 30 renowned international microfinance dignitaries proved extremely useful in creating national and international awareness about Pakistan's Microfinance policy, regulatory and business environment. It also enabled Pakistan to have visible presence on the world microfinance map, which will be instrumental in attracting greater international interest and investment in the sector. A brief on the conference have been given in **Box 1.3**.

1.3.6 SBP Capacity Building in Microfinance

An effective and responsive regulatory and supervisory framework demands an incisive and extensive view of the regulatory body. In order to whet its microfinance related capacity, SBP had entered into a partnership with Swiss Development Agency for Cooperation in FY04 and created a Microfinance Resource Pool comprising 25 officers to impart extensive microfinance related trainings during the three years ending August 2006. A number of training programs and workshops were arranged and 8 officers from the resource pool were sent on foreign trainings, seminars and conferences including the renowned Boulder training program during the FY05. To further augment the central bank's microfinance supervisory capacity, reputed international consultants[5] have been hired to develop on-site examination and off-site surveillance manuals for MFBs, which will substantially improve SBP capacity to ensure effective supervisory oversight of MFBs.

[5] M/s International Consulting Consortium of USA, the most renowned consultancy firm in Microfinance regulation and supervision. The consultants will be commencing the project from September 2005 and will be completing it by January 2006.

1.3.7 Impact of Initiatives - Outreach of Microfinance Services

With growing acceptance of microfinance as a viable business proposition, the private sector interest in establishing MFBs to extend financial services to micro enterprises has started picking up. SBP during FY05 granted license to one district based MFB and in August 2005 also granted license to a nation wide MFB. Licensing application of another nationwide MFB is at an advanced stage of processing and quite a few more were in the process of preparing their proposals for submission to SBP. The network of branches and service outlets of MFBs increased to 157 covering 66 districts across the country. The number of active borrowers grew by 60 percent to 213,000[6] and the outstanding credit portfolio increased to Rs2000 million from Rs1,189 million in June 2004. Similarly the number of depositors increased by 74 percent to 25,000[7] and total deposits rose by 22 percent to Rs588 million.

Box 1.3: International Microfinance Conference

In order to promote and develop micro finance sector in the country, a two days International Conference on Micro finance "Microfinance in Pakistan: Innovating and Mainstreaming" was held at Convention Center Islamabad on 13-14 December 2004. The objective of the conference was to create awareness about various policy initiatives taken by the government and SBP along with identifying the key issues and challenges faced by the sector both in Pakistan and in the South Asian region while suggesting recommendations to address the same.

The conference co-hosted by SBP, PPAF, PMN and Khushhali Bank was the first mega international event in the history of Pakistan Micro finance Sector. The presence of large number of reputed Microfinance players in the conference from across the world reflected the growing confidence of the international microfinance players in SBP's approach and policy direction for sustained development of the sector in the country. The conference participants widely appreciated the overall policy and regulatory environment for MFIs in Pakistan and considered it one of the most advanced and progressive in the world. The inaugural address by President of Pakistan and special address by the Prime Minister on the second day of the conference demonstrated strong commitment and resolve of the government from the highest levels to help develop the sector. The conference proved extremely useful in enabling the local players to interact with a number of reputed international Microfinance players and creating greater awareness about the policy environment both locally and internationally. The following declarations were made in the concluding session of the conference:

- Improvement in retail capacity is critically important for increasing outreach levels, which requires collaborative efforts of policy makers, practitioners, donors etc;
- Degree of regulation- Striking the right balance is a challenge;
- Innovation and diversification both in terms of products, delivery mechanism and institutional types are required to better serve the poor;
- A market oriented approach and mainstreaming with overall financial system could be instrumental in achieving financial sustainability as well as sustained increase in outreach levels;
- Subsidies create dependency and camouflage the real demand and products needed;
- Sustainability should be a concern from day one;
- Microfinance is an empowering instrument particularly for women when combined with other social development interventions; and
- Transforming NGOs into banks is a challenging task and one needs to learn form experiences of organization that have gone through the process.

[6] Excluding 250,000 borrowers mobilized by un-regulated NGO-MFIs/Rural Support Programs (RSPs).
[7] Excluding 800,000 depositors mobilized by un-regulated NGO-MFIs/RSPs and got their accounts opened with commercial banks.

1.4 SME Finance

SMEs, due to their enormous employment generation potential, have assumed a critically important role in economic development and poverty alleviation particularly in developing countries. The Government has also recognized it as an important component of its economic development and poverty alleviation strategy. SBP appreciating the importance of SMEs in economic growth and employment generation[8], has been actively engaged in promotion and growth of SME finance. The Prudential Regulations for SME finance were issued to align the regulatory framework with the real dynamics of the sector and to encourage banks to develop necessary risk management infrastructure and human resource capacity for SME financing. Besides regulatory initiatives, promotional programs have also been initiated to create awareness about policy and regulatory environment for SME finance and to encourage and facilitate commercial banks to buildup SME finance portfolio. Presently, the total SME credit portfolio of banks at Rs284 billion constitutes 18 percent of the total credit portfolio of the banking industry. Most of this portfolio, however, comprise of loans to medium enterprises, and a large number of small enterprises have no or limited access to the institutional credit. This very sector is the focus of SBP regulatory and promotional initiatives to encourage and incentivize the banks to extend their outreach to this segment of SMEs.

1.4.1 SME Sector Development Program

SBP played an active role in preparation and initiation of Asian Development Bank financed SME Sector Development Program (SDP), which is aimed at building an enabling business environment for SMEs, development of a well-articulated SME Policy, that should explicitly define the role of government and private sector, improving SMEs' access to market-based Business Development Services, improving the regulatory framework and credit information infrastructure, building commercial banks' capacity in SME finance and restructuring of SME Bank.

1.4.2 Creation of SME Department

SBP established a separate SME Department during the year to focus on all SME finance issues. The Department will closely liaise with all SME stakeholders including Banks and Development Finance Institutions (DFIs), SMEs' associations and representative bodies, SMEs regulatory and promotional bodies like Ministry of Commerce, Ministry of Labor and Manpower, Small and Medium Enterprise Development Authority (SMEDA) etc to resolve regulatory issues, information asymmetries and other issues impeding the growth of SMEs. The department, in collaboration with the SME stakeholders, will also initiate promotional, capacity building and awareness programs across the country to enable the SMEs to have continued access to the financial services. The Department Vision, Mission and key objectives have been given in **Box 1.4**.

1.4.3 Commercial Banks' Capacity Building

Under the SME SDP, SBP has recently hired a reputed foreign consulting firm[9], to provide capacity building support to selected commercial banks[10], including SME Bank, on cost sharing basis. This capacity building support will cover full spectrum of establishing a SME business line including preparation of participating banks' business plans, SME credit policy, requisite Management Information System and loan tracking and monitoring system, training of loan officers etc. Institute of Bankers Pakistan and National Institute of Banking and Finance (NIBAF) will also collaborate with the firm in providing training on SME finance to the bankers. This will translate into substantial improvement in SME finance capacity of the participating banks and will also provide prototypes and

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[8] According to recent estimates (by SMEDA), there are approximately 3.2 million business enterprises in Pakistan. The enterprises employing up to 99 persons constitute over 95 percent of all private enterprises in the industrial sector and employ nearly 78 percent of the non-agriculture labour workforce. They contribute over 30 percent to the Gross Domestic Product, Rs140 billion to exports, and account 25 percent of exports of manufactured goods besides sharing 35 percent in manufacturing value added.

[9] Bankakadmie International, Germany.

[10] Banks selected based on their interest in the program and potential to develop SME portfolio.

business models for other banks and financial institutions to develop their SME business lines. Further the improvement in SMEs' business, policy and regulatory environment as envisaged in the program will spur growth and activity in the sector enabling the banks to exploit the strong growth potential of the new market niche.

Box 1.4: SME Department

Mission Statement
To create an enabling environment and to institute a facilitating regulatory and supervisory framework, in collaboration with stakeholders, for the promotion and development of market based financial services for SMEs, Exports, Microfinance, Housing, and Infrastructure sectors.

Vision Statement
To transform into a dynamic department by learning from national, regional and international experiences and best practices so as to acquire expertise and professional excellence in development finance.

Objectives of the Department
- Promotion & Development of SME Finance
- Implementation of SME Sector Development Program
- Creating an enabling regulatory environment for SME financing
- Capacity building of banks in SME Finance
- Development and Promotion of Micro Finance Sector
- Review of Policy & Regulatory Framework for MFBs
- Licensing and Supervision of MFBs
- Capacity Building of SBP Staff in dealing with issues in SME Financing, Microfinance and Housing finance.
- Formulation and Implementation of short and long term Refinance Credit Schemes
- Supervision of the Commodity Operations Financing of the Government
- Development of Primary Mortgage Market
- Initiating measures for the development of Secondary Mortgage Market especially for medium sized banks
- Awareness creation in the banking and financial system for privately sponsored infrastructure projects

1.4.4 SME Bank Restructuring and Licensing as Commercial Bank

SME Bank was established in 2002 by merging Small Business Finance Cooperation and Regional Development Finance Cooperation to operate as a specialized institution for SMEs. SME Bank has been undergoing an extensive restructuring phase under the SME SDP to align its organizational capacity with its new strategic direction. As part of the restructuring exercise, SBP during the year issued the commercial banking license to SME Bank, enabling it to extend a whole range of banking services to the SMEs. SBP will also provide capacity building support to SME bank under the SME SDP. The initiatives are likely to result in substantial improvement in banks' capacity as a SME finance institution thus facilitating its privatization by end 2006.

1.4.5 SME Finance Conference

A major developmental and promotional initiative during the year was the International SME Finance Conference held at Lahore on 10th and 11th May 2005, which proved extremely useful in bringing all the stakeholders viz. the bankers, the trade and commerce regulatory bodies, SME representatives, chambers of commerce etc at one platform to discuss the key issues and challenges faced by the sector and evolve recommendations along with institutional mechanism to address issues in SME Finance. A brief on the conference has been given overleaf in **Box 1.5**.

Box 1.5: Conference on SME Financing Issues and Strategies

SBP organized a two days' conference on "SME Financing: Issues & Strategy" at Lahore on May 10-11, 2005. The Conference was inaugurated by President of Pakistan and was attended by all the critical stakeholders such as commercial banks, SME Associations, Chambers of Commerce, and Government Officials etc. Moreover, a number of international experts on SME Sector and SME financing made presentations on various issues and strategies in developing successful SME finance business by the commercial banks.

The overall objective of the Conference was to bring together all the stakeholders in the SME sector to generate debate on the issues confronting the sector and look at the various strategies being developed at the regulatory and policy level to increase the flow of credit and financial services to SMEs. The conference was also aimed at creating national and international awareness about various policy and regulatory initiatives taken by SBP and the impact thereof; the initiatives include:

- issuance of a separate Prudential Regulation for SME financing;
- capacity building of banks for SME lending;
- enlarging the scope of Credit Information Bureau;
- granting commercial banking license to SME Bank;
- focus on SME lending in SBP refinance schemes for banks; and
- creation of a separate SME Department in SBP.

While deliberating on the various facets of SME finance; the speakers highlighted the impediments in the flow of credit to SMEs which mainly arise from absence of financial management, lack of documentation and management structure with the SMEs and limited understanding of financial institutions about the SMEs. The conference proposed a reform agenda for ensuring flow of adequate funds and financial services to SMEs. The agenda include streamlining market research, enhancing products, services and delivery channels, improving risk management and MIS, building human resource base of banking industry etc. The conference also emphasized the need for training, capacity building programs and Business Development Services for SMEs and role of Small and Medium Enterprise Development Authority (SMEDA), which due to its expertise in SME sector could facilitate the process of making SMEs more bankable.

1.5 Consumer Finance

The rapid growth in consumer finance in recent years has been one of the major breakthroughs in broadening of access of financial service. It has not only spelled benefits to a substantially large number of new customers of the banking industry, but has also proved an important avenue for banks to diversify their loan portfolio and earn handsome profits. The quality of the consumer loans so far has also been impressive as incidence of non-performing loans has been quite low.

The size of consumer finance has grown by about eight times since 2002. In sharp contrast to 2002, when it constituted a mere 2.1 percent of the total loan portfolio of the banking system, its share has increased to 11.4 percent in June 2005. The FY05 was particularly significant as consumer financing increased by around 100 percent, which was the highest among all sectors. The personal loans and auto loans accounted for most of the growth in consumer finance with former constituting 45 percent and the later 32 percent of the total consumer loans of Rs206 billion as on June 30, 2005. The sharp increase in personal loans owes mainly to the popularity of special scheme launched by a large bank. Auto loans, which grew by around 318 percent since June 2003, played an important role in the turn around of the automobile industry of the country. Of late, mortgage loans have also started to show a healthy growth pattern. Since 2003, they have grown by around seven times in magnitude and form around 13 percent of total consumer loans as of June 2005 (**Table 1.3**). SBP played an important role in stimulating banks' interest in mortgage financing by providing favorable environment and eliminating regulatory hurdles in growth of the sector.

Table 1.3: Category-wise Break-up of Consumer Finance
(Billion Rupee)

	June 2005		June 2004		June 2003	
	Amount	**Percentage**	**Amount**	**Percentage**	**Amount**	**Percentage**
Credit cards	19.3	9.4	11.2	10.8	6.7	14.9
Auto loans	66.0	32.0	33.1	32.1	15.8	35.0
Consumer Durables	1.6	0.8	1.4	1.4	0.4	0.9
Mortgage	27.2	13.2	8.3	8.0	3.8	8.4
Personal	92.0	44.6	49.2	47.7	18.4	40.8
Total	**206.1**	**100.0**	**103.2**	**100.0**	**45.1**	**100.0**

The low interest rate scenario also played an important role in giving impetus to consumer financing. However, interest rates have started to show an upward drift since the second quarter of the year FY05, which may retard the pace of consumer finance growth besides reducing repayment capacity of the borrowers who availed facilities at floating rates. So far, however, not only the consumer finance has continued to display strong growth but also the infection ratio has remained in check. The ratio of Non Performing Loans (NPLs) to loans for consumer finance sector at 0.9 percent is well below the ratio for conventional financing, which coupled with improved credit appraisal standards provides the optimism about sustainability of consumer finance growth (**Table 1.4**).

Table 1.4: NPLs to Loans for Consumer Finance-June 2005
(Billion Rupee)

	Total Loans	NPLs	NPLs to Loans
Credit cards	19.3	0.3	1.35
Auto loans	66.0	0.5	0.73
Consumer Durables	1.6	0.1	6.13
Mortgage	27.2	0.1	0.32
Personal	92.0	0.9	1.01
Total	**206.1**	**1.9**	**0.90**

1.6 Housing Finance

SBP has been focusing on developing a market based housing finance system in the country through regulatory and promotional initiatives. The system is aimed at maximizing the lending opportunities and financial return for the mortgagee financial institutions, as well as providing sufficient choices to mortgagors to contract the most viable housing loans. During the year the regulatory framework was further simplified and relaxed to catalyze growth and activity in the sector; the major regulatory initiatives during the year include:

- Enhancement of banks' exposure to housing finance from 5 percent to 10 percent of their net advances.
- Elimination of the maximum per party limit of Rs10 million, with discretion to banks to determine the housing finance limit in accordance with their internal credit policy, credit worthiness and loan repayment capacity of the borrowers; the total monthly amortization payments of consumer loans, inclusive of housing loan, however, should not exceed 50 percent of the net disposable income of the borrower.
- Raising the maximum debt-equity ratio for housing loans to 85:15 from 70:30.
- Increasing the maximum loan tenor for housing finance from 15 years to 20 years.
- Encouraging banks/DFIs to float long-term housing bonds of not less than 10 years maturity for prudent Asset Liability Management.
- Relaxation in minimum credit rating of listed Asset Backed Securities from "A" to "A-" to facilitate securitization of mortgage finance through Special Purpose Vehicle.
- Permission to Banks/DFIs to invest or take exposure in un-listed mortgage/construction/developer finance Asset Backed Securities having a minimum credit rating of "A- (or equivalent)"

The strategic focus of SBP to institute a market-based housing finance system has significantly changed the housing finance scenario in the country; the number of banks extending housing finance has increased to *twenty-four* from just *two* banks and their housing finance disbursements jumped to Rs30,524 million from Rs3,559 million during last three years (**Table 1.5**); FY05 witnessed more than threefold increase in mortgage portfolio from Rs8.3 billion at the end of June 2004 to Rs27.2 billion at the end of June 2005. The geographical coverage of housing finance services has extended to a number of cities[11] other than Karachi, Lahore and Islamabad, that will lead to further acceleration in pace of buildup of banks' housing finance portfolio. Further, to extend the outreach to low income population, the banks have started developing housing finance products for individuals with income as low as Rs5,000. This will exponentially expand the banks' housing finance market besides enabling a large number of low income individuals to have their own housing units.

Table 1.5: Housing Finance - Gross Disbursements
(Million Rupee)

	June 2005		June 2004		June 2003	
	Banks	**HBFC**	**Banks**	**HBFC**	**Banks**	**HBFC**
Gross Disbursements	30523.84	35052.99	10168.49	32401.44	3559.2	30337.87

The sector, however, is still facing a number of challenges that need to be resolved to ensure sustenance of growth momentum witnessed during the last couple of years. The major challenges and issues include effective implementation of foreclosure laws, automation of Land Registration Information System, sufficient supply of land by government to check unsustainable rise in land prices, development of framework for establishing Real Estate Investment Trusts (REITs)[12] to attract sufficient foreign and local investment in real estate development, and building human resource and risk management capacity of banks and financial institutions to aggressively but prudently underwrite, monitor and recover the housing finance.

1.7 Strengthening of Credit Information Bureau

Lack of reliable business information and credit history has been among others a major impediment in growth of financing to SMEs, micro enterprises and agriculture. Strengthening of credit information bureau was therefore initiated as an important component of SBP drive to increase outreach of financial services to these important sub-sectors of the economy. Last year SBP Credit Information Bureau (CIB) was made on-line enabling the banks to access credit reports through their own terminals, which considerably reduced the end to end time for obtaining the credit reports from SBP CIB. The reduction/elimination of the minimum credit reporting limit[13] for CIB, also initiated last year to extend its coverage to the small borrowers, is at an advanced stage of development and is expected to be live from second quarter of FY06. This will be a major milestone achieved in broadening the access of financial services to middle and low income population in the country. It will enable the small borrowers to build "*reputational collateral*" and access financial services even in the absence of traditional physical collaterals. It will also strengthen the credit appraisal standards of banks for middle and low income clients allowing them to leverage the reliable and updated client information and their credit histories for building up portfolios in these sub-sectors.

1.8 Private Sector Credit Bureaus

In addition to strengthening the SBP CIB, the central bank is also engaged in assessing the potential and possibility of private credit bureaus in the country. For the purpose, a domestic consultancy firm[14] was hired during the year to conduct a study on "Development of National Credit Information System in Pakistan" under the World Bank Technical Assistance for Banking Sector. The study will enable SBP to (i) assess the possibility and desirability of setting up credit bureaus in the private sector, (ii) specify the parameters under which private sector credit bureaus can be established, to

[11] Multan, Rawalpindi, Faisalabad, Gujranwala, Hyderabad, Quetta, Muzaffarabad, Peshawar, Sialkot etc.
[12] Securities and Exchange Commission of Pakistan has constituted a committee for developing the REITs framework, which has made some headway and is likely to finalize the draft framework by the second quarter of FY06.
[13] Presently all loans exceeding Rs0.500 million are reported to SBP CIB. The successful implementation of the limit elimination project, effective September 2005, will require banks to report all loans irrespective of the amount to CIB.
[14] M/s Sidat Hyder Morshad Associates.

collect and disseminate data with necessary safeguards against misuse of credit information, (iii) lay down the enabling legal framework either by removing the clauses from the existing laws or stipulating a new law, (iv) provide training to the CIB personnel and, (v) specify enhancement to CIB technical platform to provide secure and efficient connectivity with the system users. The study was in the final phase by the completion of this report and would be completed by the first half of 2005.

1.9 Islamic Banking

Islamic Banking Industry worldwide has witnessed a phenomenal growth in the recent years. About 250 Islamic Financial Institutions including Islamic Banking windows of conventional banks are operating world wide, having US$250 billion of assets. Pakistan is no exception to this phenomenon and Islamic banking here too is witnessing unprecedented growth. SBP has been playing a leading role in promotion and development of Islamic Banking in the country. The separate regulatory infrastructure coupled with a full-fledged Islamic Banking Department to focus on all Islamic Banking issues gave the budding industry the necessary impetus to grow and emerge as a banking of preferred choice for the public. The central bank's drive to promote Islamic banking as a parallel system operating at a level playing field with commercial banking is aimed at building a broad based financial system in the country to enable all segments of the population to access financial services and play their due role in economic growth and development.

1.9.1 Shariah Compliance Framework

SBP has adopted a Shariah compliance framework based on international best practices and considering the evolving stage of the Islamic banking industry, which needs some handholding by the policy makers and regulators. The framework consists of (i) a central Shariah Board at SBP that advises SBP on issues referred to it by Islamic Banks; (ii) appointment of a Shariah Adviser in Islamic banks/Islamic Banking Branches for ensuring Shariah compliance in product development, policies and procedures; (iii) periodic internal Shariah review by Islamic Banking Institutions (IBIs), and (iv) Shariah compliance audit of IBIs by SBP as a part of inspection. Further, issuance of license is subject to certification by the Shariah advisor of the applicant bank that the modes, products, procedures and manuals to be used by the bank are in conformity with Shariah.

1.9.2 Shariah Board

The Shariah Board[15] established in SBP in December 2003 to advise it on modes, procedures, laws and regulation for Islamic banking, held three meetings during the year wherein the Essentials and the Model agreements of all major modes of Islamic banking were reviewed and revised after incorporating the comments of stakeholders where necessary. The Shariah Board also made some modifications in the approved Fit and Proper Criteria for Appointment of Shariah Adviser in Islamic banking institutions to make it more objective, broad based and responsive to the market conditions. Further, the board examined industry issues highlighted during the first Shariah Audit of an Islamic Bank conducted during the year and gave some recommendations for improvement in regulatory framework, which would be considered while making Prudential Regulations for IBIs.

1.9.3 Development of In-House Shariah Audit Expertise

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 was outsourced to the same firm to develop Shariah audit skills and provide hands-on training to SBP's inspection staff. The first Shariah audit was completed during the year and the Manual will now be finalized keeping in view the experience gained during the audit and the observations made by the auditors/Shariah Board. The officers and staff posted in Islamic Banking Department has been imparted extensive training in Islamic banking and finance to enhance their understanding and exposure in this fast emerging market. During the year first batch of officials of the State Bank and the IBIs completed a one year

[15] Comprising two Shariah scholars and three experts in the areas of banking, accounting and legal framework.

Post Graduate Diploma in Islamic Finance offered by the Centre for Islamic Economics, affiliated with Dar-ul-Uloom Karachi.

Further, a number of Islamic finance training and awareness building programs/sessions were arranged for the benefit of bankers, representatives of the chambers of commerce and industry, journalists, educational institutions and other stakeholders of Islamic banking and finance. Taking advantage of visits of dignitaries, world renowned scholars and experts in Islamic finance, special sessions were also organized for all the stakeholders. The initiatives have been instrumental in dispelling many conceptual misunderstandings and bringing new players in the emerging sector of Islamic financial industry. The banks and private investors have started looking at Islamic banking as a new viable and attractive market segment with a large customer base.

1.9.4 Network Expansion

The Islamic banking witnessed phenomenal growth during the year as the number of Islamic banking branches increased threefold to 62 with four more conventional banks[16] joining the Islamic Banking bandwagon, and Albaraka Islamic Bank obtaining a full-fledged Islamic bank status. The **Table 1.6** gives network expansion trends since 2003.

Table 1.6: Islamic Banking Players (End – June)

	2003	2004	2005
Number of Islamic Banks (Operating)	1	1	2
Number of branches of Islamic Banks	8	10	32
Number of Conventional banks operating Islamic Banking Branches	0	5	9
Total Number of Standalone Islamic Banking Branches of Conventional Banks	0	10	30

The Bank Islamic Pakistan[17] has also been given a license of a full-fledged Islamic Bank, which is expected to commence operations by December 2005. In-principle approval has been given to two new full-fledged Islamic banks having foreign sponsor directors who will bring in new technology, systems and Islamic banking products and will be instrumental in attracting further domestic and international interest and investment in the sector. The recent trends both in network expansion and new product development signals even faster growth and maturity in the sector in the medium term. The **Table 1.7** gives growth trends in Islamic banking during last 3 years.

Table 1.7: Islamic Banking Trends
(Million Rupee)

Description	June 2003	June 2004	Percent age Growth	June 2005	Percent age Growth
Deposits	6,517	13,158	102%	37,835	188%
Financing & Investments	5,421	13,102	142%	37,171	184%
Total Assets	8,821	18,830	113%	54,017	187%

[16] Soneri Bank Limited, Metropolitan Bank Limited, Habib Bank Limited and Bank Al Habib.
[17] Sponsored by Jehangir Siddiqui and DCD London Groups.

2 Ensuring Soundness of the Financial Sector

2.1 Overview

The overarching financial reform agenda of SBP has already started to produce positive results, and the financial institutions under the regulatory domain of SBP are far more healthy and stable compared with their condition in the pre-reform era. The turn around in the performance of majority of the institutions has not only helped in reducing the systemic risk but has also provided stimulus to overall economic growth. A strong indication of success of the reforms process is the gradual improvement in operating performance and expansion in business activities of the banking system over the last couple of years.

This fiscal year, however, proved to be a landmark for the banking system. The banking system displayed strong earnings performance and recorded unprecedented growth in its balance sheet footing. Total after tax profits, after posting an impressive figure of Rs32.9 billion for the calendar year 2004, have touched Rs22.8 billion in the last half of FY05. The impressive 33 percent growth in loans to private sector played a key role in achieving the more than targeted economic growth of 8.4 percent during the year. Despite the unprecedented acceleration, the quality of loans was robust and incidence of NPLs against fresh loans remained very low. Apart from the strengthened debt repayment capacity of the corporate borrowers because of improvement in their solvency profile, appreciable strengthening of credit appraisal and monitoring standards and strict vigilance by SBP also helped a great deal.

Despite considerable progress towards its goal of fostering a sound and dynamic financial system, a number of areas still demanded further attention. In this respect, SBP kept its focus on consolidating the reforms introduced in preceding years as well as took a number of new initiatives to further strengthen the banking system stability and to lift the regulatory and supervisory framework to the international best practices. The initiatives included raising the Minimum Capital Requirements (MCR) to Rs2 billion from December 31, 2005, announcement of road map for Basel II implementation, restructuring of problem banks, introduction of capital charge for market risk, and issuance of guidelines on country risk management, internal controls & Information Technology (IT) security. The extensive focus on enhancing the supervisory capacity in recent years has helped SBP to achieve fully/largely compliant status for 28 of the 30 Basel Core Principles for effective banking supervision. The compliance with remaining 2 principles on consolidated supervision is also likely to be achieved during FY06.

The upshot of the reform process has been the development of a highly competitive environment. The private sector, now, dominates the financial scene of the country. Increased competition has encouraged banks to innovate and use new financial instruments to facilitate transactions and adjust their risk profile. The long-term trend for financial institutions entails mergers and consolidation, realignment of business objectives and diversification of products offered, as banks strive to develop a market niche. The changing risk profile will inevitably elicit an appropriate response from SBP, which, because of greater transparency and disclosure, has also exposed itself to accountability. This intertwined relationship is expected to reinforce the individual actions leading to a more safe and sound financial system. The protection of depositors' interest and convenience to customers will remain the main challenges for the SBP to tackle.

2.2 Initiatives to Strengthen the Banking System Stability

2.2.1 Enhancing Minimum Capital Requirement

Given the vulnerability of small banks to unexpected shocks, it is important to have banks, which are strong and resilient to provide the essential bulwark against financial instability. The advent of Basel II and sweeping changes in the field of risk management has made the task of financial institutions even more challenging to develop necessary skills and technology, and only the strong and well-capitalized banks are in a better position to adapt to changing circumstances. Realizing the importance of strong banks in the emerging financial scene, SBP has embarked upon the course of gradual increase in the MCR for banks.

The Banks will be raising their MCR to Rs2 billion by end December 2005. The enhanced MCR has already catalyzed mergers and consolidation in the system and there is an expectation of further progress on this front as a number of institutions are deficient in meeting the MCR of Rs2 billion. Further to bring the MCR to international standards, SBP has plans[18] to gradually increasing the MCR to US$100 million by end 2009. Presently there are four banks with US$100 million capital - net of losses. This step will lead to more mergers and consolidations and emergence of fewer but stronger institutions, and would have far reaching consequences in context of financial stability.

2.2.2 Capital Charge for Market Risk

The Basel Committee for Banking Supervision amended the capital accord, the Basel-I, in 1996 and introduced capital charge for market risk for the first time. SBP while adopting the internationally accepted capital standards in 1997 had imposed capital requirement for credit risk only and kept the capital charge against market risk in abeyance as the banking activities at that time were not much diversified and banks had insignificant exposure to market risk. However since the recent past there have been rapid developments in the country's financial market and banks have started venturing into fields, which have exposed them to market risk. The pace of build-up of such exposure is expected to accelerate further in the medium term, requiring necessary alignment of the regulatory capital with the market dynamics. Accordingly SBP during the year imposed capital charge for market risk, in addition to capital requirement on credit risk to align the regulatory capital with the internationally accepted standards.

The revised capital adequacy standards require banks to hold capital against interest rate, and equity exposures in their trading books, whereas the capital requirement against foreign exchange risk is applicable through banks' balance sheet. The additional capital a bank has to set aside as a result of this new capital charge depends on the size of its trading portfolio. So far such portfolio forms only a small fraction and hence does not impact the respective Capital Adequacy Ratio (CAR) of banks significantly. However, with the growing exposure in these activities, CAR of the banking system would definitely be influenced in a more pronounced way.

[18] SBP Strategic Plan 2005-10.

2.2.3 Basel II Implementation

The New Capital Adequacy framework, the Basel II, finalized in June 2004 offers a comprehensive and more risk sensitive capital allocation methodology for credit and operational risks[19]. It require banks to have robust risk management framework in place to identify, measure and mitigate all material risks and hold the requisite risk based capital. It provides an opportunity to banks to improve their business strategies and risk management systems to not only effectively manage the risks but also optimally leveraging the capital base for earning enhanced returns for the shareholders. The accord is also aimed at bringing further transparency and discipline in the banking industry as it prescribes additional disclosure requirements compared to the previous accord.

SBP, after a long and comprehensive consultative process, has chalked out a road map for the implementation of Basel-II in Pakistan. The road map is based on a) feed back obtained from banks, b) assessment of financial impact derived from quantitative Impact Study carried out by Banking Supervision Department and c) the cross country analysis regarding implementation of Basel II especially in developing economies. It requires the banks to adopt standardized approach for credit risk and basic indicators/standardized approach for operational risk from January 1, 2008 and Internal Ratings Based (IRB) approach from January 1, 2010. The banks may adopt IRB approach for capital requirement against credit risk before January 1, 2010 subject to prior SBP approval. To ensure smooth transition to Basel II, the road map requires banks to have a parallel run for one and half years for Standardized approach and two years for IRB approach starting from July 1, 2006 and January 1, 2008 respectively. SBP will review and continuously monitor the banks' internal plans for Basel II implementation during the pre-implementation period as well as during the parallel run. Detailed instructions for computation of the requisite minimum capital using different approaches, and for application of the supervisory review process to measure other risk not covered under pillar I, will also be issued by December 2005.

From supervisory perspective, the most challenging area of Basel II is the supervisory review process, ie Pillar II. Although as a supervisor it will give SBP more authority yet it also poses more challenges. The new accord requires the supervisory authority to review the risk assessment models and processes at banks and validate their capacity to determine the requisite risk capital for a given risk profile of banks/financial institutions. This involves a matter of subjectivity and necessitates a structured approach as well as substantial improvement in SBP capacity and skill level in risk management systems, models and review thereof. Further the banks' level of expertise and understanding of the new accord is also far below the required level, which exposes banks to an even more challenging task. They will not only have to improve their human resources' skills level but also invest in technology and systems. SBP considering the critical importance of its own as well as banks' capacity building in implementation of the accord has initiated a series of training programs and workshops on risk management and Basel II. Banks, responding to SBP initiatives, have appointed their coordinators to lead and coordinate all activities relating to Basel II implementation and have also selected their officers for such training programs. A number of workshops and training programs were held during the year and a number of programs and workshops have been planned for the current year.

[19] The existing capital requirement for Market risk, prescribed in Basel I, has been kept intact.

2.2.4 Disclosure Requirements for Banks and DFIs

The banking system in Pakistan has undergone a major transformation from a highly regulated to a more liberalized and competitive system over a decade or so. This amply increases the significance of appropriate and adequate disclosure by banks and DFIs about their key activities, financial condition and business performance, to fully entrench the competitive spirit among the market players as well as to protect the interest of customers of these institutions. SBP has already made significant progress in aligning the domestic disclosure standards, with international practices and efforts in this regard have been unceasing. Effective from December 31, 2005, it has been made mandatory for banks and DFIs to include a comprehensive paragraph under the heading "Risk Management Framework" in the Directors' Report in their Annual Audited Accounts. In crux, the paragraph will highlight the status of compliance with the SBP's guidelines on risk management and the on-going efforts and plans to removing any deficiencies in this respect.

In addition to the above, all banks and DFIs are also required to include a Statement on Internal Controls in their annual accounts. This statement will dwell at length on management's responsibilities for establishing and maintaining adequate internal controls and procedures, its evaluation of the effectiveness of bank's internal controls and their endorsement by the Board of Directors, and finally the attestation to, and report on the board's endorsement by statutory auditors. The growing disclosure is expected to strengthen the competitive spirit among the market participants and enhance their efficiencies. This ultimately will translate into a more vibrant and growing financial system for the benefit of the whole economy.

2.2.5 Resolution of Problem Banks

The banking system in Pakistan has undergone a major restructuring and rebuilding process during last six years and the industry has transitioned from weak, under capitalized and predominantly public sector banks with huge stocks of NPLs to robust, adequately capitalized and largely private sector owned competitive sector. The dominating market share of the distressed banks[20] in the overall banking system, which was posing a major systemic risk reduced from 71 percent in 1998 to 11 percent in 2004. SBP during the year successfully completed reconstruction of a systemically important large bank in the country and handed over its management to a renowned private sector group, which injected Rs14.2 billion in the bank's capital to assume the control. There has been marked improvement in the performance, outlook and key financial indicators of the bank since the change of management in August 2004.

In addition to specific measures taken for resolution of the distressed banks, a spate of policy measures has been initiated to establish sufficient safeguards to minimize the emergence of problem banks. Such measures include but not limited to the improvement in Corporate Governance practices ie introduction of fit and proper test for appointment of board of directors, chief executives and senior management of the banks/DFIs, defining the responsibilities of Board of Directors, enhancing the disclosure requirements, issuance of risk management guidelines and strengthening of SBP supervisory capacity etc. The Institutional Risk Assessment Framework (IRAF) introduced last year has started functioning which assigns the overall risk score/rating to individual banks on the basis of four inputs ie (a) Compliance with Standards, Codes and Guidelines (b) Supervisory and Regulatory Findings (c) Financial Performance and Conditions and (d) Market Information and Intelligence. Further, to avoid any sudden crisis situation, which may cause a systemic risk, SBP has also devised a strategy to increase its interaction with the banks' and DFIs' Board Members and Senior Management. It now holds regular meetings with the Board of Directors and senior management, as well as the External Auditors, of the banks and DFIs. Such meetings are held more frequently with banks and DFIs having unsatisfactory ratings. During the year a number of meetings were held with the boards of directors and senior management of banks and DFIs. The initiatives have already

[20] 4 and 5 rated banks under CAMELS-S framework.

started translating into substantial improvement in compliance culture, governance, systems & controls and capacity of banks, and will go a long way in minimizing the likelihood of emergence of new problem banks.

2.2.6 Initiatives to Reduce Non Performing Loans

The huge stock of NPLs, forming more than 25 percent of total loans of the banking industry, was one of the major challenges faced by the banking industry at the time of initiation of financial sector reforms. The colossal level of NPLs had adversely hampered the financial health of banks/DFIs which ultimately affected their profitability and created hurdles in the process of restructuring/ privatization. The reforms, therefore, prioritized recovery of NPLs and clean up of books of Government owned banks/DFIs to make them ready for privatization.

A number of initiatives including strengthening of recovery ordinance, establishment of Banking Courts and improving the policy and regulatory environment etc were taken to address the issue. A detailed incentive scheme was also introduced in 1997 to provide a one-time opportunity to the defaulters to voluntarily settle their pending obligations under which a total of 15,360 cases involving an outstanding amount of Rs9.406 billion were settled with a cash recovery of Rs4.165 billion. To further expedite the process, following initiatives were undertaken in 2000:

- Committee for Revival of Sick Industrial Units (CRSIU) was established through notification of Federal Government in May 2000 for the revival of the sick industrial units through rescheduling/ restructuring.
- Corporate and Industrial Restructuring Corporation (CIRC) was established by the Federal Government in September 2000 with a mandate to acquire and subsequently auction the non-performing assets to be referred to it by the nationalized banks and public sector financial institutions.
- A National Accountability Bureau (NAB) Cell was established at SBP to expeditiously process the cases of willful defaulters referred by the financial institutions to SBP under provisions of NAB Ordinance, 2000.

The measures had produced tangible results and NPLs of substantial amount were settled/rescheduled/ restructured by CRSIU or transferred/referred to CIRC/NAB. However, a large number of NPLs, which were in default since long and had no or limited chances of recovery, were still appearing in the books of banks/DFIs and the banks' management were reluctant to clean their balance sheets from such non-performing and fully provided for loans. In order to facilitate the banks/DFIs to deal with these loans, SBP designed *a flexible and liberal incentive scheme in October 2002* in consultation with the banks/DFIs and Federation of Pakistan Chambers of Commerce and Industry (FPCCI), to help banks/DFIs to clean up their balance sheets, provide an opportunity to the borrowers to settle their long outstanding liabilities on flexible terms and where possible help in revival of their businesses / sick units. The scheme required banks/DFIs to develop their own indigenous schemes with the approval of their respective Board of Directors keeping in view the SBP guidelines. The key features of the scheme have been given overleaf in **Box 2.1**.

The results of the scheme have been very encouraging; the banks/DFIs settled over 50,000 cases involving outstanding amount of Rs74.88 billion and made cash recovery of over Rs11.61 billion. An additional recovery of more than Rs9 billion is expected by mid 2007 as borrowers, who have settled their cases, have been allowed a maximum period of 3 years to liquidate the entire settled amount. This also includes 885 cases settled by SBP committee, comprising a retired senior banker as its chairmanship and two representatives each from Pakistan Bankers Association and FPCCI, constituted for resolution of disputes under the scheme.

The Scheme has largely benefited the small borrowers having outstanding amount up to Rs0.5 million, who accounted for 95 percent of total cases settled under the Scheme (**Table 2.1**). The Scheme has also helped 328 sick industrial units to revive and thus generated or protected the livelihood of over 17,000 employees. Further, most of these loans were classified under 'loss' and had very little probability of being ever serviced. These loans have been on the balance sheets of the banks for a long period of time and were fully provided for. The settlements under the scheme thus enabled the banks to clean their balance sheets without having any adverse impact on their financial condition and profitability. Though the scheme has since expired; the banks may develop their own policies with the approval of their boards to settle the NPLs on ongoing basis. SBP will however issue detailed guidelines on writing off NPLs during FY06 to set broad parameters for the banks' write off policies to ensure transparency and consistency.

Table 2.1: Impact of SBP Scheme for Writing off Irrecoverable Loans

(Million Rupee)

Total Amount Outstanding	Cash Recovery Made	Cash Recovery until 2007	Total Amount Written off	Number of Beneficiaries	
				Below Rs0.5 Million	Above Rs0.5 Million
74,879.880	11,611.367	21,380.661*	53,499.219	47,635	2,393

* The amount is inclusive of Cash Recovery Rs11,611.367 million already made

Box 2.1: SBP Scheme for Writing Off Irrecoverable Loans

SBP designed a flexible and liberal incentive scheme for writing off irrecoverable loans in October 2002. The following were the salient features of the scheme:

- Only those NPLs were eligible for settlement under the Scheme, which were classified as "Loss" for 3 years or more. Court and decreed cases fulfilling above criteria were also eligible for settlement, however, in such cases decretal amount plus mark-up allowed by the court, was considered as outstanding amount for the purpose of the Scheme. The cases transferred to CIRC or referred to NAB by Governor SBP under section 31-D of NAB Ordinance were not eligible for settlement under the Scheme.
- The NPLs for the purpose of the Scheme were divided into 3 categories viz. A-Category (NPLs having outstanding amount up to Rs0.5 million); B-Category (NPLs involving outstanding amount of more than Rs0.5 million and up to Rs2.5 million); and C- Category (NPLs having outstanding amount more than Rs2.5 million).
- For settlement of the A-category cases the banks'/ DFIs' Board of Directors could decide the settlement amount. However, for the settlement of 'B' and 'C' category cases the banks/DFIs were required to recover maximum possible amount on the basis of outstanding amount vis-à-vis Forced Sale Value of available securities.
- Before allowing write-off, all liquid assets including FDRs, Government Securities, Share Certificates etc held under lien and pledged goods were required to be realized and sale proceeds thereof appropriated towards the reduction of outstanding liability of the borrower.
- At least 10 percent cash down payment of settled amount at the time of signing of agreement and remaining amount within a maximum period of 3 years at least on quarterly basis. No mark-up is applicable on the settlement amount to be repaid within 3 years.
- The cases settled under SBP Scheme are also eligible for fresh financing subject to viability of project/ business, risk profile of the borrower, compliance with rules and regulations etc.
- In order to encourage the borrowers to come forward and repay entire amount in lump sum, SBP allowed the banks/ DFIs to provide some discount on the basis of average lending rates.
- Federal Government announced exemption of income tax on the amount written off/ waived under Banking Policy Department Circular No 29 of 2002.
- The scheme was a one-time opportunity initially for a period of six months, however, on representation of trade bodies and as well as banks/ DFIs, the Scheme was extended up to June 30, 2003 except ZTBL for which, final expiry date was December 31, 2003.
- In order to resolve the disputes between the borrowers and banks/ DFIs under the Scheme, SBP constituted an independent committee under the chairmanship of retired senior banker, with representation from FPCCI and Pakistan Banks Association with two members each. The decisions of the Committee were binding on the borrowers as well as on banks/DFIs. After completing the task Committee has dissolved on January 31, 2005.

2.2.7 Deposit Insurance

Privatisation of most of the public sector financial institutions, with more than 80 percent of financial assets and deposits now under private management, has necessitated an appropriate depositors' protection mechanism as the government guarantee for the depositors of the privatised banks ceases to exist. SBP, being the regulatory body and custodian of depositors in the country, accordingly took the initiative to develop the Deposit Insurance Scheme (DIS) in the country. A working group was constituted to conduct a study for setting up an explicit DIS in line with the international best practices. The working Group based on review of DIS of nine countries where it is functioning successfully, and keeping in view the socio-economic and geopolitical conditions prevailing in the country, had finalized recommendations for the DIS for Pakistan's financial system covering the level of coverage, contribution mechanism by banks, institutional type, and legal frameworks for introduction of the DIS. The recommendations were discussed and shared with the stakeholders including Pakistan Banks Association during the year and improvements where necessary were made.

The institutional structure for the proposed scheme has also been finalized after extensive consultation with the stakeholders. The DIS will be introduced by establishing a wholly owned subsidiary of SBP to be housed within SBP, which provides the most cost effective, administratively convenient and organizationally distinct solution. It will also avoid overlapping and duality of supervisory functions and will be able to leverage SBP supervisory resources and systems to assess the financial condition of individual banks to assign premium rates to them.

The scheme after approval of Central Board of SBP has been forwarded to the government for approval, and necessary initial funding. An amendment in SBP act has also been proposed to allow SBP to establish subsidiary for providing coverage to the depositors of banking industry in the country.

2.3 Initiatives to Strengthen the Supervisory System

A well equipped supervisory system having capacity to ensure discipline, good governance and transparency in the financial system and also to assess the risks faced by the banks and financial institutions, is a pre-requisite for development of a market based financial system. The strengthening of supervisory system has been the major focus of restructuring exercise initiated six years ago. A number of initiatives in this respect have been taken since then; the following paragraphs briefly discuss the initiatives taken during the year.

2.3.1 Core Principles of Banking Supervision

The Core Principles for Effective Banking Supervision have become the most important global standard for prudential regulation and supervision. The country's compliance with these principles is considered an important benchmark for the financial sector assessment, the assessment of supervisory capacity of the regulatory body and technical assistance provided by multilateral agencies.

A joint mission of International Monetary Fund (IMF) and World Bank carried out assessment of financial system stability of the country in 2004. The mission in its final assessment report appreciated major financial sector reforms and expressed satisfaction on the impact of the reforms, which have resulted in sounder and more efficient financial system. The mission assessed SBP as compliant /largely compliant with 26 principles and, materially non-compliant to the remaining four. Subsequent to the Mission's report, capital charge for market risk was introduced and guidelines on country risk were issued, which made us fully compliant with two more principles. The two principles in which SBP is still materially non-compliant relate to consolidated supervision which requires some amendments in Banking Companies Ordinance (BCO) 1962. While the amendments in BCO are being finalized for forwarding to the Government for incorporation in the law, the coordination with Securities and Exchange Commission of Pakistan (SECP) has been enhanced and the process of signing Memorandum of Understandings with the supervisory authorities of other countries to facilitate Global Consolidated Supervision has been initiated to comply with the core principles on consolidated supervision.

2.3.2 Stress Testing

The sophisticated and state-of-the art tools of analyses have assumed significant importance in the present day financial industry to measure and manage various risks. Stress testing is one of the most widely used techniques to determine the likely situations of financial distress. This enables the market players to think up an appropriate response to secure themselves against the possible deterioration in their financial worth. SBP had started conducting in-house stress testing exercise from September 2003, initially focusing on the five large banks. The IMF-World Bank mission on Financial Sector Assessment Program (FSAP) also carried out a stress test for the twelve largest Pakistani banks as well as the three groups of public sector commercial banks, local private banks, and foreign banks based on the same data ie September 2003. A similar stress testing exercise was undertaken during the year using the operating and financial data as of December 31, 2004[21]. This exercise was patterned on the methodology followed in the FSAP, using the macro prudential approach with a focus on twelve largest banks as well as the three major groups of banks. However, the scope was enlarged to discuss some additional risk scenarios for rational decision making on the basis of the results. The possible risk scenarios included deterioration in the quality of credit portfolio, exchange rate, interest rate, equity price movements and liquidity withdrawals. So far, the banking system of Pakistan is found to be fairly resilient to the historical and hypothetical shocks of both the univariate and multivariate types.

While the stress testing team at SBP has made major strides in increasing its skill levels, the journey to perfect the stress-testing model continues unhindered. One of the major obstacles remains the insufficient number of observations, which prevents establishment of inter-relationships among the various variables to develop a reliable regression equation. In order to address the various issues pertaining to the construction of fully developed stress test model, a roadmap has been laid down to gradually upgrade and implement the stress test as a part of continuous exercise to monitor the various risks facing the banking system.

2.3.3 Risk Assessment Model

In order to strengthen off-site monitoring and assessment of risk inherent in banks, a project with the assistance of Financial Sector Reform and Strengthening Initiative is underway. The project objectives are development of a risk assessment and stress-testing model that would enable supervisory departments at SBP to quantify major risks in banks and also help assess their position under various stress scenarios. A reputed international consultancy firm has been hired to provide expertise to carryout the project. The target date for the completion of the project is June 30, 2006. The successful completion of this project will give a boost to supervisory capacity of the central bank enabling it to ensure effective supervisory oversight of banks and financial institutions in the fast changing risk management dynamics and technological sophistications.

[21] The results of the stress test were disseminated in a separate chapter in the Banking System Review of 2004.

2.3.4 Country Risk Guidelines

The growing integration of global financial markets in recent times has led to substantial cross border flows of capital, simultaneously giving rise to significant overseas exposure of financial institutions. Though the share of Pakistani banks in the global market has remained trivial, there was still a need to develop appropriate guidelines on country risk for banks to strengthen their risk management systems to cover their overseas exposures. SBP accordingly issued comprehensive guidelines on country risk management during the year, which has not only filled the vital gap in the regulatory and supervisory framework and enabled SBP to achieve compliance with Basel Core Principle on country risk, but has also provided a viable course for banks to expand their operations across borders to explore more profitable business opportunities. The banks/DFIs having cross border exposures, both on and off balance sheets, are now required to follow the guidelines and put in place their respective Country risk Management Policies consistent with the level of their cross border exposure and their country risk appetite. The guidelines provide flexibility to the banks/DFIs to adapt them in line with the size and complexity of their cross border business. They require the banks/DFIs to establish exposure limits depending upon their risk appetite, put in place systems to assess the country risk and set out a comprehensive Management Information System along with internal control and audit system for effective and continuous monitoring and reporting of their country risk exposures.

2.3.5 Internal Controls Guidelines

Strengthening of internal control systems in banks and financial institutions has been the key focus of SBP supervisory initiatives since the initiation of financial sector reforms and shifting to risk based supervision. Regular inspections by SBP teams assess the effectiveness of systems and controls of banks and DFIs, and any deviation from the standards reflect on their ultimate ratings. The banks have made major strides in improving their internal control systems in recent years, which are visible in significant improvement in their performance and substantial decline in cases of frauds and forgeries. To further strengthen the internal controls systems, SBP during the year issued *Guidelines on Internal Controls*, which prescribed minimum standards for the banks/DFIs' internal control systems. The guidelines require banks/DFIs to ensure that all their organization members should know their roles and responsibilities and participate in institution wide understanding and implementation of internal control systems. The banks/DFIs shall ensure full compliance with the Guidelines by December 31, 2005 and shall disclose their external auditors' opinion on the quality of their control systems in their annual audited accounts with effect from December 31, 2005.

2.3.6 Monitoring of Fraud and Forgery Incidents

The banking business is built on fiduciary responsibility with deposits constituting 90 to 95 percent of the assets base and providing necessary sustenance to the operations. Safeguarding the interests of depositors is therefore, the primary responsibility of SBP as the regulator of the financial sector. The initiatives to strengthen the control systems, the governance structures etc are aimed at enhancing banks' capacity to minimize potential losses due to operational lapses and frauds and forgeries. In view of the importance of frauds prevention strategy in overall operational risk framework, SBP during the year revised reporting requirement for banks/DFIs on frauds/forgeries/dacoities cases to compile detailed information on all attempted and actual frauds/forgeries/dacoities. This will not only enable SBP to remain apprised about such incidents in banks/DFIs but also enable it to augment its supervisory techniques to review and monitor the control deficiencies and follow-up actions etc during onsite examinations. The information will also be used to develop a database of frauds, forgeries, and dacoities events, which will be used for measuring operational risk and determining capital requirements there-against.

2.3.7 Business Continuity Planning Guidelines

Business Continuity Planning (BCP)[22] has gained critical importance in the recent years requiring the organizations to have in place contingency and business continuity plans and strategies with specific responsibilities, for resumption of critical business functions in case of disasters and severe disruption of functions. Keeping in view the significance of the subject, and to help strengthen overall resilience of the financial system, SBP during the year issued the BCP guidelines requiring the banks/DFIs to incorporate BCP in their regular business operations. The guidelines discuss the key components of BCP which include Clear-cut policy and adequate budget; key persons' detailed description of roles/responsibilities; emergency plan for accessibility; succession plans for critical staff and senior management; business impact analysis; detailed program for the development, implementation, and maintenance of BCP; program for training and awareness of staff; coordination with external parties and maintenance contracts / service level agreements, and require banks/DFIs to develop their BCPs keeping in view their size, scale and complexity of businesses.

The guidelines also emphasize testing and validation of BCP on regular intervals and require the banks/DFIs to make it an integral part of the plan. They also require banks/DFIs to keep themselves abreast of the best international practices and revise their BCP as and when circumstances warrant. SBP inspection teams will also monitor the status and adequacy of BCP during regular onsite examination of banks/DFIs.

2.3.8 Information Technology Security Guidelines

Given the heavy reliance of the banking industry on information systems, the importance of ensuring security of information systems and technology has also grown manifold. Security lapses in this respect may significantly undermine the smooth functioning of banks. To address this sensitive issue, during the year, SBP issued guidelines for banks and DFIs for establishing an effective institution-wide IT security framework to protect their financial and technical assets; to lessen the likelihood of internal or external attacks on IT resources and to limit the potential damages due to inadvertent or malicious incidents.

The guidelines provide guidance on areas including IT security concept, risk management, IT security policy and plan development, IT security areas, IT security team, awareness and training, incident management, contingency and disaster recovery planning and information system audit and certification. The banks/DFIs have been required to have a well functioning and reliable IT Security System, which should include policies on all key areas as highlighted in the guidelines. The banks/DFIs have also been encouraged to engage IT consultants to prepare/assist in preparing IT security plans in case of absence of adequate in-house expertise.

[22] BCP refers to an organization's plan and strategy to resume critical function(s) within a predetermined time after a disaster or disruption. BCP may be a part of a larger organizational effort to reduce operational risk associated with lapses in information security controls, and thus has a number of overlaps with the practice of risk management.

2.3.9 Data Warehouse

The Data Warehouse Project initiated in 2003 is at a very advance stage and a number of its modules would be operational by December 2005. The project is aimed at improving the data quality, elimination of redundancies in reporting requirements thus lessening the burden on banks, ensuring consistency in data series and promoting data sharing among the users. The banks and financial institutions will be submitting the data on-line to the data warehouse, from where it will be accessed, used and manipulated by different users within SBP. Once operational, the data warehouse will facilitate swift and quality decision-making by providing fast access to various users. These along with numerous other benefits will help promote the broader objective of financial soundness and stability.

2.3.10 Reporting Chart of Accounts

The Reporting Chart of Accounts (RCOA) is one of the major components of the Data Warehouse Project. It will be a middleware between the reporting institution's information system and the reporting requirement of SBP. The RCOA initiated and completed during the year is aimed at introducing uniformity in data reporting to SBP and provides a comprehensive coding system, detailed composition of each variable along with precise definition and reporting instructions.

2.3.11 Financial Derivatives Business Regulations

Pakistani banks have recently started using derivatives products after SBP allowed the banks to undertake derivatives business with their customers, only after getting specific approval from SBP. The first formal derivatives transaction was done as early as 2003. Considering the high degree of risks in derivatives and its evolving stage in the country, a cautious approach to gradually ease regulatory requirements commensurate with market conditions has been adopted and initially the major focus remained either on market-making or on hedging some exposures.

The Financial Derivatives Business Regulations (FDBR) were issued during the year to give an enabling regulatory framework for development of the derivatives business and remove the condition of specific SBP approval for each and every derivatives transaction. The regulations set out the regulatory framework for the Over the Counter (OTC) financial derivative transactions and define the eligibility criteria and procedure for banks/DFIs/Non Bank Finance Companies (NBFCs) to become Authorized Derivatives Dealer (ADD) or Non Market Maker Financial Institution (NMI), and prescribe minimum operational, dealing and risk management standards, reporting and disclosure requirements. The regulations also specify the derivatives transactions, which the financial institutions can undertake including Foreign Currency Options, Forward Rate Agreements, and Interest Rate Swaps, along with permissible currency and tenor benchmarks. The financial institutions desiring to enter into derivative transactions, not covered under the regulations, will however obtain specific prior approval from SBP. The scope of the FDBRs is broad and they cover NBFCs[23] also. All the financial institutions including NBFCs interested in undertaking derivative business shall obtain SBP approval to operate as ADD or NMI and be subject to its supervision and scrutiny. By June 30, 2005 two foreign banks have been granted the status of ADD under these regulations.

[23] NBFCs for all other purposes are under the regulatory and supervisory ambit of SECP.

2.3.12 Anti Money Laundering

Pakistan is an active member of Asia Pacific Group on Anti-Money Laundering. It participates in its programs and meetings for implementation of Anti Money Laundering (AML) regime in the country and extends cooperation to various assessment missions and committees that visit the country for taking stock of the legal/regulatory regime and enforcement mechanism. SBP has taken a number of initiatives to prevent use of banking channels for money laundering. The draft Anti Money Laundering Law, finalized in consultation with stakeholders, has since been approved by the Cabinet and currently is under consideration in Ministry of Law, Justice and Human Rights.

SBP also holds awareness and capacity building programs, workshops and seminars to sensitize the banks' management and staff about the importance of AML initiatives and their direct and indirect benefits to the economy as well as the banking industry. It organized an international seminar on AML in March 2005 to create greater awareness about AML framework and regulatory and supervisory initiatives as well as approaches adopted elsewhere in the world to check money laundering and terrorist financing. The seminar proved a great success to create awareness and take stock of any difficulties at implantation stage of the requirements. A brief on the seminar has been given in **Box 2.2**.

Box 2.2: Seminar on Anti Money Laundering

SBP organized a two day International Seminar on 29-30 March 2005, at Islamabad, to create awareness and educate the bankers about the risks and issues facing the financial sector in the context of money laundering and terrorist financing. The Seminar covered various key issues and challenges faced by the sector and discussed course of action to address the issues. The seminar was attended by professionals of international repute and important stakeholders in Pakistan including Chief Executive Officers and Compliance Officers of banks in the country. The banks and other financial institutions highlighted their views in implementation of AML requirements. On the whole the event has been great success in that its objective was to create awareness and take stock of any difficulties at implantation stage of the requirements. The seminar concluded with the the following resolve:

- Banks will improve their Know Your Customer systems and procedures. Equally important is to know your business and product since every product has its peculiar features which need to be analyzed with respect to risks inherent in it.
- Compliance Officers will have to be more objective and responsible in discharge of their duties. Compliance Officers not only take care of issues related to AML but broader areas of compliance with laws and regulations. They need support from other segments of the institution in order to carry out their responsibilities.
- Banks should pay attention to unusual pattern of transactions and report their suspicions to authorities if any transaction is not justifiable as per business norms. This is an important requirement for financial institutions which goes a long way in protecting against legal risk.

3 Maintaining Price Stability with Growth

3.1 Overview

As the accommodative monetary policy stance of SBP, pursued over the last couple of years, culminated in strong economic growth during FY05, the inflationary pressures also started to mount. Initially, the supply-side factors played key role in igniting inflationary pressures; the role of swift expansion in credit also started to become visible during FY05. This inevitably triggered concerted response from the government and SBP. The government's decision to allow the import of essential items to improve the supply conditions combined with SBP's efforts to tighten monetary conditions have succeeded in restraining the fast accelerating inflation.

The focus of SBP's policy measures remained on striking a balance between containing inflationary pressures and sustaining the growth momentum. The policy in the early period of the fiscal year was therefore, to allow interest rates to rise gradually. The slow increase in interest rates however did not dampen the borrowers' appetite for bank funds as business opportunities grew manifold on the back of growing demand for their products as well as their anticipation for greater increases in interest rates in subsequent months. The availability of substantial liquidity in the system also facilitated the unhindered growth in credit to various sectors of the economy. The varied nature of these factors further reinforced the inflationary pressures initially created by shortfall in supplies and rising fuel costs.

This forced SBP to adopt a more aggressive monetary policy posture in the last quarter of the year and raise the discount rate by 150 basis points (bps) to 9 percent, giving a strong signal to the market of its future intent. Further, to keep the overall liquidity of the system at moderate levels, frequency of Open Market Operations (OMOs) was increased and the repo tenors were made flexible. Despite the unrelenting measures to control inflation, ever rising oil prices, capacity constraints and impact of natural calamities may lead to the persistence of inflation at the current level. This makes the central bank's task even more challenging and necessitates effective monetary and exchange rate management to ensure price stability and sustainable economic growth.

3.2 Monetary Policy Statement

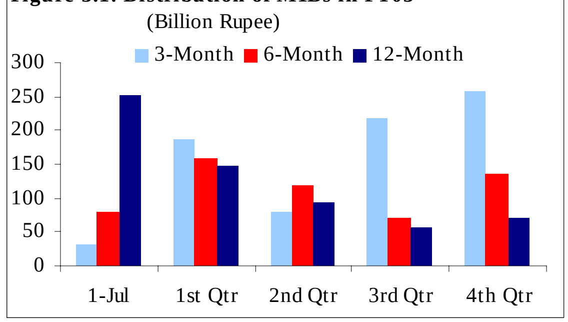
The biannual issuance of Monetary Policy Statement (MPS) since FY03 is one of the most significant steps to make monetary policy formulation and implementation process more objective, predictable and transparent. The statement makes a thorough assessment of major economic developments and gives SBP monetary policy stance during the next six months. In its first MPS for FY05 (July - December 2004), SBP reiterated its commitment to price stability and indicated a proactive and more vigilant policy stance to major economic developments particularly worsening inflation outlook. The MPS for second half of FY05 signaled a more aggressive approach to rein in mounting inflationary expectations.

3.3 Conduct of Monetary and Credit Policy

The gradual tightening of monetary policy, started in the last quarter of FY04, continued in most part of the FY05 to respond to rising inflationary trends while maintaining the growth momentum, achieved through concerted and coordinated efforts of fiscal and monetary authorities. The inflationary tendencies, which initially emanated solely from supply shortages of key food items, gained further strength from rising house rent index on the back of rising property prices & construction cost and later from rising oil prices. By the close of third quarter, the inflationary pressures reached ominous levels requiring more aggressive and immediate monetary and fiscal responses. Thus, SBP raised the discount rate by 150 bps to 9 percent, thereby setting the stage for high yields on various government papers and their inevitable impact on the banks' lending and deposit rates. Accordingly the pace of interest rate hike picked up and within roughly three months, the yields on 3-month, 6-month, and 1-year Market Treasury Bills (MTBs) increased rapidly by 230 to 250 bps compared to the rise of 326-370 bps in nine months prior to the upward revision of the discount rate. Similarly, the weighted average lending rates of the banking industry rose by 261 bps to 7.66 percent during FY05.

The distribution profile of MTBs (**Figure 3.1**), which was skewed heavily towards 12-months bills in July 2004 tiled in favor of 3-months MTBs by the close of FY05. That reflects market expectations for further hikes in interest rates. However, SBP will be keenly observing the inflation trends, as disclosed in its MPS for July-December 2005, and the pace of tightening will largely depend on the inflation behavior and its attributes.

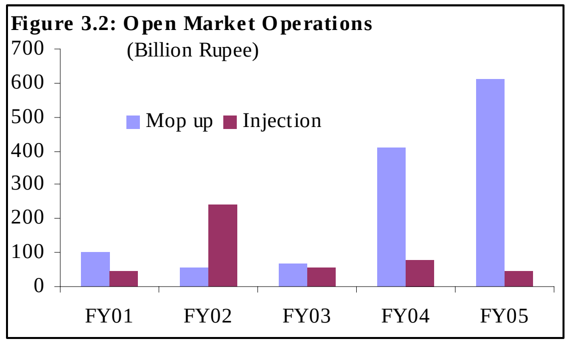
Figure 3.1: Distribution of MTBs in FY05



3.3.1 Open Market Operations

The OMOs counter remained very active during the year, largely to mop up excess liquidity from the market in line with the monetary tightening policy. During FY05, SBP mopped up Rs611.10 billion and injected Rs44.20 billion (mainly during Eid seasons) as compared to mop up of Rs410.70 billion and injection of Rs76.70 billion in the previous year (**Figure 3.2**).

Figure 3.2: Open Market Operations



To make OMO's more effective, flexible tenor OMOs ranging from Overnight to 6-months were introduced that enabled SBP to effectively enforce its monetary policy stance and to keep overnight interest rates at the desired levels in line with its monetary policy stance.

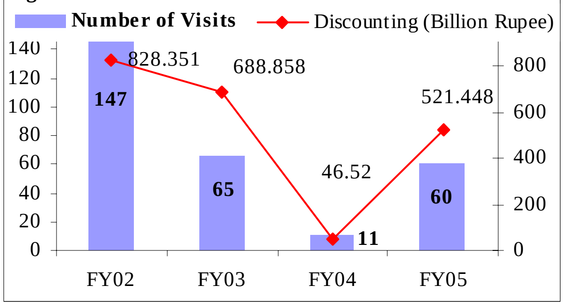
Further to reduce volatility of overnight rates and to enhance the depth of money market, following further initiatives were taken:

- The practice of simultaneous auction of 3-month, 6-month and 12-month Treasury Bills was initiated which enabled the market to have the cut-off yields of all three tenors simultaneously.
- The Money Market Computerized Reporting System was introduced, which strengthened the money market liquidity estimation process to a great extent, enabling SBP to conduct its monetary policy operations more effectively. It also enabled SBP to disseminate daily information on secondary market trading through its website, thus enhancing the price discovery mechanism in secondary market for government securities.

3.3.2 Activities on Discount Window

In line with tight monetary policy, the overnight market was kept tight through conduct of frequent OMOs. This led to substantial rise in frequency of banks accessing SBP discount window which increased to 60 times in FY05 as compared to 11 times during the year FY04 (**Figure 3.3**). The amount of discounting also was substantially larger at Rs521.448 billion as compared to Rs46.520 billion in FY04. The discounting activity, however, remained low when compared to FY01 and FY03 due to enhanced frequency and efficiency of OMOs.

Figure 3.3: Activities on Discount Window



3.3.3 Statutory Liquidity and Cash Reserve Requirements

The Statutory Liquidity Requirement and Cash Reserve Requirement (CRR) are now considered more as prudential instruments to mitigate liquidity risk in the banking system than monetary management instruments. However, this fiscal year, the banking industry's request to lower the CRR rate to enable them to meet the rising private sector credit demand and further augment their earnings was declined not on prudential grounds (as more than adequate level of investments in government securities provided sufficient cushion against liquidity risk) but because of its effects contrary to the stated SBP policy of tightening of monetary policy at the time. A one percent cut in the CRR rate would have immediately injected additional liquidity of Rs21 billion in the market and thus building further pressure on the inflation front.

3.4 Government Bond Market

Pakistan Investment bonds (PIBs) are the key government instruments to provide benchmark rates to the market for medium to long-term lending. During the year, SBP continuing its efforts to align the bond market with the international best practices, required the banks and financial institutions to classify the PIBs into three categories ie i) held to maturity, ii) held for trading and iii) held for sale. This however resulted in squeeze in liquidity in the secondary market as majority of the institutions classified their securities in held to maturity category to avoid revaluation losses on account of rising yields. It also resulted into flattening of the yield curve, as there was no new issue of PIBs during the year. The market expected higher yields on the fresh issues in line with the rising yields on MTBs. The Government, however, opted to rely on short term MTBs for raising funds from the market pending fresh issuance of PIBs for the time being.

SBP also started publishing the secondary market data on its website to promote transparency and minimize information asymmetry, which is expected to give spur to trading in the secondary market. The data includes volumes of secondary market in a particular issue and minimum and maximum rates of trades of all government securities including PIB and Treasury Bills.

In another move for strengthening the primary dealership of government securities, two new banks were allowed to act as primary dealers (PDs) for government securities, increasing the total number of PDs to fourteen. SBP has also incorporated new threshold limits for PDs, which will reinforce its efforts towards development of secondary market for government bonds. The release of new PIB issues on regular intervals will be critical in success of these efforts.

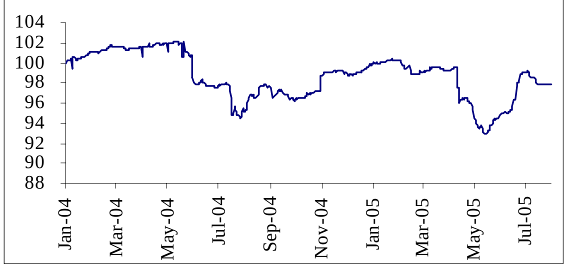
3.5 Pakistan Government Bond Index

Like Stock Exchange index, bond market indices provide an effective tool for measuring performance and quantifying risk in the bond market. As the bond markets and bond trading is a recent phenomenon in Pakistan, no such index was available for the bond market in Pakistan. SBP therefore, encouraged private sector players to develop and introduce bond indices. Accordingly following three bond indices were launched during the year:

1. BMA Pakistan Government Bond Index (BMA-PGBI)
2. Jahangir Siddiqui Pakistan Government Bond Index (JS–PGBI)
3. Financial Market Association Pakistan Government Bond Index (FMA-PGBI)

3.5.1 BMA-PGBI

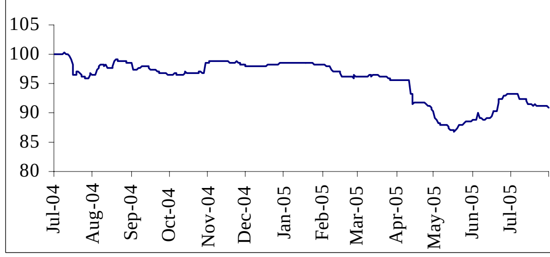
Figure 3.4: BMA-PGBI



BMA-PGBI is managed by M/s BMA Capital Ltd. It is a Total Return Index and includes all the outstanding issues of PIBs having residual maturity of more than one year. PIB issues are priced at yields published at Reuters Pakistan Revaluation rates (PKRV) page. The base date of the index is January 1, 2004 and base value is 100 (**Figure 3.4**). Calculation methodology of index is based on the market value[24] of PIB issue. Monthly rebalancing is done to include new issues of PIB and exclude old issues having less then one year maturity. It is published daily on Reuters and Bloomberg on day end basis.

3.5.2 JS–PGBI

Figure 3.5: JS-PGBI



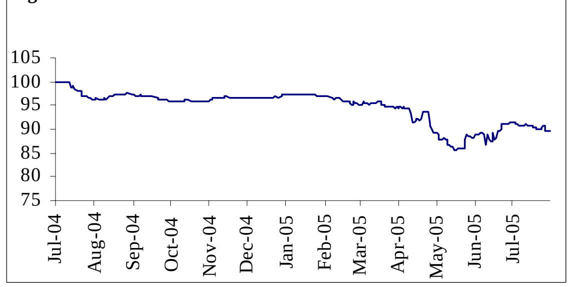
JS–PGBI is managed by Jahangir Siddiqui & Co. It is a clean price index. The index includes only those PIB issues having outstanding balance of more than average balance in each tenor and residual maturity of more than one year. The base date of the index is July 1, 2004 and base value is 100 (**Figure 3.5**). Calculations of index are made by plugging five tenors weights and selected issues weight in the index. All issues are valued on their market value. It is priced on yields published on Reuters PKRV page, and yields are interpolated for issues having maturity between the two yields quoted on PKRV. Rebalancing of the constituents of the index is automatic, old issues falling under category of less then one year maturity are excluded and new issues with balance above average in the respective tenor are excluded.

[24] Market value = Amount outstanding * Gross price. Gross price = Clean price + Accrued interest. Further any realized coupon is reinvested daily at the index yield (weighted average yield of all indexed bonds).

3.5.3 FMA-PGBI

FMA-PGBI is managed by Financial Market Association of Pakistan and it is published daily on Reuters. The base date of the index is July 1, 2004 and base value is 100. The FMA is publishing two indices as Clean Price Index (**Figure 3.6**) and Total Return Index. The constituent of the both Indices are only those issues having maturity of more than one year and having outstanding amount of more than the average outstanding in the respective tenor. Calculations of index are made by plugging five tenors weights and selected issues weight in the index. This is the only index which is priced on the actual prices quoted by Primary Dealers on the Reuters page Pakistan Investment Bonds, where as the other two indices are deriving prices from yields quoted by brokerage houses. Rebalancing process is automatic like JS-PGBI.

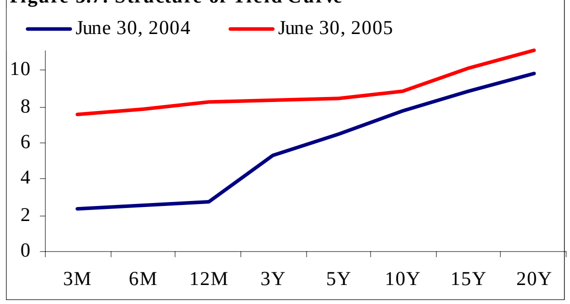
Figure 3.6: FMA-Clean Price Index



3.6 Structure of Yield Curve

The rising interest rate scenario set in since the last quarter of FY04 naturally impacted the yields on government papers to exhibit rising trends during the FY05. At the start of the fiscal year, yield curve was upward sloping; however it flattened by the close of the year, as SBP resorted to more vigorous tightening of monetary policy in the second half of FY05. While the MTBs rates registered sharp rise of more than 500 bps during the year, the rise in PIBs' yields could not keep pace with those of MTBs resulting in flattening of long term yields largely due to absence of any fresh PIB issue. The yield curve structure as such favors investment accumulation at the shorter end, which may dry out long term funds for the government besides making the yield curve unrepresentative of market expectations (**Figure 3.7**). The release of new PIB issues, therefore, is critical for development of bond market as well as ensuring credibility of long term yield curve as a reference rate for private sector for raising long term funds.

Figure 3.7: Structure of Yield Curve



3.7 Extension of KIBOR up to 3-years

Initially Karachi inter-bank offered rate (KIBOR) was quoted for one-week, two-weeks, one-month, 3-months and 6-months tenors. In order to establish KIBOR as benchmark for pricing of lending products of longer maturity, it was essential to extend the tenor of KIBOR up to 3-years. Therefore, the tenor which was extended to 1-year in FY04 extended to 3-year in FY05. Although, six-month KIBOR is more widely used by banks as benchmark for corporate lending, the existence of 1-year, 2-year and 3-year KIBOR would facilitate banks in pricing of derivative products such as Interest Rate Swaps on Pak Rupee (PKR) and Term Finance Certificates. Further, to promote transparency, flexibility and market based pricing, all banks and DFIs were directed to use KIBOR as a benchmark rate for determining pricing of all Rupee Corporate/Commercial lending.

3.8 Strengthening of Research Function

The capacity of research function of central banks to make in-depth and incisive analysis of economic, business, and financial issues, is critically important for effective monetary policy formulation and making professional and candid assessment of economic policies and performance. Strengthening of research function has, therefore, been an important component of the overall restructuring process initiated in 2000. The research function since then has undergone major restructuring, reorganization, reorientation, capacity building and skill enhancement through induction of professionals at all levels and extensive trainings, exposure visits and access to reputed journals, research bulletins etc. The concept of research teams responsible for reviewing specific/specialized areas and burning questions faced by economy, has been introduced along with a culture of freedom of expression and recognition of individual as well as team efforts, which have been instrumental in motivating the researchers to produce quality outputs. Further to improve the quality of research papers, the practice of external refrees has been introduced and a panel of reputed refrees has been developed. This has substantially improved the quality of the papers and their credibility for use as a reference in economic policy formulation as well as future research.

This has not only enabled SBP to make monetary policy formulation and implementation process more objective, predictable and transparent but also translated into substantial improvement in the quality of its publications, which are now considered amongst the most respected and widely referred documents on Pakistan economy due to their in-depth analysis, expanded coverage, high level of disclosure and candid review.

3.8.1 Research Bulletin

The launching of SBP-Research Bulletin, a referred journal with international referees, is another outcome of the initiatives during the year to strengthen the research function. The journal focuses on Pakistan's economy with emphasis on empirical studies. The broader objective of the Bulletin is to enhance the scientific standards of SBP, and like any other scientific publication, it aims at dissemination of knowledge particularly to policy makers, market stakeholders, and academic researchers.

3.8.2 SBP Working Papers

In order to further improve SBP's research profile and expanding research in terms of quality and quantity, it is important to initiate work in areas not covered in main publications. In this context, the Research Department has introduced working papers on different topics. Other departments are also encouraged to participate in the working paper series. These short papers contain in-depth empirical analyses of issues and are intended to provide policy makers new insights and dimensions for policy formulation. By end June 2005, six working papers were released and posted on SBP website (www.sbp.org.pk).

3.8.3 Macroeconomic Projections

The research departments of SBP were engaged in conducting macroeconomic projections even before the restructuring process. However, the scope of projections and involvement of researchers in this exercise was limited, thus the projections were disseminated internally only. With the commencement of restructuring process, the sole responsibility of macroeconomic projections was given to the Research Department. At the beginning, a complete business process of macroeconomic projections was developed. In this context, objectives and parameters of macro economic projections were also laid down. The broad objectives of macroeconomic projections were: (1) to help policy makers develop a view of future economic growth; (2) to provide opportunity for reviewing Bank's operational targets on quarterly basis; (3) to assess performance of the economy on quarterly basis; and (4) to form and promote the Bank's vision on annual economic growth prospects. These projections have now been made part of SBP main publications, to disseminate SBP views about the future trend of key macroeconomic variables.

3.8.4 Macro-Econometric Modeling

SBP is also developing the Macro-econometric Model of Pakistan economy. This project will help in exploring and quantifying the sustainable and interpretable relationships between macroeconomic aggregates of Pakistan economy. In addition to allowing testing of various economic theories on Pakistan's data, this project would help in forecasting and analyzing the various economic policies - particularly the monetary and exchange rate policies.

3.8.5 Textile Cost Competitiveness

Keeping in view the importance of the textile sector in the promotion of economic activities and foreign exchange earnings of Pakistan, SBP is supervising a study on cost competitiveness of Pakistan's textile sector to assess its viability in the liberalized regime of international trade. To carry out the study, SBP Central Board has appointed an outside consultant and a Steering Committee, comprising members from private as well as public sector representatives to oversee this project. The draft report submitted by the consultant is based on the domestic survey of textile units and secondary data pertaining to competitor countries namely India, Bangladesh, Sri Lanka, China, Turkey and Vietnam. The report is expected to be finalized after incorporating comments and suggestions from the stakeholders.

4 Exchange and Reserve Management

4.1 Overview

This fiscal year proved challenging for exchange and reserve management with oil prices rising unabatedly to record levels, substantial growth in non oil imports and speculative forward buying, which put the rupee under pressure particularly in the first four to five months of the fiscal year. SBP remained vigilant to the developments in the foreign exchange market and successfully achieved exchange rate stability with the rate stabilizing at around Rs59.50 to a US Dollar during most part of the year after touching Rs61.30 to a US Dollar in November 2004.

The foreign exchange reserves built during last four years coupled with even flow of home remittances throughout the year provided the necessary cushion to ensure exchange rate stability. This vindicates SBP's stance to build up reserves when there is surplus in the market for effectively coping with exogenous shocks like the unprecedented hike in oil prices the world is experiencing since mid 2004. The interventions in the inter-bank forex market and financing of oil import bill directly from reserves however caused the SBP foreign exchange reserves to decline to US$10.482 billion at the end June 2005 from US$11.110 billion at the beginning of the year. On the reserve management front, SBP during the year, further enhanced its internal capacity and established an Investment Services Cell to transact and coordinate with the external fund managers who have been allowed to manage a portion of the reserves. This will further enhance the performance of SBP's externally managed portfolio, which has already outperformed its benchmarks and added considerable value after fees and expenses.

The drive to formalize the money changers and bring them under the regulatory ambit of SBP initiated in 2003 was successfully completed during the year with all the money changers either transforming into 'A' category Exchange Companies (ECs) or their franchises or branches or 'B' category ECs. The drive however does not end here; now the even greater challenge is to ensure effective regulatory and supervisory oversight of these newly born exchange companies, introduce necessary documentation, governance and transparency standards and substantially improve quality of their human resource.

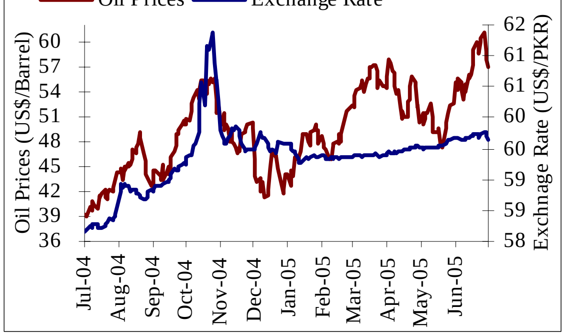
4.2 Exchange Rate Management

The US Dollar to Pak Rupee parity exhibited two distinct phases during the year, one marked by significantly high degree of volatility with rupee continuously loosing ground in the first five months up to November 2004 and the second showing a strengthening of rupee along with reduced volatility (**Figure 4.1**).

Figure 4.1: US$/PKR Interbank Rate

The high exchange rate volatility in the first two quarters could be ascribed to rising oil prices, prepayment of expensive debt and substantial growth even in non oil import bill. Oil traded at an average price of US$33.69 to a barrel on the New York Mercantile Exchange during FY04, but rose 45 percent to an average of US$48.84 to a barrel during FY05 (**Figure 4.2**).

Figure 4.2: Oil Prices vs Exchange Rate



The volatility was further exacerbated by the speculative sentiments that engulfed the market once the rupee started showing a downward trend in the first quarter. To counter this pressure on the exchange rate, SBP increased its frequency as well as volumes of interventions; however it did not produce desired results as the Rupee continued to remain under pressure. In response, on October 31, 2004 SBP decided to finance oil import payment directly from its reserves. The decision produced immediate results and the market sentiments quickly turned in favor of the rupee enabling it to rapidly cover the lost ground and appreciate more than 3 percent to Rs59.35 to a US Dollar. The post November 2004, period was marked by significant reduction in exchange rate volatility as the rupee since then moved within a narrow range of Rs59.30–Rs59.70 to a US Dollar.

Table 4.1 presents the oil-support provided by SBP till June 30, 2005, since the November 2004 decision. While the average monthly support since November 2004 remained around US$357 million, the total oil import bill footed by SBP by June 2005 amounted to US$2.86 billion. The direct financing of oil payments from reserves not only lend stability to rupee dollar parity but also left the inter bank market fairly liquid enabling SBP to buy back a significant proportion of the total oil support provided to the market. However, on overall basis, SBP remained a net supplier of foreign exchange to the market and its foreign exchange reserves were reduced by US$629 million to US$10.482 billion.

Table 4.1: SBP Oil Support

Month	Million USD
Nov-04	407.24
Dec-04	409.32
Jan-05	302.07
Feb-05	361.75
Mar-05	332.88
Apr-05	294.34
May-05	357.13
Jun-05	391.14

4.3 Reserve Management

The SBP had almost no in-house capacity for reserve management until a few years ago. This capacity had to be gradually built up by recruiting the skilled manpower and the managers, installing soft ware packages and systems, instituting organizational change, setting up operating procedures and oversight mechanisms. During the last few years, the Risk Management Unit was set up and a Head of Risk Management was recruited from overseas. Similarly, the Head of Investment Services Cell and the Back office were also recruited to man these functions. The organizational responsibilities and division of labor between the Front office, Mid office and Back office were defined and operating procedures laid down. In-house management of reserves through inter-bank placements was further strengthened by specifying the risk parameters in which the maximum counter party limits could operate.

An external consulting firm ie Mercer International was hired to advice on the selection and monitoring of external fund mangers. As a result of an open international competitive bidding process, nine international reputed firms were given the mandate to manage US$3.2 billion of reserves for investment in international fixed income securities. The terms of reference of Investment Committee were also revised and it was given the powers of issuing guidelines and oversight rather than making operational decisions. The strategy of placing part of reserves with external fund managers was approved by the Investment Sub-Committee of the Board and then by the Board itself. The Sub-Committee also reviews the performance of the external mangers in relation to the benchmarks agreed with them. A report is then presented to the Board of Directors for their consideration.

The reserves management strategy adopted last year, continued during the year under which the reserves' investment portfolio has been categorized according to liquidity ie cash and short-term. The external managers are mandated with benchmarks based upon global fixed income aggregated indices customized to the bank's risk appetite. Formal reporting procedures are in place and detailed performance reviews are conducted bi-annually with all external managers.

The internally managed cash portfolio was kept in short duration during the year, keeping in view the rising interest rate scenario. Risk parameters as laid down by the SBP Risk Management Cell, and updated in line with international developments on an ongoing basis, are ensured at all times along with guidelines pertaining to interest rate duration strategy prescribed and reviewed through weekly meetings of the bank's Investment Committee.

Internal and external liquidity management and control techniques are also updated to more accurately reflect the varying levels of cash flows through SBP accounts maintained abroad, and to maximize yields on excess balances on a day-to-day basis. Further, active currency movements analysis was initiated during the year, to effectively manage the liabilities falling due in non-US Dollar currencies and savings/gains on conversions for cash flow needs.

4.4 Liberalization of Foreign Exchange Regime

The foreign exchange regime liberalization efforts gathered further momentum during the year, as SBP took a number of further steps to liberalize the regime. They include:

4.4.1 Permission to Locally Established Mutual Funds to Invest Abroad

As a major step toward liberalization during the year, the locally established Mutual Funds were allowed to invest abroad up to 30 percent of the aggregate funds mobilized (including foreign currency funds), in permissible categories subject to a cap of US$15 million at any given time. This will open up investment avenues for investors and enable the Mutual Funds to diversify their portfolio of investments and secure better returns for the unit/certificate holders of the mutual funds. It will also discourage capital flight from Pakistan and provide a formal channel for investments abroad. This will, however, require more prudence on the part of mutual fund managers to make best possible risk return trade off while investing abroad and greater level of vigilance on the part of SECP to ensure that adequate risk management systems are in place to manage such investment portfolios.

4.4.2 Remittances on account of IT Services

In order to facilitate private sector companies[25] for payments on account of utilization of IT Services, a general permission was granted to the Authorized Dealers to release foreign exchange up to a maximum of US$100,000 or equivalent in other currencies, per invoice for the following IT based remittances:

- Satellite Transponder charges.
- International Bandwidth charges.
- International Internet service charges.
- International Private Line charges.

[25] Subsequently the facility was also been extended to the branches of the foreign companies, which are operating in Pakistan with the permission of the Board of Investment to undertake permissible business/commercial activities.

- Software license/maintenance and support fees for proprietary/specialized software.
- Subscriptions/payments for access to foreign electronic media and databases.

4.4.3 Facility to Sell Surplus Foreign Currency Notes to State Bank

In order to facilitate the banks to dispose of their surplus cash foreign currencies, the Authorized Dealers were allowed to sell surplus cash US Dollars to the respective Field Offices of SBP BSC. This additional facility has helped banks to minimize the cost of accepting cash US Dollar Notes at their counters.

4.5 Exchange Companies

The network of defunct Money Changers, operating in an unregulated environment, was highly susceptible to illegal use. Moreover, the network functioning as a parallel market was creating hindrance for SBP in management of the exchange rate. The ECs framework was, therefore, enacted in FY03 to bring exchange and remittance business under a proper financial discipline. The framework required the 'Authorized Money Changers' (AMCs) to either transform into ECs or become Franchisees of newly established ECs.

In the second phase, AMCs with small financial means were facilitated and encouraged to form ECs of 'B' category with a reduced paid-up capital of Rs20 million[26] but with a limited scope of business viz. sale and purchase of FCY notes and coins only. Reserve Requirement for this category of ECs was also kept low at 10 percent of the paid-up capital and to accommodate maximum number of AMCs in the new system, a minimum of 5 AMCs were required to form the 'B' Category ECs. The initiative was well received and enabled a large number of smaller AMCs to transform into 'B' Category ECs. It also enabled SBP to bring almost 95 percent of the AMCs network under its regulatory ambit. By June 2005, 26 A category ECs with a network of 87 branches, 216 Franchisees and 144 Payment Booths/Outlets and 33 'B' Category ECs with network of 234 branches were operating in the country. Besides the ECs, "Restricted Authorization" has also been granted to 3, 4 and 5 star hotels for purchase/encashment of foreign currency notes, coins and travelers cheques for the hotel customers.

With the transformation of AMCs into formal ECs, a large number of undocumented transactions have come under the fold of formal framework, which requires proper documentation, record keeping and adherence to internationally accepted Know Your Customer norms, and thus will help SBP in effective enforcement of AML regulations. It also enabled SBP to substantially narrow the gap between interbank and kerb market exchange rates, which played an important role in improving the flow of home remittances during last two to three years. The balance of payments for FY05 for the first time includes the receipts and payments made through the ECs and conveys a more comprehensive and realistic picture of the transactions on external account of the country.

The transformation of AMCs into formal ECs, however, has posed considerable challenges of ensuring effective regulatory and supervisory oversight, inculcating corporate culture, good governance, transparency and proper documentation and record keeping structure in the newly established ECs. The focus during the year, therefore, remained on building necessary supervisory capacity at SBP for effective supervision of ECs and sensitizing the ECs' management about the importance of documentation, corporate governance, systems and policies, computerization/ automation, and human resources development etc. A number of meetings, even at the highest level of SBP, have been held with the Heads of ECs to apprise them of the challenges ahead and the necessity to create the requisite infrastructure and capacity to ensure conformity of their business practices with established international norms and governing rules and regulations. A number of

[26] To be increased to Rs25 million by June 2005.

capacity building and training programs have also been organized both individually by SBP and in collaboration with Institute of Bankers Pakistan, in Karachi, Lahore and Rawalpindi for ECs' management and staff. The programs proved very useful in creating greater awareness about the ECs' regulatory framework and removing various misconceptions in the minds of participants.

To augment its own supervisory capacity, SBP during the year, further strengthened the 'ECs Inspection Division' created in 2003 to exclusively focus on all supervisory issues of the ECs, and established 'ECs Supervision Units' at all 16 Field Offices of SBP BSC for on-site and off-site supervision of 'B' Category ECs. A comprehensive inspection manual covering all areas of operations of ECs and risks thereof was developed and in-house training sessions and workshops were arranged to enhance skill level of officers examining the ECs' affairs. The compliance/enforcement function was also strengthened and actions including suspension and cancellation of licenses on violation of rules & regulations, standard norms and practices were taken against the delinquent ECs which helped in creating desired disciplined operational environment in the sector.

Further, to improve documentation of Foreign Currency flows and introduce necessary checks in export of Foreign Currency Notes by the ECs, a joint booth of SBP and Customs was established at Jinnah International Air Port, Karachi which is operative from April 4, 2005. The step has not only facilitated quick turn around time for such flows to become a part of the formal sector (Interbank/Inter Exchange Companies Market) but related documentation has also helped in converging to the requirements of AML/ Know Your Customer as expected internationally.

5 Strengthening of Payment Systems

5.1 Overview

Payment and Settlement Systems are the strategic component of financial infrastructure of the country and have evolved rapidly in last few years. An efficient and well functioning national payment system is critical for smooth functioning of financial markets and stability of financial system. The phenomenal growth in financial markets, introduction of innovative derivatives and hedging products, fast pace of changes in communications and information technology providing platform for integration of systems globally and end-to-end straight through processing capabilities overcoming the time zone and currency constraints, have dramatically changed the context in which these systems operate, making the reforms of payment system all the more important than ever.

SBP being cognizant of the crucial role of Payment and Securities Settlement System, has introduced numerous reforms that include promoting gradual migration from a predominantly cash and paper-based system to electronic payments, encouraging banks to invest in technology and improve the payment and settlement system infrastructure, improving the efficiency of the payment systems, initiation of projects like Real Time Gross Settlement (RTGS) system, awareness creation and information dissemination about the role, importance and issues of payment system and protection of consumer interests.

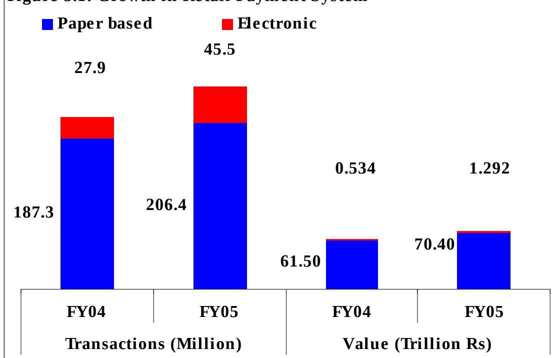
5.2 Progress in of Electronic Payment Systems

There has been substantial improvement in payment system infrastructure and consumers' payment patterns over last few years particularly in urban areas, which is evident from exponential growth in Automated Teller Machines (ATM) Cards, Debit & Credit Cards, ATM outlets, Points of Sales (POS) accepting payments through cards and number of online branches of commercial banks providing swift intra bank account to account funds transfer facilities. The long queues in banks' branches to withdraw funds have slimed down in urban centers due to growth in ATMs and the interconnectivity of the two ATM switches viz. the MNet and 1-Link. With strategic focus of SBP to develop a well functioning and efficient payment system in the country coupled with rapid technological changes, the pace of growth in payment system infrastructure will further accelerate in the medium term and its outreach will extend to even smaller towns. This will enable a larger number of consumers to use the enhanced and extended payment system infrastructure, and will bring greater efficiency and cost effectiveness in the system.

5.3 Retail Payment System

The total retail payments grew by 15 percent in value to Rs71.7 trillion and 17 percent in number to 251.9 million transactions. The paper based banking transactions grew by 10 percent from 187.3 million in FY04 to 206.4 million in FY05 whereas the value of the transaction increased by 14 percent from over Rs61.5 trillion in FY04 to Rs70.4 trillion in FY05 (**Figure 5.1**). In comparison, electronic banking transaction registered 63 percent growth over last year from 27.9 million in FY04 to 45.5 million in FY05 and 142 percent growth in value from Rs534 billion in FY04 to over Rs1,292 billion in FY05.

Figure 5.1: Growth in Retail Payment System



The break up of electronic transactions sums that ATMs, which are commonly used for small value cash withdrawals, shares 66 percent of the total number of electronic transactions with 12 percent share in value (**Table 5.1**). POSs commonly used for purchases of consumer goods, shares 28 percent of the total number of electronic transactions with 3 percent share in value. Business entities are now benefiting from online banking, which accounted for 85 percent of the total value of electronic transactions with just 6 percent share in total number of electronic transactions.

Table 5.1: Shares Within E-Banking Transactions

Description	Number	Value
ATMs	66	12
POS	28	3
Online	6	85

Though paper based transactions accounted for 82 percent of the total retail payment transactions, there is a visible increase in the share of e-banking in terms of number of transactions (**Table 5.2**). In one year, the share of electronic banking transactions increased from 13 percent to 18 percent. In terms of value of retail payment transactions, electronic banking has captured 2 percent share after 142 percent growth in one year alone. This indicates an immense potential for growth by electronic banking even in terms of capturing part of the existing retail payments market. The fast growing online branches network is all set to exploit true economies of scale provided by electronic banking and will translate into phenomenal growth in electronic banking and funds transfer etc.

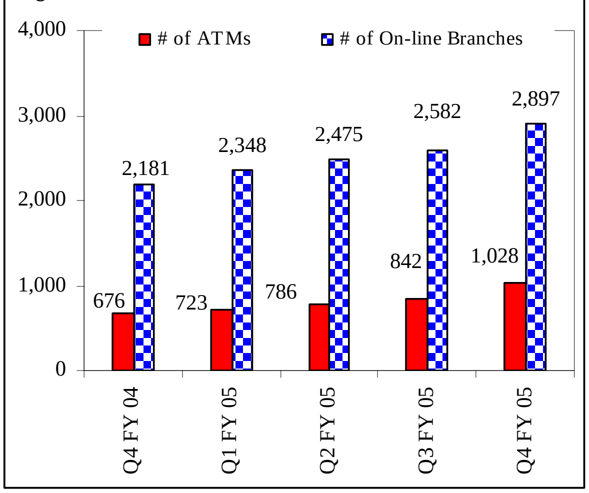
Table 5.2: Transformation of Retail Payment System

Contribution	2003		2004-5	
	Number	Value	Number	Value
Paper Based (Percentage)	87	99	82	98
Electronic (Percentage)	13	1	18	2

5.3.1 ATM Network

Currently ATMs are being used mainly for cash withdrawals, account to account funds transfer, utility bills payments and balance inquiry statements. Their number has reached 1,028 at end of June, 2005 from 676 at the beginning of the fiscal year, indicating an increase of 50 percent or 352 ATMs in FY05 alone (**Figure 5.2**). Of these 186 ATMs were installed in the fourth quarter of FY05.

Figure 5.2: No. of ATMs and Online Branches



Number of cash transactions on ATMs in FY05 was 29.7 million transactions against 19 million transactions in FY04, showing growth of 56 percent, whereas the value of cash transactions registered 72 percent growth to Rs153.7 billion in FY05 from Rs89.4 billion in FY04. ATM usage for funds transfer has also started picking up; intra bank and account to account funds transfer via ATMs during the year increased by 151 percent in number to 41 thousand and 216 percent in value to Rs766 million.

5.3.2 Online Branches Network

The online branch network is also expanding at a fast pace and reached to 2,897 at the end of June 2005 from 2,181 at the beginning of the fiscal year, indicating an impressive increase of 33 percent or 716 branches (**Figure 5.2**). The addition of 315 branches into online network in the fourth quarter is signaling further acceleration in the pace of growth of the online branches. The coverage of online branches as a percentage of total branches (7,068 branches) has now reached 41 percent. With this pace, the whole branches network of the banking system will be online in very near further, which will substantially improve efficiency of the payment system.

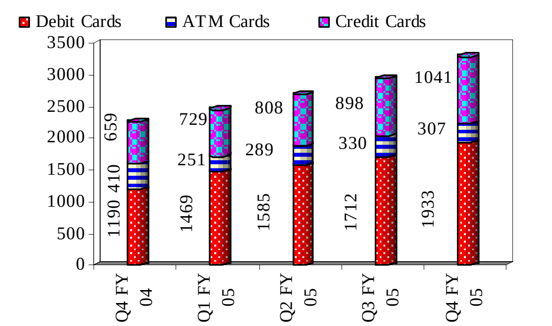
5.3.3 Point of Sale Transactions

Usage of cards at POS is expanding with the passage of time. This channel recorded remarkable growth of 62 percent in number of transactions to 13 million transactions in FY05 from 8 million in FY04. Value of transactions grew by 56 percent to Rs42.8 billion in FY05 from Rs27.4 billion in FY04.

5.3.4 Number of (Credit/Debit/Smart) Cardholders

Number of credit, debit and ATM cardholders reached to 3.3 million during FY05, showing growth of 45 percent. Out of total cardholders, number of credit cards increased from 659 thousand to 1,041 thousand and debit cards from 1,190 thousand to 1,933 thousand (**Figure 5.3**). The ATM cards which can only be used on auto teller machines were 410 thousand at the end of FY04 came down to 307 thousand at the end of FY05 as most of the banks have converted ATM cards into debit cards. Banks are now also introducing Chip and Pin SMART cards to improve the security of plastic money which would enhance consumer's confidence.

Figure 5.3: Number of Cardholders (000)



5.4 Clearing and Settlement Systems in Pakistan

As a custodian of the Payment System of the country, SBP supervises the operation of the clearing house for the member banks operating within its jurisdiction. Automated Clearing services are provided by National Institutional Facilitation Technologies (NIFT) under the supervision of SBP in nine major cities of Pakistan. A complete range of conventional clearing services including overnight clearing, same day high value clearing, intercity clearing etc are provided by NIFT. In rest of the business centers the process is manual.

Six SBP Banking Services Corporation (SBP BSC) local offices are still supervising the paper based manual clearing and settlement process and wherever SBP BSC local office is not available, NBP has been delegated this process under supervision of SBP. Representative of the member banks are required to attend the Clearing House for receipt and delivery of clearing documents from/to each other at fixed hours. These clearing meetings are held twice a day, excluding the special clearing meeting in the afternoon which is meant only for returns of unpaid cheques/documents.

The Local US Dollar Clearing System provide low cost and efficient clearing system for US Dollar denominated local instruments. 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 fully utilizing this facility.

5.5 Real Time Gross Settlement

The RTGS system named as Pakistan Real time Inter bank Settlement Mechanism (PRISM) is at an advanced stage of installation and is expected to be live by first quarter of 2006. It will automate the current inter-bank settlement systems for large value payments at SBP and will minimize the risks like credit, liquidity and settlement risk inherent in the end of day settlement system. Its implementation will make the payments systems much more efficient and resilient, offering transactional features which are hard to achieve under the current settlement systems. The RTGS system is based on Society for Worldwide Inter-bank Financial Telecommunication topology and includes the functionalities of Queue management, Grid Lock Resolution and interfacing with Globus.

PRISM will not only automate the Inter Bank funds transfer but will also facilitate the settlement of government securities transactions in primary and secondary markets. After the implementation of PRISM, settlement of securities between the participants will be on Delivery vs. Payment basis thus reducing the risk in securities trading by minimizing the settlement lag. SBP will also be able to settle the OMO transaction through the PRISM. PRISM will also bring more efficiency in inter city and intra city clearing between the banks as the NIFT will be doing clearing on multilateral basis and these clearing results will be settled on Real Time basis in PRISM. PRISM will also facilitate the commercial banks in making time critical third party funds transfers on behalf of its customers.

5.6 Payments System and Electronic Funds Transfers Act 2005

As SBP is embarking on large electronic schemes such as the nation wide RTGS, it is necessary that efforts should be made to bring about necessary changes in legislative framework that synchronizes and synthesizes with the initiatives taken by the Government of Pakistan and ensures conformance with Bank for International Settlements Core Principals for Systemically Important Payment Systems.

Accordingly "Payments System and Electronic Funds Transfers Act 2005" has been drafted in consultation with stakeholders and forwarded to the Ministry of Finance for necessary approvals. The proposed Act addresses issues like operation of payment systems, including the clearing and settlement obligations of the parties involved, supervisory role of SBP, documentation requirements by the participants, liabilities of parties in Payment Systems and legal proceedings in case of any conflict, finality and irrevocability of settled transactions etc. The Act also gives necessary legal coverage to PRISM. SBP is also framing the requisite rules and regulations for the smooth operations and participation in PRISM.

Management Strategy of SBP

6 Human Resource Development
7 Information Technology Development
8 Accountability, Transparency and Disclosure
9 Strategic Plan 2005 - 2010

6 Human Resource Development

6.1 Overview

Human resource development continued to be an important intervention for SBP to transform itself into a modern and dynamic central bank. During the year human resource development strategy focused on attracting, motivating and retaining high caliber staff by aligning compensation, performance evaluation and promotion policies and providing ample training and development opportunities. At operational level, activities in human resource development focused on creating awareness about the newly introduced human resource management processes, responding to user feedback on simplification of procedures and updating allied policies. The strategy translated into overall improvement in employees' satisfaction level; however the rising turnover particularly in the young professionals continued to be a challenge for management.

6.2 Manpower Profile

The composition of human resource base has changed considerably during last five years; support staff has contracted to 213 whereas the employees undertaking key functions (officer grade 2 and above) have increased to 810 in June 2005, representing approximately a ratio of 1:4 in terms of support staff to management employees (**Table 6.1** and **Figure 6.1**). This shift in composition of the manpower profile is attributable to regular induction of fresh graduates under State Bank Officers Training Scheme (SBOTS), Research Analysts & Statistical Officers schemes, internal promotions of officers having potential and basic requirements for higher grades as well as fresh recruitments in higher grades. The manpower profile of SBP in terms of various grades of staff across departments is given overleaf in **Table 6.2**. The reduction in support staff is in line with the overall organizational changes implemented in SBP in the recent years, involving introduction of three tier organizational hierarchy for decision making, automated processes and Business Process Reengineering initiatives.

The number of female staff has almost doubled, from 58 in 2000 to 100 in June 2005; however, this is still less than 10 percent of the overall staff strength and efforts are continuing to improve this ratio.

Table 6.1: Human Resource Profile of SBP

Number of Employees

	2000	2001	2002	2003	2004	June 2005
SG-1	1	2	2	2	3	3
OG-7	7	7	8	7	6	6
OG-6	36	53	45	39	35	41
OG-5	54	75	72	85	81	75
OG-4	63	90	99	86	96	111
OG-3	217	270	240	248	234	264
OG-2	276	226	291	366	383	310
OG-1	256	237	279	236	222	220
Support Staff	349	264	223	217	213	213
Specialized Professionals	0	0	0	7	8	50
Contract Staff	137	105	98	91	126	73
Total	**1396**	**1329**	**1357**	**1384**	**1407**	**1366**

Figure 6.1: Human Resource Profile of SBP

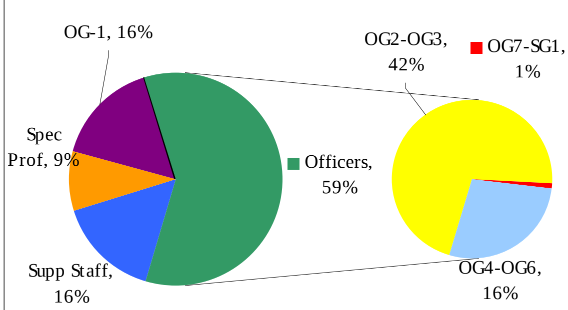


Table 6.2: Department-wise/Grade-wise Working Strength as on June 30, 2005
Number of Employees

Departments	OG-7	OG-6	OG-5	OG-4	OG-3	OG-2	OG-1	Spec Prof	Supp Staff	Contract Staff	Total
Accounts	0	1	4	4	24	34	44	0	20	0	131
Agricultural Credit	0	1	3	0	6	4	8	0	6	0	28
Audit	0	1	2	4	6	5	3	0	3	0	24
Banking Inspection	0	3	10	14	38	52	5	0	10	0	132
Banking Policy	0	3	4	5	20	21	16	0	12	1	82
Banking Supervision	0	2	2	8	15	15	15	0	11	1	69
Corporate Services	1	1	1	1	8	11	21	0	23	0	67
Exchange & Debt Management	0	0	2	3	12	17	8	0	7	0	49
Economic Policy	0	3	3	4	8	19	3	0	10	0	50
Exchange Policy	0	2	1	3	14	15	8	0	6	0	49
Human Resources	0	0	2	3	19	31	37	1	55	2	150
Islamic Banking	0	0	1	2	0	4	2	0	2	1	12
Information Systems	0	1	6	5	14	5	12	39	5	56	143
Legal Services Division	0	0	0	0	0	1	3	8	2	1	15
Payment Systems	0	1	0	0	2	5	2	0	2	1	13
Research	1	1	1	8	4	21	7	1	6	4	54
Small & Medium Enterprises	0	1	0	2	7	9	2	0	3	0	24
Statistics	0	1	8	25	18	13	9	0	9	0	83
Strategic Planning Unit	0	1	0	0	0	2	0	0	0	2	5
Risk Management Cell	0	0	0	0	1	2	2	0	2	1	8
Investment Services Cell	0	0	1	0	0	3	1	0	2	1	8
Staff attached with Executives	0	0	0	0	5	1	4	0	14	2	27
Central Staff Pool	3	18	24	20	43	20	8	1	3	0	140
Total	5	41	75	111	264	310	220	50	213	73	1362
Governor / Deputy Governors / Executive Director											4
Grand Total	**6**	**41**	**75**	**111**	**264**	**310**	**220**	**50**	**213**	**73**	**1366**

6.3 Recruitment
Recruitment at almost all levels through a transparent and competitive mechanism has been an important component of human resource buildup and skill enhancement strategy of SBP. With the introduction of *Personality Profiling*, a new selection tool, in addition to competitive written test, group discussion and competency based behavioral interviews after a quality short listing process; the selection process has become more objective and scientific. While recruitment of fresh graduates under SBOTS is a regular annual feature[27], high caliber professionals at middle and senior management level are also recruited on need basis. During FY05, 44 fresh graduates were recruited under SBOTS, and process for recruitment of a fresh batch of Joint Directors (JDs) was initiated, it however stretched to first quarter of FY06 as negotiations with external recruits[28] took more than the expected time. The bulk of fresh recruitments during last five years have been at entry level under SBOTS and at middle management level as JD (**Table 6.3**).

Table 6.3: Consolidated Recruitment Position from 2000 to 2005
Number of Employees

Year	OG-2			OG-3	OG-4	OG-5	OG-6	Total
	Analyst	Statistics Officers	SBOTS					
2000	0	0	0	0	0	0	0	0
2001	0	0	41	0	0	31	4	76
2002	24	12	46	0	3	2	1	88
2003	20	1	67	2	1	20	0	111
2004	0	0	28	1	0	0	0	29
2005	0	0	44	1	0	0	0	44
Total	**44**	**13**	**226**	**3**	**6**	**53**	**5**	**348**

6.3.1 Special Recruitment
All recruitments in SBP are made while observing the provincial and regional quota prescribed by the Federal Government. However, SBP is the pioneer public sector organization that has made special efforts for increasing representation of people from less developed areas in its human resource base. The 44 officers hired under SBOTS during FY05, were selected from Sindh (Rural), Balochistan, Federal Administered Tribal Area, Azad Jammu and Kashmir and Northern areas as a special batch.

6.3.2 Recruitment under Separate Salary Structure for Specialized Professional
To address the issue of market based compensation for qualified and experienced professionals in specialized areas such as IT, Legal Services, RTGS, Risk Management, Reserve Management etc. SBP introduced a Separate Salary Structure for Specialized Professional (SSSSP). The structure has helped SBP in not only attracting the best talent but to retain that talent and enjoy the benefits resulting from quality performance, long term commitment and an increased employee loyalty.

6.3.3 Contractual Recruitment
In addition to the recruitments under SSSSP, professionals were also recruited on various positions on contractual basis to meet the temporary and short term needs of SBP in specialized fields; bulk of these recruitments were made for the IT up-gradation project as reflected in the summary, given in **Table 6.4**.

Table 6.4: Specialized Recruitment on Contractual Basis
Number of Employees

	Managerial Positions	Non-Managerial Positions	IT Professionals
2000	10	28	13
2001	6	0	44
2002	10	1	17
2003	5	4	9
2004	3	0	56
2005	1	0	0
Total	**35**	**33**	**139**

27 Made biannual effective FY06.
28 Total 17 Joint Directors (12 from within SBP & SBP BSC and 5 external) were selected.

6.3.4 SBP Image as a Prospective Employer

To attract quality professionals/fresh graduates to seek employment in SBP from across the country, an awareness building and information dissemination campaign was initiated during the year; SBP participated in International Trade and Commerce Network conference and other important business and economic events held during FY05 and established information kiosks to create awareness about the critical role of SBP in the country's economy and the challenging employment opportunities it offers to the capable, talented and qualified persons. Further, liaison and coordination with reputed universities and colleges has also been increased to create the similar awareness amongst the student community. The universities'/colleges' management was also apprised of SBP internship programs and encouraged to send nominations of their students for the programs.

6.3.5 Internship Program

The 8-week internship program introduced in 1996, has now become a regular and popular event and has been instrumental in enhancing the level of awareness about SBP's role and functions as well as working environment in universities and colleges. The program caters to around 60 students (30 male and 30 female) every year, selected on the basis of merit and provincial quota from all the accredited universities of Pakistan. During FY05, 60 students of post gradate classes attended the regular internship program. In addition, 60 students from different universities attended the special internship program[29]. **Table 6.5** details the number of students who have successfully completed their internships since 2000.

Table 6.5: Year wise of Regular and Special Internship

	Year	Interns		Year	Interns
Regular Internships	2000	34	**Special Internships**	2003	9
	2001	49			
	2002	54		2004	32
	2003	55			
	2004	51		2005	60
	2005	60			
	Total	**303**		**Total**	**101**

6.4 Employee Turn over

The profile of employees separating from SBP has gradually shifted from employees availing Early Retirement Incentive Schemes to those resigning (**Table 6.6**). Officers in grade 2 and above, aged less than 30, accounted for bulk of the resignations. The trend is attributable to substantial improvement in skill level and exposure of employees, particularly young professionals, due to heavy investment in their training and development. As the human resource base strengthens in terms of knowledge base and skills, their retention becomes a new challenge.

Table 6.6: Employee Separation Profile

Number of Employees

	2000	2001	2002	2003	2004	June 2005
Retired	56	20	6	9	5	6
Expired	9	3	5	6	5	2
Resigned	1	5	14	12	22	22
Early Retirement	110	92	16	38	7	0
Dismissed	0	0	0	0	1	0
Total	**176**	**120**	**41**	**65**	**40**	**30**

The turnover rate of regular employees at 2.04 percent, though below the industry average, is quite high when compared to recruitments done in the last four years (**Table 6.7**). SBP management has taken several steps during FY05 to check this trend including revision of Promotion policy for OG-2 to OG-3, enhancement in annual merit increase, revision of compensation package and an increased focus on improving quality of work life.

Table 6.7: Employee Turnover

	Number of employees resigned	Number of Regular Employees	Employee Turnover
2000	1	910	0.11%
2001	5	960	0.52%
2002	14	1036	1.35%
2003	12	1076	1.12%
2004	22	1068	2.06%
June 2005	22	1080	2.04%

[29] The special internship programs are organized for students of law, journalism, business, economics, statistics, mathematics, commerce, computer science and accountancy.

6.5 Training

Training is an integral part of SBP's human resource development strategy. The training policy primarily focuses on three main areas:

- Central Banking Track
- Management Track
- Function Specific Track

During the year focus remained on intermediate and advanced level courses in central banking track and soft skills development under the management track. For middle and senior cadre officers, the emphasis remained on fine tuning their managerial skills, whereas the focus for entry level officers was on function specific trainings to help build their technical skills to undertake different assignments in their respective area of work. In addition progressive training requirements, mandatory for all officers, in each of three tracks, have been prescribed to address the developmental needs of employees as they advance in their respective careers. **Table 6.8** gives the comparative number of officers who have undergone various Training Tracks programs in FY04 and FY05.

Table 6.8: Participants of Training Tracks Programs

Training Tracks	Participants	
	FY04	FY05
Central Banking Track	715	1080
Management Track	-	685
Function Specific Track	354	850
Total	**1,069**	**2,615**

Note: Data includes multiple participations in different programs by an officer.

6.5.1 Management and Soft Skills Training

A comprehensive project under World Bank's Technical Assistance for Banking Sector program was initiated during the year to enhance and enrich the managerial as well as soft skills of SBP employees particularly at middle and senior management level. The project, awarded to a consortium of consulting firms, is expected to translate into substantial improvement in SBP officers soft skills set including performance management, dispute resolution, customer services, organizational development, etc. The project initiated in September 2004 will conclude in March 2007. **Table 6.9** gives a summary of the training programs delivered during the year.

Table 6.9: Training programs under Technical Assistance for Banking Sector

Training Program	Target Audience	FY05		
		Sessions	Days	Participants
Training of Trainers	Selected officers	1	15	28
Training of Trainers Part II	Selected officers	0	0	0
Management Training for Senior Management and Line Managers	JDs - EDs	1	3	26
Training as People Managers	JDs - HODs	3	6	71
Strategic Planning/Strategic Management	JDs - HODs	2	8	74
Value and Shared Behavior	ADs - SJDs	5	10	133
Human Resource Management for Managers	JDs - HoDs	1	2	22
Coaching and Counseling	JDs - HODs	3	6	72
Human Resource Management Courses for HRD Staff	HROs - JDs	0	0	0
Customer Services (HRD+Others)	Officers - ADs	6	12	162
Performance Management (HRD)	HROs - JDs	1	2	21
Human Resources Planning (HRD)	HROs - JDs	1	1	27
Organizational Development	OG-2 - ADs	2	10	51
Techniques of Advising and Counseling Staff in Careers Development	JDs - SJDs	2	2	48
Total		**28**	**77**	**735**

6.5.2 Participation in Foreign Training Programs

This fiscal year another 126 officers (**Table 6.10**) attended foreign training programs in different institutions including Federal Reserve Bank, Bank of Australia, Centre for Central Banking Studies - Bank of England, Bank of International Settlement, International Monetary Fund, World Bank, Central Bank of South Africa, Bank of Korea, Bundesbank etc. The training programs covered a wide range of areas related to central banking functions and were funded fully or partially by the host institutions. Programs that were not funded this way were alternatively sponsored by World Bank's Technical Assistance for Banking Sector program.

Table 6.10: Participation in Foreign Training Programs
Number of Officers

Period	OG-2	OG-3	OG-4	OG-5	OG-6	Total Participants
2003-04	31	53	15	33	25	157
2004-05	30	31	20	26	19	126

Further, SBP in collaboration with Asian Development Bank invited international experts to develop and update teaching modules in the areas of monetary policy, financial sector regulation, commercial & investment banking, and financial market operations. Since October 2003, these international experts have imparted training to more than 200 SBP officers.

6.5.3 SBP Scholarship Schemes

SBP pursues a generous scholarship scheme for its employees as well as general public for pursuing higher studies. A total of 16 scholarships for higher studies both for local and foreign institutions were granted during the year. **Table 6.11** gives the details of the scholarships availed by the officers.

Table 6.11: Scholarship Beneficiaries

Discipline	FY04	FY05
PhD in PIDE / QAU	-	2
Ex-Pakistan Study Leave	5	10
Study Leave In Pakistan	5	3
Sabbatical	-	1
Total	**10**	**16**

6.6 Performance Management

SBP Performance Management System (PMS) introduced in FY03, has completed three consecutive performance cycles. The SBP PMS has been under continuous review to keep it responsive to the evolving needs of the organization and make it least taxing on the daily operations of SBP. Improvements in performance appraisal, bell curve ranking, annul merit increase, performance bonus and competency model were introduced during the year.

6.6.1 Performance Appraisal

Based on the experience of last two years, it transpired that two independent appraisals were not warranted. Accordingly, this fiscal year the second appraiser was made reviewer, who would ratify or change the appraisal/rating of the appraiser based on his/her interaction with the employee. However in case of changing the rating of the appaiser, the reviewer has to give reasons for the change. The change resulted in considerable simplification of the appraisal process and the appraisal form.

6.6.2 Bell Curve Ranking

Bell curve ranking of employees based on performance and competency is a competitive policy of rewarding best of the best. Every year the bell curve is aligned with the overall performance of SBP. Accordingly, this year, keep in view the enhancement in overall performance of SBP in its core functions, 15 percent of the employees earned the highest performance rank 'A', 25 percent 'B+', 50 percent 'B' and 10 percent 'C' rank under the bell curve principle. For officers in grade 2, 3 and 4, this bell curve ranking was made at departmental level and for officers in grade 5 and 6 it was applied on bank wide basis. The ranking is used for deciding Annual Merit Increase and Performance Bonuses only, while for promotions, trainings etc the actual appraisal ratings are taken into account.

6.6.3 Annual Merit Increase/Performance Bonus

In line with SBP policy to attract, retain and reward high performance employees, a higher Annual Merit Increase and Performance Bonus was approved for the employees. The Annual Merit Increase for regular employees is detailed in **Table 6.12** and **Table 6.13**. Employees in Separate Salary Structure and those in OG-7 were allowed Annual Merit Increase of 5 percent and 6 percent respectively.

This year the 'B+' rated employees (OG-2 to OG-6) were also awarded Performance Bonus in addition 'A' rated employees to reinforce their commitment and hard work as well as enhance the culture of performance based reward and recognition. The grade wise breakup of Performance Bonus awarded to 'A' and 'B+' rated employees is given in **Table 6.14**.

Table 6.12: Annual Merit Increase for OG-1 and below

Performance Evaluation	Annual Merit Increase
49-50	4.5%
47-48	4%
41-46	3%
11-40	2%
0-10	NIL

Table 6.13: Annual Merit Increase for OG-2 to OG-6 (SG)

Appraisal Category	Annual Merit Increase
A	9%
B+	7%
B	5%
C	1.50%

Table 6.14: Performance Bonus

Grade	Performance Rating	
	A	B+
OG-2	10,000	5,000
OG-3	12,500	6,250
OG-4	17,500	8,750
OG-5	22,000	11,000
OG-6 and OG-6 (SG)	25,000	12,500

6.6.4 Competency Model

The competency model and dictionary was also reviewed and changed during the year to align it with SBP's Core Values, make it flexible and role/function specific rather than grade specific. The number of core competencies was reduced from six to three ie Achievement Orientation, Teamwork and Communication. A maximum of three role specific and four function specific competencies will now be mutually decided by the appraiser and the appraisee from the Competency Dictionary during the planning stage of the PMS, taking into account the job requirements and individual's development needs. In other words, a minimum of six and maximum of ten competencies (including three core competencies) will be selected for all appraisees. Rating of competencies will be done directly on the rating scale of zero to five (0-5) as detailed in **Table 6.15**.

Table 6.15: Rating of Competencies

Rating Scale	Frequency of Competency Demonstration
0-1.5	Rarely demonstrates/does not meet the required level, needs significant development.
1.51-2.5	Sometimes demonstrates/below expectations in some aspects, improvement required
2.51-3.5	Usually demonstrates/meets target expectations in all aspects
3.51-4.5	Demonstrates most of the time/exceeds expectations in most aspects
4.51-5	Consistently demonstrates/ exceeds expectations in all aspects

The Competency Dictionary has been divided into four parts to align it with the role of employees viz; Individual Contributor, Unit Head, Divisional Head and Head of Department. Also, definitions given in the Dictionary have been made more concise, broad-based and user-friendly. Employees will be able to select competencies from a total of 29 competencies grouped in five clusters based on the widely accepted concepts of critical job success behaviors. These changes have further simplified the appraisal process and the appraisal form. All these revisions of the competency model and dictionary will be implemented from FY06.

6.7 Employee Recognition Policy

The employee recognition policy and program was introduced in FY04, to reward and recognize employees who demonstrate positive behavior through their performance towards achieving goals or enhancing the image of SBP. Objective criteria along with separate recommendation and approval levels have been defined to ensure objective and transparent use of the policy. During FY05, 340 employees were recognized under different levels based on their contribution in organizational performance (**Table 6.16**).

Table 6.16: Grade wise Number of Employees Awarded

GRADES	Level-2	Level-3	Level-4
OG-1 & below	47	2	0
OG-2	94	17	1
OG-3	60	19	0
OG-4	22	5	0
OG-5	3	10	1
OG-6	0	1	2
Spec & contract Staff	31	25	0
Total	**257**	**79**	**4**

6.8 Promotion Policy

During FY05, the promotion policy was also refined to make it more objective, transparent and compatible with the organizational changes made in the recent past. All previously approved promotion and career growth policies for OG-1 and below (including automatic promotion of OG-1 on acquisition of Master of Business Administration degree) was discontinued. However, the OG-1 employees who had already been allowed to join MBA courses under the scheme remained eligible for promotion as OG-2 on successful completion of their studies. This will ensure a single route for induction and recruitment to OG-2 level that is transparent and uniform across the board.

Promotion from OG-2 to OG-3 has been made independent of vacancy consideration. All OG-2 officers are now eligible for promotions as OG-3 on completion of three years of service in their current grade provided they have obtained a PMS rating equal to 3.50 or above on average during their past three appraisal years, completed mandatory training requirements and no disciplinary proceedings have commenced or inquiry initiated against them. Promotion of OG-3 and above are based on PMS ratings, trainings, competency based interviews and are subject to availability of vacancies in the higher grade.

A total of 90 officers were promoted during FY05 compared to 40 in FY05. The big rise in number of promotions is attributable to change in promotion policy of OG-2 to OG-3 during FY05. A breakup of the promotions under the new Promotion Policy is given in **Table 6.17**.

Table 6.17: Promotions under the New Promotion Policies

Cadre	Promotions	
	FY04	FY05
OG-1 to OG-2	9	3
OG-2 to OG-3	9	56
OG-3 to OG-4	16	19
OG-4 to OG-5	2	3
OG-5 to OG-6	4	9
Total	**40**	**90**

6.8.1 Promotion Based on Professional Growth

In addition to the usual structured promotion process, the concept of promotions based on professional growth has been introduced. Employees in OG-3, OG-4 and OG-5 grades who excel in their respective professional fields but could not be promoted under the usual structured promotion process due to lack of vacancies may be promoted on professional growth basis. Career progression on professional growth basis is made as an exception rather than rule. Such promotions are made by a decision of a panel comprising of the Governor and the two Deputy Governors, who review recommendations by concerned Head of Departments in case of OG-3 & OG-4 employees and OG-7 Executives in case of OG-5 employees. However, no promotion was made during FY05 under the policy.

6.9 Succession Planning

In order to develop a broad based skills set, improve employees' career advancement opportunities and to provide flexibility for the organization to address succession demands in an effective manner, compulsory interdepartmental rotation of officers has been introduced whereby all officers with 3 years of completed service in their present grade or department are transferred to other departments within the cluster; **Table 6.18** gives grade wise break-up of the rotations/transfers made under the policy. Similarly, managerial jobs are now internally posted and options are sought. The applicants are then screened, interviewed and short-listed for the jobs based on their competencies and future aspirations.

Table 6.18: Grade wise breakup of Officers Transfer or Rotated

Year	OG-6	OG-5	OG-4	OG-3	OG-2	OG-1	Total
2002	2	14	4	18	20	5	63
2003	3	3	7	36	34	16	99
2004	3	12	14	50	36	13	128
January to June 2005	2	3	0	5	10	8	28
Total	**10**	**32**	**25**	**109**	**100**	**42**	**318**

Further, a new interdisciplinary skill enhancement policy was introduced from FY05, where by officers of general side can be transferred to specialised side like research, statistics etc and vice versa, to get a well-rounded exposure of SBP functions. So far 10 officers have availed rotation under this policy.

7 Information Technology Development

7.1 Overview

The IT up-gradation project remained in full swing during the year and is close to completion. Most of the labour and data intensive work being carried out at SBP has been automated; from retrieval of data, data compilation, reorganization to subsequent processing by different departments of SBP, the whole value chain, has been automated to reduce inefficiencies and increase accuracy of data. All SBP and SBP BSC offices are now electronically connected. All work stations are equipped with desktops linked with the internet and SBP intranet. The project rollout in SBP BSC field offices is progressing at a satisfactory pace and will be completed by December 2005. Thus the extremely limited and fragile IT base has been transformed into a state of the art IT and communication infrastructure enabling the central bank to substantially improve the efficiency and effectiveness of decision making process, communications, and control systems.

7.2 Globus

To automate the retail and treasury functions of SBP and SBP BSC, Globus banking solutions system has been adopted. The customization of core banking functionalities already on offer in Globus, their testing, data conversion and deployment have been completed. New functionalities have also been developed in the Globus system for the retail banking functions specific to only SBP. On complete implementation of Globus system, all 16 field offices of SBP BSC along with SBP will be online and integrated at real time and churning out live and reliable information on the banking sector. This setup gives SBP management an immense capability of managing business risks centrally, in line with international standards.

In FY05, the pace of work increased in the area of new developments. The Prize Bond system was completed giving SBP BSC the capability to operate and monitor all operations of Prize Bonds centrally. Deployment of Cash Department part of the Issue System, was successfully completed and was carried over to the branch rollout phase. Development and testing of the "Issue Department" phase of the Issue system was also completed at Karachi issue office and presently its implementation at Lahore issue office is in progress. The currency division part is also in the final stage of its deployment.

The pace of rollout of Globus in SBP BSC field offices picked up substantially during the year. Presently twelve SBP BSC field offices are operationally online with SBP, Karachi setup whereas training in two offices (Gujranwala and Sialkot) is underway. At Hyderabad and Sukkur infrastructure deployment and the Basic Office Automation Training is in its final stages after which theapplication rollouts will start.

Table 7.1: Area-wise Deployment of Globus

Deployment Stage		Carried on to Branch Rollouts
Core Globus with customization	**SBP BSC - Karachi Office:**	
	· Operations of Banking Zone (Public Accounts Department, Deposit Accounts Department, Tellers, Local Remittances, General Banking)	All Branches
	· Operations of Refinance Division (Export Refinance, LMM)	All Branches
Core Globus with new development	**SBP BSC - Karachi Office:**	
	· Prize Bonds Operations	All Branches
	· National Savings Scheme Operations at SBP	All Branches
	· Issue System	
	– Cash Department	All Branches
	– Issue department	Four Circle Offices
	– Currency Division	SBP and SBP BSC–Accounts Departments

The implementation of advanced enterprise-wide system like Globus has resulted in substantial improvement in reliability of data and overall efficiency of user departments. Further, there has been a tremendous improvement in the quality of human resource especially in the field offices where people didn't even have the basic know-how of computers. By working on the Globus system a good number of officers are now familiar with modern banking concepts like customer and accounts management, fund transfers and securities management. A good number of processes have also been standardized and many are in the process of being streamlined by SBP BSC management. With the automation project in the completion phase, SBP is now primed to further improve its operational efficiencies.

7.3 Enterprise Resource Planning

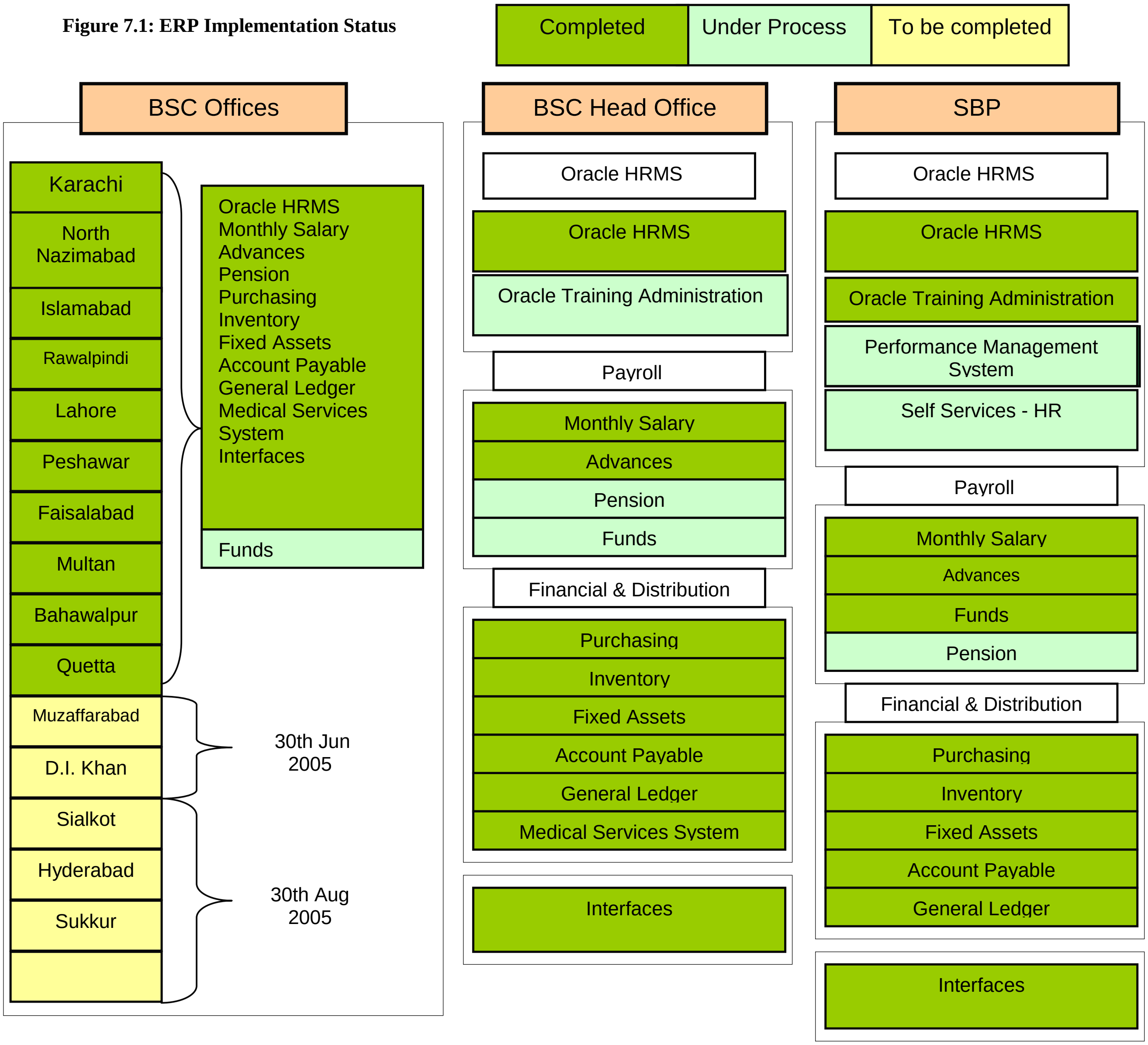
To automate and integrate the support functions and capture the data churned out by the Globus system, an Enterprise Resource Planning (ERP) tool, the Oracle E-Business Suite has been adopted. Oracle Financials part of the E-Business Suite brings with it a well-developed and tested set of business workflows that have been adopted by SBP. Its Fixed Assets module is a complete asset management solution that will assist in selecting the best accounting strategies at SBP. It gives online updates to management for additions, transfers, retirements and other unrecorded changes to ensure that asset inventory remains accurate at any point in time. Oracle Human Resource Management System (HRMS) part of the E-Business Suite has enabled SBP to achieve a well-managed human resource system, turning human resource management into a strategic advantage. It has the ability to manage the entire recruitment cycle, position and career management, succession planning, administer and maintain benefits plans and perform head counts budgeting.

Performance Management System of SBP was automated during the year where as the Oracle Self Service Human Resources (SSHR) which extends the functionality of standard Oracle HRMS by enabling both employees and managers to participate in human resources management via a web browser will be implemented in FY06. Development of Training Administration module is under progress. Leveraging largely on the information base and features of HRMS, System Enabled Process Realignment was also completed.

By the end of September 2005, the same model will be replicated in SBP BSC and its 16 branch offices. Necessary modifications have been made to accommodate unique processes. However, the basic idea is to implement a standard solution across the entire enterprise that will bring about standardization of work methodologies and allow transparency in transactions, thus making it easier to audit information by tracing it back to its origin. System can be used to do a comparative analysis of performance of different offices.

Owing to the bifurcation of SBP into two distinct parts ie SBP and SBP BSC, each entity is being treated as a separate Business Group. This is the chosen method so that in future the two entities may have their own human resource policies, promotion criteria, grades and designations. It will also provide data security by limiting the accessibility of data across business groups. Currently, SBP and SBP BSC perform a lot of services for each other (eg Medical and Engineering Services). A method has been designed by which the relevant entity can be charged for the services rendered, via inter-company transactions.

Figure 7.1: ERP Implementation Status



The implementation of ERP has made SBP more efficient by reducing manual paperwork and increasing the capabilities of various departments to handle a larger workload without having to increase manpower. Around 100 plus manual registers have been discontinued and replaced by different reports of Oracle ERP. The General Ledger (GL) entries generated within Fixed Assets, Purchasing, Inventory, Accounts Payable, Payroll and Globus will be directly entered into the system by the concerned departments, eradicating the need for creating any GL entries for these functions within the GL module. The role of Accounts Department of SBP will change towards monitoring, controlling and reporting. Limited or no flow of manual vouchers required from any of the offices for verification and processing. Automated consolidation of accounting information at SBP, SBP BSC Karachi Office and offices will now occur. This ability to consolidate information is a crucial benefit of having data available electronically across the various offices on the ERP systems.

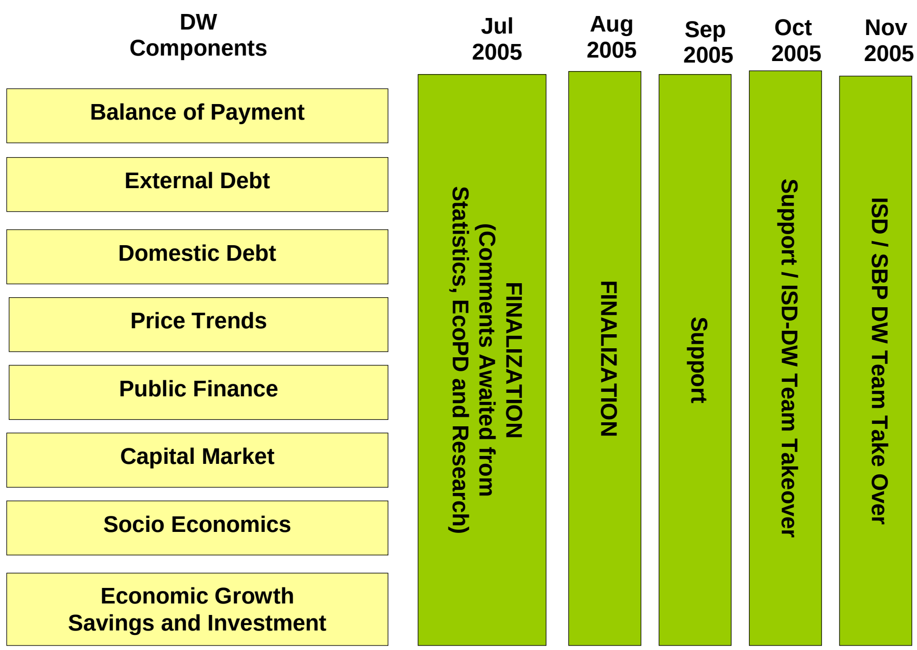
7.4 Data Warehouse

SBP is currently constructing an enterprise wide data warehouse to enhance its capacity for timely acquisition of large quantity data, its organization, storage and retrieval. The data warehouse will be connected (on line) with the other automated operational systems (like Globus and Oracle). The data warehouse will add considerable value to the monetary policy management, research and banking supervision capacity of SBP. SBP is automating data on critical indicators of the economy and banking sector, categorized in 10 major subject areas. These are:

- Credit Information Bureau
- Balance of Payments and Exchange Rates
- Banking and Money Sector
- Capital Markets
- Price Trends
- Economic Growth, Savings and Investment
- Socio-Economics
- Public Finance
- Domestic Debt
- External Debt

This Enterprise Data Warehouse (EDW) will integrate the data on these subject areas and make historic as well as current data available online. Two of the ten subject areas, Credit Information Bureau and Balance of Payments & Exchange Rates subject areas are live. The remaining subject areas have been delivered except for 'Banking and Money'. The delivered subject areas are going through another round of 'User Acceptance Testing' to check the quality and variety of reports and information to be generated by the warehouse.

Figure 7.2: SBP Data Warehouse Status of Delivered Subject Areas Timelines



System design of EDW is being finalized and in parallel, development of the Banking sector module is underway. A review session has been conducted with the SBP coordinators on the Analysis environment of this sector. Portal development is underway and a complete Solution is expected to go into testing by December, 2005. The EDW will also have a data acquisition gateway that will provide a single electronic channel for data acquisition and validation process.

The process improvements envisaged by SBP through the implementation of the above architecture are manifold.

7.4.1 Automated Data Acquisition

Banks can be mandated to use the newly established acquisition layer, which will reduce their time and effort on statutory reporting. All data formats will be pre-defined and available online for inspection. All validation rules will be automated and rigorously applied. Any data validation failure will result in the data set being passed back to the data provider for correction. This also has the added benefit of placing the onus for data quality back on the data provider rather than on SBP who currently devote large amount of resources to this effort.

7.4.2 Reduction of Redundant Data Reporting

Due to the decentralized nature of data acquisition, with many departments within the central bank acquiring data, the same data finds its way to the central banks repository. This consumes resources and slows response times thus further contributing to the inefficiency of the existing system. By centralizing this process and removing data acquisition authority from the departments, much redundancy (if not all) will be eliminated. This will streamline information supply chain and a cleaner data set for analysis purposes.

7.4.3 Greater Analysis Capabilities across the Enterprise

The EDW will cater for daily data updates that will allow data to be available within 24 hours of its receipt by SBP within the defined business rules for that particular data updates (this access time may be extended if additional data for validation and cleansing purposes is required and not yet received). Additionally, the presentation layer allows for greater flexibility in the manipulation, analysis and visualization of data with a direct “one-click” link to popular spreadsheet applications if required.

7.5 Networks

The IT infrastructure is the backbone to SBP automation drive. Dedicated personal computers have been provided to almost all officers of SBP, SBP BSC head office, local offices, and those at NIBAF. These workstations are interconnected via local area, metropolitan wide and wide area networks.

7.5.1 Local Area Network

The Core of any Information Systems is the Infrastructure over which a reliable Network setup is built up. SBP has deployed Fast Ethernet, structured network system in all SBP centers, in 15 different cities of Pakistan. The Main Data Center is in Karachi, which has state of the art campus clustered setup for the core applications of Globus and Oracle ERP. A hot backup site has been established clustered with the primary site over Fiber Optic cabling system, mirrored with the Primary Server farms in real time. The campus network has a large setup having more than 2000 desktops and workstations interconnected at over 100 Megabytes per second speed. In order to contrive this IT setup, SBP has deployed Extreme-Networks Multilayer switches at the core, Vanguard Routers at Wide Area Network (WAN) links and 3-Com switches for desktop connections.

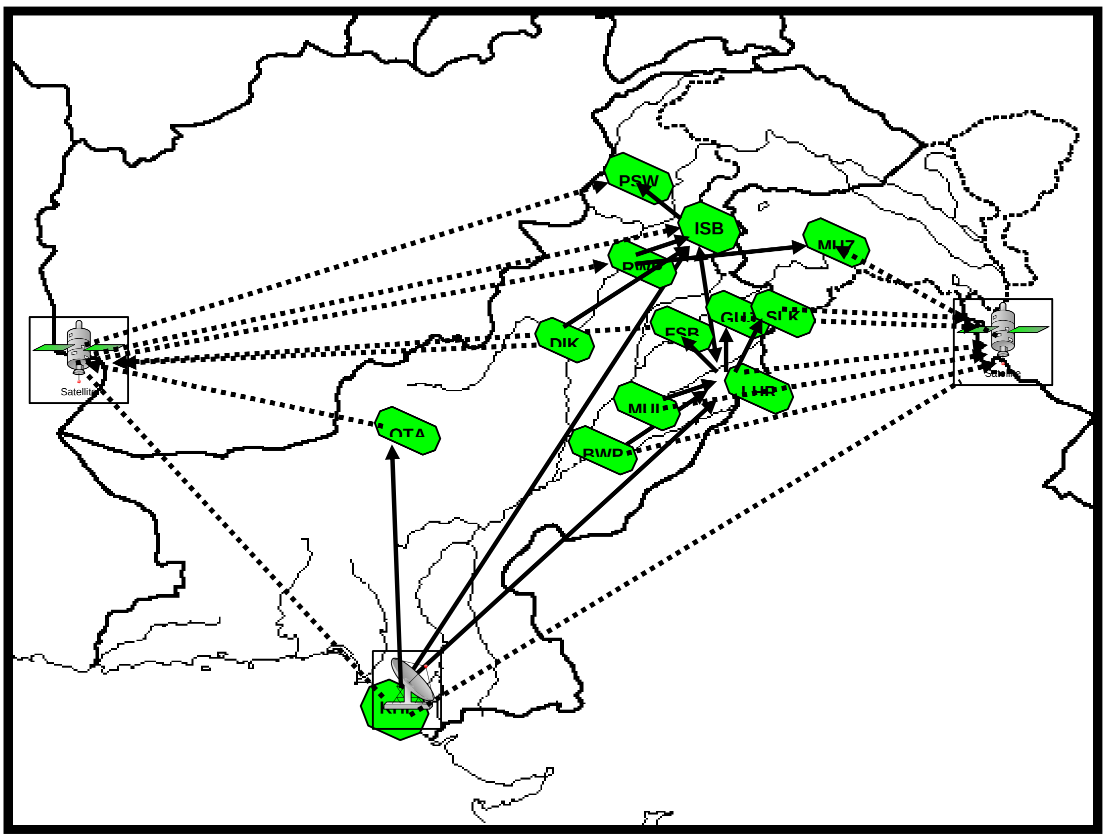
In total more than 3,494 structured 10/100 Megabits per second Local Area Network nodes have been installed so far in SBP, SBP BSC and NIBAF. All network points are powered by conditioned electricity supplied by a heavy duty Uninterrupted Power Supply situated beside the main Data Center and similar electric and data infrastructure has been deployed across all SBP BSC offices.

7.5.2 Wide Area Network

SBP WAN team designed the nationwide network to interconnect SBP and SBP BSC offices. Three WAN technologies have been used to connect SBP BSC offices outside Karachi ie (a) Microwave Wireless Bridges – for Metropolitan Area Network connectivity in Karachi, (b) Digital Cross Connect System (DXX)/High bit rate Digital Subscriber Line (DSL)- the Primary WAN medium and (c) Single Carrier Per Channel Very Small Aperture Terminal (VSAT) links – the additional WAN connectivity. For WAN connectivity over DXX/DSL nation wide, leased circuits from National Telecommunication Corporation has been obtained whereas reputed internet service providers have been engaged for providing VSAT based connectivity.

SBP has recently acquired Fiber Optic Termination at its main data center, through which the backbone E-1 connections have been made to Lahore and Islamabad, which are the other two collocation centers for other sites located geographically nearby. Another significant plan in near future is to establish an Information Extranet Systems for other financial institution to submit the required information through the Information Acquisition Gateway for the Data Warehouse project.

Figure 7.3: SBP WAN Nationwide Network



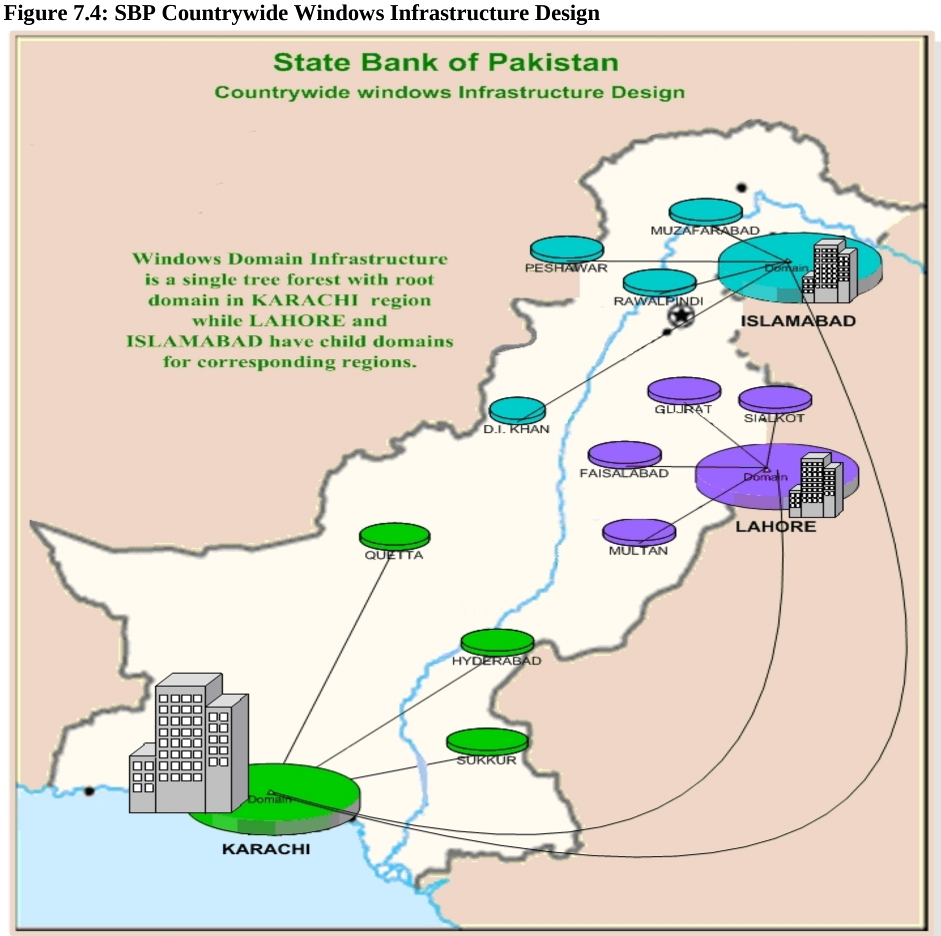
7.6 Unix Platform

The core central banking applications, including Globus, ERP, and EDW have been built on the Unix platform. At present, SBP has two data processing sites which have Hewlett Packard (HP)-UNIX based mid-range servers to run the core banking applications along with HP N-Class servers. In addition to these, there are two HP A-Class and four itanium base servers which have been procured with assistance from the Pakistan Banks Association for the credit information service for the local banking industry.

7.7 Windows Systems Infrastructure

With the introduction of IT project rollout a Hybrid Windows Systems Infrastructure has been established to provide centrally managed services to Desktop Personal Computer users at 17 country wide locations of SBP and SBP BSC. The Windows servers deployed as part of this rollout are enabling the information users to run the required business applications along with access to SBP e-mail, file sharing and internet proxy services.

Figure 7.4: SBP Countrywide Windows Infrastructure Design



The Windows Systems Infrastructure is a hierarchical Domain structure based on Microsoft Windows 2000 Active Directory; Microsoft Exchange 2000 Sever; Microsoft Internet Security and Acceleration Sever 2000, Microsoft System Management Server 2.0; and Norton Antivirus Corporate Edition 9. Following core services are provided to Desktop users in SBP and SBP BSC offices:

- Enterprise Active Directory for centralized logon and security management
- County-wide setup of E-mail Servers for intranet and internet emails
- Centralized and automated management of Internet Protocol address through out the network
- Secure Web Mail Access from Internet
- Automated management of anti virus and windows security updates
- Internet Proxy
- Centralized File Sharing services in SBP Karachi and SBP BSC Lahore.

7.8 Training

IT trainings are an important component of the IT development of SBP. A total of 2,183 officers/staff of SBP have been imparted the basic office automation training, 960 were trained in Globus and 815 in ERP.

8 Accountability, Transparency and Disclosure

8.1 Overview

The improvement in SBP image since the recent past, as a responsible central bank and regulator of the financial sector could be possible among others due to increased focus on transparency, openness, policy formulation through consultative process, information dissemination etc that enabled the central bank to operate in an environment of trust and public accountability. The FY05 witnessed further emphasis on accountability and transparency as a formal communication policy was formulated to further enhance and streamline information dissemination; the number of economic and statistical publications was increased and a medium term (2005-2010) strategic plan was unveiled to apprise the market players about SBP plans for the financial sector during next five years and give direction to internal management for future endeavors. Further the internal and the external stakeholders' surveys were conducted for the second consecutive year to assess the approval rating of various change initiatives as well as stakeholders' satisfaction on SBP performance in different areas; the results showed considerable improvement in overall satisfaction level over the last year. The accountability mechanism built in the bank's statute coupled with a culture of openness, transparency and participative decision making, which has now firmly entrenched in the organization, provides optimism for further improvement in SBP performance and image as the central bank.

8.2 Accountability *vis-à-vis* External Stakeholders

The Public at large, the Government, banks, financial institutions and financial markets constitute the important external stakeholders of SBP. It produces a number of regular publications on economic performance, monetary policy, banking and financial sector that provides a conspicuous platform to convey the central bank's assessment of economic and financial outlook in reasonable detail, and to transmit key messages to the public and financial markets. This rids the market from uncertainty and speculative sentiments and enables the market participants to make well informed decisions. It also increases the reputational cost to policy-maker for pursuing an objective different from the stated one. In other words, these documents serve as benchmarks against which the intentions of the central bank can be openly scrutinized, thus increasing transparency and accountability.

8.2.1 Parliament

SBP statute makes it accountable to the parliament. It submits quarterly reports to the parliament on performance of the economy, which besides giving a non partisan assessment of the economic policies, provides for an accountability mechanism for SBP performance review. During the year three quarterly reports on performance of the economy for the quarters ended September 30, 2004, December 31, 2004 and March 31, 2005 were published and submitted to the parliament. The reports in addition to making and independent assessment of economic performance, the growth trends in various sectors, price movements and their attributes, also highlighted SBP policy and approach to respond to various developments on economic front particularly the worsening inflationary outlook.

8.2.2 National Assembly and Senate Committees

Senior SBP officials, on request, attend meetings of various Standing Committees and sub-committees of the National Assembly and Senate to respond to the queries, questions and observations of the public representatives. During the year senior SBP officials attended quite a few such meetings and briefed the committees about various SBP initiatives for ensuring financial system stability, SBP scheme for write-off of irrecoverable loans, various reports issued by SBP, Agriculture Credit growth trends, AML Law and amendments in other banking laws proposed by SBP. Further, 28 questions raised on the floor of Senate and 39 questions raised on the floor of National Assembly on issues, relating to core functions of SBP and banking sector performance, were responded along with relevant details to satisfy the public representatives.

8.2.3 Review of SBP Performance

As another initiative to improve accountability and transparency, SBP has started publishing its annual Performance Review since FY03. The performance review takes stock of SBP initiatives to achieve progress towards strategic objectives as well as build and enhance its institutional capacity to align it with the strategic direction. During FY05, the annual performance review for FY04 was published and disseminated, enabling the internal and external stakeholders to assess its performance during FY04.

8.2.4 Review of the Banking System

The Banking System Review, now a regular quarterly activity, is another initiative to keep stakeholders fully abreast with the developments in the banking system in Pakistan and give them an assessment of the overall health, stability and resilience of the banking system, which constitutes more that 85 percent of the country's financial system. The review also highlights various policy developments and SBP regulatory and supervisory initiatives to strengthen the banking system during the particular quarter/year. During FY05, an annual banking system review for calendar year 2004 and three reviews for the quarter ended June 2004, September 2004 and March 2005 were published and widely disseminated.

8.2.5 Monetary Policy Statement

The MPS (Monetary Policy Statement), issued biannually, is one of the most significant SBP initiatives to make the monetary policy formulation and implementation process more objective, predictable and transparent. During the year SBP issued two statements and conducted monetary policy operations in conformity with the tone and direction of the statements, which landed substantial credibility to MPS.

In its first MPS for FY05 (July–December 2004), SBP reiterated its commitment to price stability and indicated a more vigilant policy stance to major economic developments particularly the rising inflationary pressure. In its second MPS for FY05 (January–June 2005), SBP signaled a more aggressive approach to rein in mounting inflationary expectations.

8.2.6 International Standards for Data Dissemination

SBP has taken a number of steps towards adopting international standards for data collection, compilation and dissemination. A major step in this direction was implementation of Balance of Payments Manual–5th edition (BPM5) of the IMF. With the implementation of BPM5 and fulfilling all requirements in other sectors, Pakistan was accepted as a member of General Data Dissemination System–a framework developed by the IMF to assist member countries to develop their statistical system with the objective of producing comprehensive and accurate statistics for policy-making and analysis.

Another set of standards prescribed by the IMF for dissemination of economic and financial data is the establishment of Special Data Dissemination Standard to enhance availability of timely and accurate statistics. The compilation of International Investment Position (IIP) of Pakistan was the only remaining element of data categories in the external sector required for SDDS subscription at the level of the central bank. This challenging task was completed during the year and IIP for 2003 and 2004 (Provisional) were disseminated in accordance with the guidelines provided by IMF in the BPM5.

8.2.7 External Stakeholders Survey

External stakeholders' survey is another initiative for improving self accountability to gauge stakeholders' perception of SBP performance in key operational areas. The results of the survey are discussed and the feedback is used as guidelines for further improving performance. Last year Institute of Bankers Pakistan had conducted the survey to assess the external stakeholders' satisfaction. This year, the survey was conducted by M/s Anjum Asim Shahid Rahman representatives of Grant Thornton International in Pakistan. The survey carried special significance this year, as the results were extensively referred to during the Strategic Management Conference held in December 2004 to develop the Strategic Plan 2005-2010.

The stakeholders were divided into two distinct categories; indirect and direct stakeholders. Banks, MFBs, DFIs and ECs were categorized into direct stakeholders while members of financial markets, chambers of commerce, business associations, media and academia were categorized in indirect stakeholders. Separate questionnaires were designed for the direct and indirect stakeholders, addressing their specific areas of concern. Special emphasis was laid on direct stakeholders as they come under direct supervision of SBP and their feedback would be the most relevant on SBP's performance. A total of 97 stakeholders participated in the survey with 100 percent response rate. 100 percent of the respondents from direct stakeholders were their senior management of which 62 percent were personally interviewed. Details on the survey methodology and description of stakeholders are in **Box 8.1**.

The survey results noted a significant improvement in overall image of SBP. The satisfaction level of the stakeholders for most of the core functions was high with the exception of foreign exchange management, credit to priority sectors and Islamic banking, which earned relatively lower satisfaction level. The efforts made by SBP in improving the working environment, quality of work and quality of human resource were recognized and appreciated by both direct and indirect stakeholders.

Figures 8.1 and **8.2** overleaf graphically explain the main results of the survey.

Box 8.1: Methodology of the External Stakeholders' Survey

A six digit rating scale was used for each of the questions to assess actual satisfaction levels within the 'very satisfied' or 'very dissatisfied' status. Open ended questions were also included to solicit recommendations and suggestions. The questions were designed to specifically gauge SBP performance vis-á-vis:

- Institutional image based on functional roles
- Assessment of resource deployment
- Quality and mode of information dissemination
- Development of policy and regulatory framework
- Operational efficiency
- Offsite and onsite monitoring assessment
- Staff Interaction
- Overall performance and growth

For the purpose of the survey, the stakeholders were divided into two categories, direct and indirect stakeholders. Banks, Development Finance Companies, Micro Finance Banks and Exchange Companies were categorized in direct stakeholders. Government Ministries, Government and Non government Organizations, Stock Exchanges, Multinational Companies, Multilateral Financial Institutions, Academic Institutions, Business Associations and Chambers, Credit Rating Agencies and the Media were categorized as the indirect stakeholders. 53 institutions were sampled from the direct stakeholders and 44 from indirect. 44 percent of the stakeholders were personally interviewed, while 90 percent of the respondents were the senior management of the stakeholder organizations.

Figure 8.1: Function Wise Satisfaction Level on SBP Performance

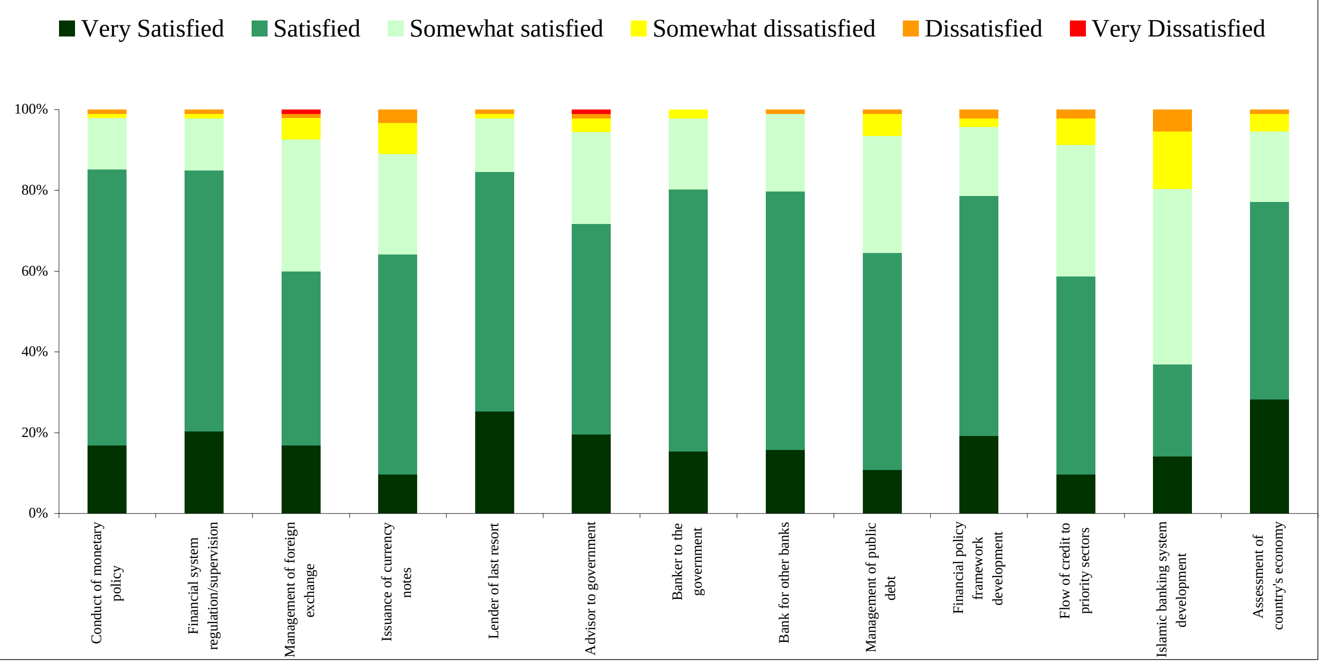
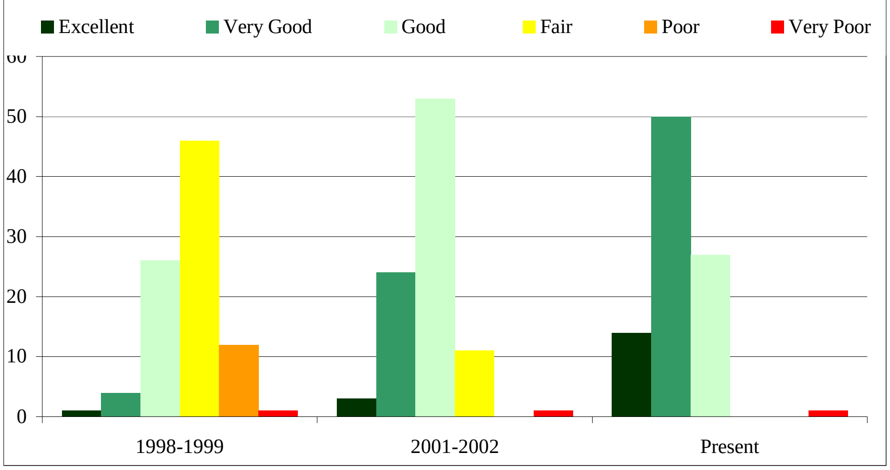


Figure 8.2: An Overall Assessment of SBP's Performance



8.3 Accountability *vis-à-vis* Internal Stakeholders

A well defined as well as well functioning internal accountability and control mechanism is a pre-requisite for building strong institutions. The restructuring and reforms in SBP in the recent years, has laid extensive focus on strengthening of the control mechanism and developing a culture of openness, trust, participative decision making and establishing open channels of communications. This has not only improved the quality of decisions and control mechanism but also enhanced employees' commitment towards organizational objectives.

8.3.1 Decision Making Process

An elaborate system of decision making is in place in SBP. Powers and responsibilities have been distributed to correspond to various levels in the organizational hierarchy. While the Central Board is the highest decision making body in SBP, to promote and institutionalize the participative decision making, Corporate Management, Group Management and Department Management Teams have been created to discuss corporate, functional group and department level issues. The same channel is used for monitoring progress of achievements and identifying bottlenecks in implementation, if any.

Central Board

The Central Board is the principal decision making body at SBP. It consists of the Governor as Chairman of the Board, Secretary Finance and seven other directors drawn from private sector. All decisions are taken by majority of the members present. Due to SBP's critical role in the economy, the members of the Central Board bring with them a wide range of experience from academia, agriculture, banking and industrial sectors of the economy.

Board Subcommittees

The Board is assisted in its work by seven Sub-Committees on Audit, Monetary and Credit Policies, Budget and Expenditure, Human Resources, Automation, Building Projects, and Investment. The Subcommittees deliberate and finalize issues related to their respective areas for final discussion and decision in the Board.

Corporate Management Team

The Corporate Management Team (CMT), responsible for decision-making at the corporate level, is headed by the Governor and consists of Deputy Governors, Executive Directors, Economic Advisor, Managing Director SBP BSC, Chief Spokesman, and Director Corporate Services Department who acts as the Secretary of the Team. The CMT acts as the principal forum for debate and decision on critical policy as well as operational issues having institution wide impact.

The CMT is assisted in its work by six Policy Groups. Three Policy groups on Human Resources, Information Technology and Payment Systems are headed by the Deputy Governor (Management) and three groups on Banking, Monetary and Exchange Rate Policy, and Exchange and Debt Management are headed by the Deputy Governor (Banking).

Group Management Team

The Group Management Team (GMT) is responsible for decision-making at the functional group level. It is headed by an Executive Director who is responsible for decision-making in respect of administrative, financial, monitoring and organizational functions relating to the cluster of departments working under him.

Departmental Management Team

The Departmental Management Team (DMT) is a forum for decision-making at the departmental level. It is headed by the Director of each department and consists of all the Divisional Chiefs reporting to him and 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.

8.3.2 Internal Audit

The Internal Audit function provides an important mechanism for internal control and accountability. The function has been strengthened extensively through capacity building, skill enhancement, induction of professionals and increasing independence under the bank's overall restructuring. The Audit Department now reports directly to the Governor/ Audit Committee of the Board and has shifted its focus from checking compliance of policies and rules towards examining and assessing the quality of the risk management, control framework and governance structure in place in different departments and organs of the bank. While initiating audit, it identifies the risks faced by the department and the framework to manage and mitigate the risks, which forms the basis of the audit program for the department being audited. During the year, the department completed risk-based audit of 16 departments, including two service departments of the SBP BSC.

To shift to complete risk based audit, the department has completed preparation of risk registers of three SBP departments ie Internal Bank Security, Information Systems, and Accounts Departments in consultation with departments' management; and has plans to complete another three by June 2006. The exercise will be followed by assigning risk ratings to the departments which will help in deciding the frequency of future audits. This will allow the Internal Audit Department to optimally utilize its resources and focus on departments and areas which possess greater risks.

8.3.3 Employee Motivation Survey

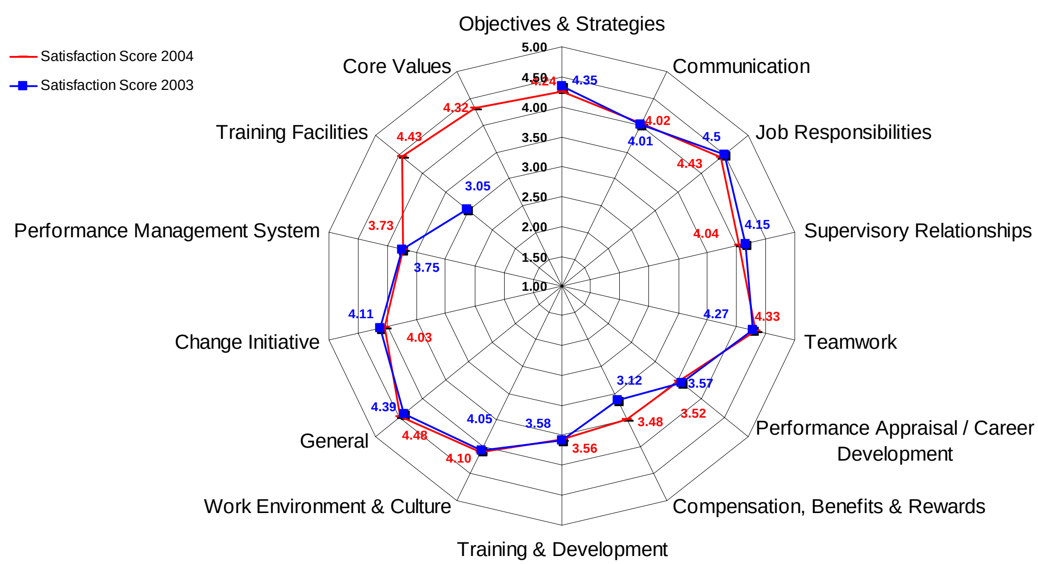
The employee motivation survey conducted in December 2004 for the second consecutive year, recorded an over all satisfaction score of 4.10 compared to 3.99 in 2003. The overall results of December 2004 survey suggested that the primary areas of concern for the employees are Performance Appraisal and Career Development, Training and Development, Compensation, Benefits and Rewards and Performance Management System in which they displayed comparatively lower levels of satisfaction ranging from 3.48 and 3.73 where as Job Responsibilities, Training Facilities, level of Teamwork, and Objectives and Strategies received high satisfaction rating form 4.33 to 4.48. Detailed results of the 2004 survey results with comparison to 2003 survey results is graphically illustrated in **Figure 8.3** and the Methodology in **Box 8.2**.

Box 8.2: Methodology of Employee Motivation Survey

The survey methodology comprised of a questionnaire designed to collect employees' (OG-2 and above) feedback on current level of employees' satisfaction, employee motivational factors, strengths and weaknesses of employee-related policies and approval rating for various recently introduced change initiatives. The survey questionnaire facilitates to identify key aspects that can be worked upon to improve employees' satisfaction in the following categories:

- Objectives and Strategies
- Communication
- Job Responsibilities
- Supervisory Relationships
- Teamwork
- Performance Appraisal and Career Development
- Compensation, Benefits and Rewards
- Training and Development
- Work Environment and Culture
- General (Questionnaire and Feedback)
- Change Initiative
- Performance Management System
- Training Facilities
- Core Values

Figure 8.3: Comparison of 2003 and 2004 Survey Results



8.3.4 Improvements in Quality of Work Environment

After the survey conducted in year 2003, departmental Survey Action Teams were formed within SBP to analyze the results of the survey and to draw Survey Action Plans for consolidating the areas of strengths and addressing the gaps identified. Various projects have been underway to further improve quality of work environment for the employees of SBP. Recently, work on establishment of a gymnasium, renovation of the canteen building and Medical Services Department was completed.

8.4 Corporate Social Responsibility

As a responsible and socially conscious corporate entity, SBP has taken several initiatives. The initiatives include beautification and up-gradation of I.I. Chundrigarh Road, establishing a state of art and well equipped Learning Resource Centre for SBP staff, students and researchers, rehabilitation of Boultan Market Building and establishing a Museum to exhibit the cultural and artistic heritage collected by SBP since its establishment in 1948.

The Learning Resource Centre with a Library, syndicate rooms, self learning work stations, reference rooms, computer facilities and auditorium will soon be opening to cater to the learning needs of the staff, students, academics, researchers, media persons etc. The Learning Resource Centre will be a one-stop resource shop for its users. Queries about SBP can be routed to the Learning Resource Centre, which will allow those interested in seeking information about SBP to gain access to relevant information in the shortest possible time.

The Learning Resource Centre will also have a Media Information Center and Bookshop. The Manager Learning Resource Centre will proactively promote and market its facilities like the auditorium to banks, financial institutions and other organizations for holding seminars, meetings and other events. An Event Manager, reporting to the Manager Learning Resource Centre, will be responsible for organizing seminars, conferences and special events at the Centre. Once the Learning Resource Centre is launched and running successfully, this project may be replicated in other SBP offices around the country.

The SBP Museum likely to be established by November 2005 will serve the following objectives; (i) to preserve our cultural heritage that exists in the form of the old SBP Building and the acquisitions we have made over time, (ii) to provide an opportunity to the general public and especially the younger generation to learn about SBP's history, money and coins, monetary policy and its evolving role over time and (iv) to establish a tradition of cultural exchange with other museums around the world particularly those owned and managed by central banks.

9 Strategic Plan 2005-2010

9.1 Overview

Strategic planning exercise at SBP was initiated in early 2000 with the development of a detailed concept paper on functional and organizational status of the bank and its future vision and plans. The paper broadly outlined plans for functional improvements in the areas of monetary policy formulation, supervision and regulation of the financial institutions, exchange and reserves management and payment systems, and highlighted the management strategies to align the institutional capacity with these functional objectives. SBP is now firmly committed to this change process and is building up a supportive infrastructure necessary for continued excellence. To review the progress of the change process, annual Change Management Conferences were held from 2000 to 2003. The conferences also served as an important self-accountability tool and brought together the top management of SBP in a consultative and consensus seeking mode. SBP has come a long way since the initiation of the Change Management Program in 2000. The transformation process is ongoing and SBP is yet to cross many milestones in its journey towards becoming a more proactive, dynamic and responsive central bank.

Most of the reform initiatives undertaken since 2000 under the Change Management Program were due for completion by the end of 2004. The most immediate task was, therefore, to formulate a 'successor' program and ensure continuity of reforms. With the experience of change process, SBP realized the importance of flexibility in planning and opted for establishing a strategic planning framework over long term planning. A Strategic Planning Unit was setup to facilitate and institutionalize the strategic planning process and a medium term Strategic Plan 2005-2010 was developed through extensive consultation with internal and external stakeholders. The plan will serve as a blueprint of SBP's reforms agenda for the next five years and envisages leveraging organizational strong points, minimizing areas of weakness and exploiting developmental opportunities to ensure continued excellence in achieving strategic objectives. The strategic plan will be implemented by aligning the subsequent annual departmental business plans with the strategic plan and reviewed after three years to keep it relevant with the changing circumstances and continuously aligned with the central bank's overall mandate.

9.2 Objectives and Key Features

The Strategic Plan 2005-2010 provides direction to SBP management for future endeavors and initiatives and gives clear signals to the banking and financial industry about SBP plans for the financial sector in the medium term. The plan has identified specific actions for each of the strategic objective, to be initiated and completed during next five years. The extensive stakeholder involvement in the plan build-up process lends it the ownership necessary for success of the plans. The Strategic Plan will ensure that SBP continues to pursue its strategic objectives of broadening access of financial services to all segments of the population, ensuring soundness of the financial sector, effective monetary management of the economy, prudent exchange and reserve management, and efficient and sound payment system. The Strategic Plan will also ensure that SBP has the necessary institutional capacity that the institutional development process keeps pace with the developments in strategic areas as well as expectations of the stakeholders.

9.3 Strategic Action Plan 2005-2010

9.3.1 Financial Sector Deepening and Broadening of Access

The banking system, in the recent years, has been able to broaden the access of financial services to agriculture, SMEs, consumer finance, micro finance and Islamic financing. The impact of this broad based access to institutional credit on the economy has been both direct as well as indirect. The stimulus to aggregate demand through private sector credit expansion has resulted in higher production, employment and growth. SBP has also removed restrictions imposed on nationalized commercial banks for consumer financing. The short to medium term Strategic Plan is to consolidate and build on the existing initiatives in agriculture finance, SMEs, Mortgage and Microfinance. The strategy includes strengthening of the existing microfinance regime, expansion of agriculture credit to small farmers and for livestock and development of a robust SME sector. Under the Strategic Plan, the commercial banks' SME finance capacity will be strengthened, liaison with SMEDA and other public and private service providers will be enhanced and an SME credit guarantee fund would be established to encourage banks to develop the SMEs portfolio.

Islamic banking is fast becoming popular not only in Pakistan, but all over the world. Cognizant of this fact a two-pronged strategy of attracting international banks of quality to locate in Pakistan and nurture a cadre of professional Islamic bankers domestically, has been devised under the Strategic Plan.

9.3.2 Proactive Supervision and Regulation of Financial Institutions

The Strategic Plan envisions building upon the successes achieved during last five to six years in financial system soundness and strengthening the regulatory and supervisory systems. To strengthen the off-site surveillance system, SBP plans to implement the new IRAF and augment CAELS framework by "stress-testing and scenario analyses". The new IRAF will provide continuous monitoring and enhance SBP capacity to identify the weaknesses and problems at an early stage and to take timely remedial action. The framework will bring together crucial offsite surveillance and on-site inspection information, through an automated system for proactive supervision of banks and early detection of banking crisis.

To resolve potential banking crisis, SBP plans to formulate an agile banking crisis resolution mechanism through implementation of Prompt Corrective Action regime and reinforce it with modification in the BCO 1962. This will prove critical in preempting and resolving potential banking crisis in a systematic and orderly fashion.

Cognizant of the risks arising out of money laundering, SBP has been vigilant in the area through consultations with all the stakeholders and representatives of the banking industry and has made Know Your Customer framework more stringent. Under the Strategic Plan, as the AML law becomes fully operational, SBP will facilitate setting up of a Financial Intelligence Unit, intensify contacts with the new Economic Crime Wing under NAB and lay down rules of engagement to prevent, detect, and prosecute banking crimes. For achieving consolidated supervision, cooperation with other regulatory bodies (foreign and local) will be intensified for enhanced off-site monitoring and targeted on-site inspections of cross border branches.

Under the Strategic Plan, a smooth transition from Basel-I to Basel-II and institutionalization of stress testing will strengthen the existing risk management regime in the medium to long term. To accomplish this task SBP plans to enhance internal capacity to assess the banks' risk measurement, management and mitigation efforts on a systematic basis.

9.3.3 Privatization of the Public Sector Banks and Divestment of Government shares in Privatized Banks

The banking sector, which was fully dominated by Nationalized Commercial Banks (NCBs), has now been opened up to the private sector. Four out of the big five NCBs have been privatized. Under the Strategic Plan, SBP plans to facilitate the Government in privatization and divestment of Industrial Development Bank of Pakistan, SME Bank & ZTBL, and divestment of remaining Government shares in the already privatized banks. The strategy is to proactively play its role as an advisor and facilitator of the privatization process by bringing improvements in the selection of strategic investors, due diligence process, and successful completion of the transactions.

9.3.4 Strengthen the Financial Sector

To further strengthen the financial sector, SBP will focus on introducing a safety net through the intended DIS scheme and a phased increase in the regulatory capital requirement. Although the minimum capital requirement has been raised to Rs2 billion, effective from end December 2005. SBP is aiming to prescribe US$100 million as minimum capital by end of 2009 to bring it in line with international standards. At present, there are ten banks with US$100 million capital. In the coming years, the professional development of the human resource base of banking industry will be an area of major focus. SBP has formed several working groups of the banking industry to come up with appropriate recommendations, which after review by the Pakistan Bankers Association and approval by SBP, will form the basis of Human Resource Policy guidelines for all the banks.

9.3.5 Conduct Forward Looking Policy Analysis

It has long been recognized that monetary policy management needs a forward-looking dimension due to the existence of long lags between policy actions and their intended effects on output and inflation. SBP plans to build a macro model to make dynamic impact analysis of various policy scenarios. This will help in exploring the inter-linkages in macroeconomic variables, particularly understanding the transmission mechanism of monetary policy. At the same time, SBP plans to strengthen the forecasting group to make it more effective and result oriented. The revision in monetary aggregate is particularly important for SBP as it anchors its monetary policy to the monetary aggregate. SBP plans to compile M3 on monthly basis.

9.3.6 Enhance Effectiveness of Monetary Policy Implementation

SBP relies heavily on OMOs to implement its monetary policy. Experience shows that at times the market remains significantly liquid or illiquid, as SBP is not able to intervene at the desired level and overnight rates face volatility. In order to manage the short-term call money market more effectively, SBP plans to introduce the Liquidity Adjustment Facility in Pakistan. The proposed framework will be subject to a regular quarterly review by the Monetary and Exchange Rate Policy Committee (MERPC). Under the Strategic Plan, SBP also plans to restructure the existing MERPC in the medium to long term through extending its membership to two external experts on monetary policy, raising its status as a decision making body by introducing necessary changes in the SBP Act, and releasing minutes of the meeting to the public after suitable time lags.

9.3.7 Improve Research and Data Dissemination Capability

SBP plans to publish a Monthly Inflation Monitor that will contain analytical charts and tables on prices. At a later stage, this document will be transformed into an Inflation Report that will not only evaluate the developments in inflation and economic conditions, but also analyze the linkages between monetary developments and inflationary trends.

With a view to improving its profile in scientific research, under the Strategic Plan, SBP plans to substantially increase the quantum of working paper by 2010. SBP also plans to estimate expenditure patterns on the basis of annual surveys conducted by Federal Bureau of Statistics. The monitoring and analysis of expenditure patterns is important for determining the impact of economic policies on income distribution, poverty, consumption and saving behavior.

SBP is also planning to develop a mechanism for periodic review of all data series compiled. Some of the statistical series have outlived their utility whereas information on other highly useful variables such as employment, nominal and real wages, corporate debt, household debt, real estate and construction price indices are missing. Primary data collection is at present limited to banking and monetary statistics. This strategy will help in increasing the scope, coverage and quality of data to support policy makers, researchers and other stakeholders.

9.3.8 Deepening of Financial Markets

Introduction of Zero Coupon Yield Curve through the bootstrapping process is being planned under the Strategic Plan. New financial products will be traded in the Money/Bonds market by the introduction of Zero Coupon Yield Curve and Bond Stripping. Corporations have already been encouraged to launch their own financial instruments like Term Finance Certificates etc. Although the amount raised by this instrument is still insignificant in relation to the equity market, the rate of growth is very encouraging. Recognizing the need for tradable financial instruments for Islamic banking treasury operations, SBP plans to design and implement these new instruments. SBP is also planning the listing of government securities particularly PIBs on the stock exchange. This will broaden the investor base through inclusion of retail/small institutions.

9.3.9 Prudent Exchange Rate and Reserves Management

Foreign exchange reserves form part of the national assets and these needs to be deployed rationally keeping in mind the principles of safety, liquidity, and return. The reserves, which are currently deployed by SBP’s in-house reserve management treasury dealers, are in short-term high quality bank deposits. Under the Strategic Plan, SBP plans to improve the return on these reserves, within the Central Board’s approved risk parameters, through capacity building of the front, middle and back offices and to develop competitive benchmarks for future performance.

SBP is presently monitoring exchange companies through weekly returns and on-site inspections. Exchange companies in Category B have already been given one year to organize themselves, appoint CEOs with proper qualifications and experience and to automate systems. Under the Strategic Plan, SBP plans to develop an effective monitoring system for these companies. There is also a strong need to have on-line real time monitoring of these companies, which SBP plans to establish by end of 2006.

Partial capital account convertibility has been achieved in Pakistan and all current account transactions can be carried out without any prior approval or restrictions. Under the Strategic Plan, capital account convertibility plan will be evolved in a phased manner so that the immediate impact on balance of payments remains limited and manageable. Once the experience from this partial liberalization is gathered, the next round of reforms can be designed for further movement in this direction. Foreign Exchange Regulations Act 1947 will also be updated to make it in sync with the Economic Reforms Act 1992.

9.3.10 Efficient and Sound Payment Systems

The planned implementation of RTGS system will automate the inter-bank settlement process of large value payments at SBP. An important component of the project is reviewing of the existing legal framework and its updating to cater for RTGS system. Further, to reduce the settlement time significantly and increase cost effectiveness, SBP plans to establish an electronic clearinghouse. Instead of paper cheques, its image will be forwarded by payee’s bank using secured network and the clearing will be done automatically. SBP also plans to promote accelerated adoption of e-banking and ensure that all banks get networked and connected electronically within the next two years

9.3.11 Human Resource Development

Following the implementation of modern management practices in the areas of recruitment, performance management, career advancement, and training and development in the last five years, SBP now plans to increase employee attraction, retention and motivation. Under the Strategic Plan, SBP will be reducing recruitment timelines, devising innovative compensation and benefit plans, establishing employee counseling, providing equitable training opportunities and enhancing the performance management systems. To develop the capacity to offer market based targeted compensation and benefits packages for the high performers, line managers' ability to provide performance-based incentives is being enhanced. Moreover, flexi benefit plans are being introduced to address the needs of a diverse workforce. Equitable training opportunities will be identified for line and support staff through specialized higher education to ensure continuous up-gradation of skills and knowledge base in their respective areas.

9.3.12 Strengthening of Legal Framework

A number of new areas are emerging where SBP plans to venture or has already initiated work, like e-banking, DIS, electronic clearinghouse, Public Key Infrastructure, Exim Bank and Digital Certification. Under the Strategic Plan, SBP will assist in formulating and strengthening the legal framework governing these areas. Many of the functional strategies listed above encompass either updating/changing the existing legal frameworks or facilitation of enactment of new laws in areas like AML, Private Credit Bureaus, Banking Crisis Resolution, Islamic Banking, Capital Account Liberalization and legislation for Government Securities.

9.3.13 Business Process Re-engineering

The focus of Business Process Re-engineering is to enhance the operational efficiency and internal controls by removing redundancies in business processes while taking advantage of the implementation of Globus, ERP and RTGS. Under the Strategic Plan, SBP will bring the existing reporting system online and expand the current reporting framework by 2006. A new Chart of Accounts will be implemented and an interface of Globus with the 'Project for Implementation of Financial Reporting and Accounting' will be developed to enhance efficiency in reporting of Government Accounts.

9.3.14 Information Technology

The data analysis requirements of SBP and the need to use appropriate business intelligence applications are ongoing. On complete automation of SBP with IT systems like ERP, Globus, and EDW, the Project Management Office will hand over the IT systems to the Information Systems Department. It is SBP's long-term plan to keep the quality of application up-dated as per the business needs for continuously improving its data management capacity. SBP will be continuously looking into various available options to upgrade it existing IT systems and bring in new software where ever necessary.

9.3.15 Strengthening of Contingency Mechanisms

To ensure continuity of critical functions (time sensitive) of SBP and prevent any major disruption in financial system of the country, SBP plans to establish a technology Disaster Recovery Center to cope with any interruption due to a technology fault or a disaster. The enforcement mechanisms to ensure regular testing and up-dating will be in place by end 2005 and will be coordinated by the Business Continuity Process coordinator with the relevant critical departments.

SBP Subsidiaries

10 State Bank of Pakistan Banking Services Corporation
11 National Institute of Banking and Finance

10 State Bank of Pakistan Banking Services Corporation

10.1 Overview

The SBP BSC came into existence after bifurcation of SBP under SBP Banking Services Corporation Ordinance-2001. It started operations from January 2, 2002 as a subsidiary of SBP and has successfully passed through an embryonic phase of three and a half years. According to the charter of SBP BSC, all retail banking functions fall under purview of its management. At present, SBP BSC has eight departments and 16 field offices all over Pakistan. The retail banking business performed by SBP BSC mainly include currency management, banker to the federal and provincial governments, banker to commercial banks, foreign exchange operations, management of savings and debt instruments of the government, remittance of funds etc. SBP BSC is headed by a Managing Director, supported by Directors heading the departments and Chief Managers heading the field offices.

10.2 Corporate Structure of SBP BSC

The general superintendence, direction and management of the affairs and business of SBP BSC and overall policymaking in respect of its operations are vested in its Board of Directors. The Board of Directors is the governing body of all businesses performed by SBP BSC. In discharging its functions, the Board ensures compliance of the orders and directions that are issued by SBP from time to time. The Board meets at regular intervals to take vital decisions in connection with SBP BSC's operations. Some of the areas in which decisions were made during the period under review are as follows:

- Budget and accounts related matters, including budgetary reviews;
- Human Resources policy issues and training budget of SBP BSC;
- Matters relating to pensioners;
- Engineering projects and maintenance issues;
- Upgrading of Printing Press of the SBP BSC and
- Strengthening and improving internal controls mechanism in the SBP BSC.

10.2.1 Constitution of the Sub-committees

The Board of Directors of SBP BSC is supported by different sub-committees, which have been assigned terms of reference to supervise policy and operational matters. The following three sub-committees have been constituted for this purpose at SBP BSC level.

- Sub-Committee of the Board on Human Resources
- Sub-Committee of the Board on Audit
- Sub-Committee of the Board on Budget and Expenditure

The above sub-committees are actively monitoring various operations of the SBP BSC and analyzing the issues referred to them as per their terms of reference approved by the Board

10.3 Currency Management

Given the predominantly cash-based economy of the country, currency management has been one of the key functions of SBP BSC. Exclusive efforts have been made to streamline the processes and bring efficiency in the currency management that included formulation of currency management framework/guidelines for training of the relevant stakeholders to manage the currency related matters. The automation of the related processes/activities and completion of roll out of Globus Banking

Solutions in the 16 field offices will bring further efficiency besides improving the process of currency management.

10.4 Banker to the Government

SBP BSC performs the treasury functions on behalf of the federal as well as provincial governments at its 16 field offices. All government receipts and payments are routed through its field offices for the areas falling within their respective jurisdiction. In addition, all the receipts/payments made by NBP on behalf of the government are also reported to the concerned field office of SBP BSC. This provides an interface between the NBP, the Government and Accounts Department of SBP BSC at its Head Office, Karachi. Further more, as the banker to the Government, it is obligatory for SBP to provide debt management services on different floatation of loans, repayments, redemption etc. The operational management of public 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 is carried through field offices of SBP BSC.

10.5 Operational Arm of SBP

The SBP BSC is also performing functions as an operational arm of SBP. This role has no specific boundaries, as it is the statutory obligation of SBP BSC to perform the functions entrusted by SBP. Some of the important functions assigned by SBP are as follows:

10.5.1 Export Finance-Disbursement and Monitoring

SBP BSC undertakes all operational functions for disbursement under the export finance scheme, including execution of agreements with banks, recording of loans in the books and recovery of both mark-up and principal.

10.5.2 Foreign Exchange Operations

While SBP deals with the policy matters relating to foreign exchange, some operational functions related to this area have been assigned to the Foreign Exchange Operations Department (FEOD) of SBP BSC. The FEOD is responsible for implementation of foreign exchange policies framed by SBP for exchange rate stability. It operates through units formed at the field offices. The supervision and final compilations of data are carried out at the Head Office. The inflow and outflow 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 also the prime concern of SBP BSC in close coordination with Exchange Policy Department of SBP.

10.5.3 Local Credit Advisory Committees

Local Credit Advisory Committees have been formed at the field offices of SBP BSC to keep close liaison with all regional/local stakeholders. These committees have representation from various segments of the economy *vis-à-vis* banks, DFIs, government departments, chamber of commerce & industry, SME associations, farmers associations and other businessmen. The chief managers of the field offices chair the meetings of the committees held on quarterly basis. The committees have been useful in creating awareness about various financial services available to SMEs & farmers and in resolving issues in flow of adequate funds to these sections. The handsome growth in agriculture and SME credit during last couple of years could partly be ascribed to the role of these committees.

10.5.4 Operational Role in Monetary Management

Field offices of SBP BSC help in the implementation of the monetary policy, which is formulated by SBP. At operational level, since SBP BSC offices maintain the accounts of the commercial banks and other financial institutions to maintain their CRR and Statutory Liquidity Requirement as well as for their placements, the field offices facilitate concerned departments of SBP in monitoring of the statutory requirements for maintaining various reserves. SBP BSC Karachi office interacts frequently with relevant departments of SBP. It also provides back office support to SBP in conducting the OMOs, auction of Treasury Bills and PIBs etc.

10.5.5 Payment System

In order to assist SBP in carrying out its prime responsibility as a custodian of the payment system, the field offices of SBP BSC perform multiple services through their counters besides providing clearing and settlement facilities. 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 features of payment services handled at Public Accounts Department/Deposit Accounts Department counters of the SBP BSC field offices. 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. The implementation of RTGS will bring further efficiencies in settlement system besides eliminating the risk associated with day end settlement system.

10.6 Human Resources

The total number of regular employees working in SBP BSC at the end of June 2005 are 5,452 consisting of 638 employees at Head Office and 4,814 employees at its 16 field offices. Moreover, 208 employees are also working on contract/ daily wages or part time basis in different capacity. The details of the strength of human resource in SBPBSC are given in **Table 10.1**.

Table 10.1: Total Working Strength of SBP BSC

Head Office / Field Offices	Position as on	
	June 30, 2004	June 30, 2005
Head Office Karachi	643	638
Bahawalpur	102	96
Dera Ismail Khan	91	88
Faisalabad	308	309
Gujranwala	79	82
Hyderabad	243	247
Islamabad	256	250
Karachi	1,172	1,106
Lahore	924	910
Multan	240	240
Muzaffarabad	61	63
North Nazimabad, Karachi	140	177
Peshawar	426	426
Quetta	206	202
Rawalpindi	303	306
Sialkot	144	142
Sukkur	172	170
Total	**5,510**	**5,452**

SBP BSC is actively engaged in improving and refining human resource policies based on modern management practices. The primary focus of SBP BSC human resource policies is to improve the skill set of employees through extensive trainings in the relevant areas. During FY05, 760 officers attended training programs offered by NIBAF, Institute of Bankers Pakistan and other training institutes. Further, a policy of regular rotations and promotions has been introduced to prepare the capable and committed for higher positions.

11 National Institute of Banking and Finance

11.1 Overview

Growth and development in the banking sector in recent years has generated tremendous scope and demand for training and capacity building. Realizing its role as the training arm of SBP, NIBAF has continued to build the capacity of the central bank at all levels, by diversifying the training base, introducing advance and specialized courses for senior managers, meeting the training gaps in terms of delivery & coverage and making qualitative improvements in the training curriculum both at the post induction and skill up-gradation levels.

With a view to move towards self-reliance and to fully utilize the resource potential after meeting SBP needs, the institute's strategy and policy thrust was to gradually include and enhance training activities for other financial institutions. Some of the areas worth exploring were bilateral collaborations with private commercial banks and other financial institutions both at home and abroad. As a result the number of training programs for other institutions increased significantly thereby utilizing unused resources and boosting the quantum of revenue. The policy of exploring new avenues and bringing into its training fold new stakeholders paved the way for gradual movement towards self reliance and proved a major breakthrough in marketing its services that strengthened the resource base as well as enhanced the trust and confidence of the financial sector in NIBAF.

11.2 Academic Performance FY05

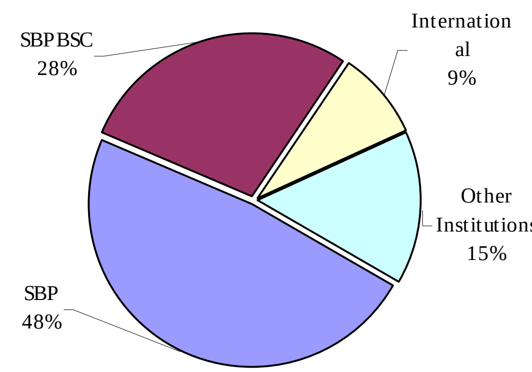
During FY05, NIBAF not only continued to fill the skill gap of SBP and SBP BSC but also addressed the multi-faceted training needs of domestic commercial banks. It also included developing countries in its training ambit, enabling it to further market its expertise and optimally harness the potential of the institution. Since SBP requirement for skills up-gradation at foundation level has almost been addressed, the focus during FY05 remained on offering intermediate and higher-level courses in central banking, commercial banking and management. Five such courses spread over an eight-week duration were conducted for the first time for the middle and senior level officers of SBP (**Table 11.1**).

Table 11.1: Achievement against Target for FY05

Training Programs	Target			Actual delivered			Variance
	ISD	KHI	Total	ISD	KHI	Total	
SBP	**26**	**48**	**74**	**15**	**52**	**67**	**-7**
1. Post Induction	22	0	22	13	-	13	-9
2.Skill Up-gradation	4	48	52	2	52	54	0
a) Foundation	-	24	24	-	26	26	2
b) Intermediate	-	20	20	-	20	20	0
c) Advance	4	4	8	2	6	8	0
SBP BSC	**19**	**19**	**38**	**19**	**19**	**38**	**0**
International	**8**	**-**	**8**	**12**	**-**	**12**	**4**
Other institutions	**-**	**-**	**-**	**20**	**-**	**20**	**20**
Sub-Total	**53**	**67**	**120**	**66**	**71**	**137**	**17**
Facilities Outsourced	**30**	**-**	**30**	**100**	**6**	**106**	**76**
Total Weeks	**83**	**67**	**150**	**166**	**77**	**243**	**93**

Though almost fifty percent of the total trainings planned and delivered were for SBP, the share of SBP BSC also witnessed an increase to twenty eight percent of the total business plan (**Figure 11.1**). The training needs of SBP BSC were addressed at the skills up-gradation levels against their demand while a total of 38 weeks training was delivered as planned at both Islamabad and Karachi campuses.

Figure 11.1: NIBAF Trainings by Stakeholders



NIBAF also helped and facilitated in hosting two Training of Trainers conducted by Research Department and Economic Policy Department of SBP, each of two-week duration during FY05.

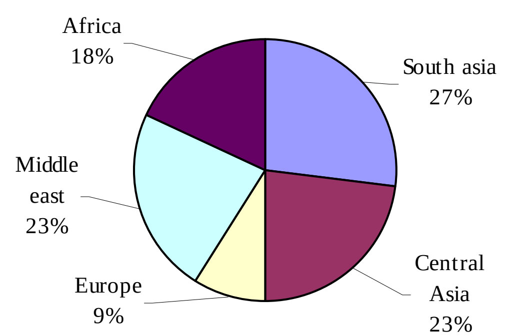
11.3 New Areas of Training

During the year, 12 weeks of international training programs were arranged against the planned target of 8 weeks. Whereas, another 20 weeks of customized and specialized trainings were delivered for domestic commercial banks that enabled the institute to earn the esteem and confidence of stakeholders.

11.3.1 International Training Programs

One of the major achievements during FY05 has been the success of international training programs. The institution succeeded in expanding the coverage of the two regular International Training Programs that are now largely attended by the nominees from over 30 friendly countries of different regions as shown in **Figure 11.2**. Further, during FY05, the increasing number of self financed participants reflects the rising image and repute of the training programs and facilities offered to international participants. Besides the regular international programs, NIBAF accommodated requests from foreign banks/institutions at a short notice including Seychelles Savings Bank. Moreover, a special training program on SBP transformation process, structural change, information systems transformation, human resource management and the change management program, was successfully designed and delivered for a group of officials from Central Bank of Sri Lanka, headed by their Assistant Governor, at NIBAF Islamabad. NIBAF also successfully hosted a three days conference of South Asia Association for Regional Cooperation Finance Coordinators which was well received by international and national participants both in terms of issues discussed and arrangements made.

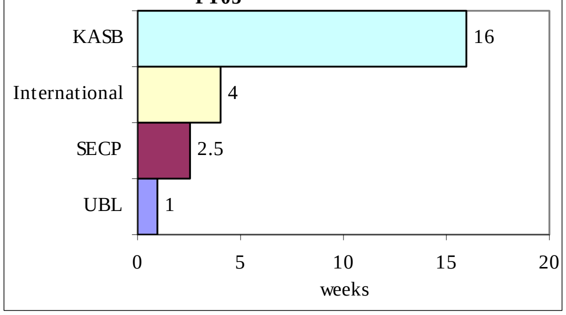
Figure 11.2: Regional Participation in International Trainings



11.3.2 Training Programs for Commercial Banks and Financial Institutions

During FY05, NIBAF designed and delivered a customized Post Induction Management Trainee Program of 18 weeks duration for 20 newly recruited management trainees of KASB Bank. The program has been well received by the banking industry and prospects of further demand for such programs are bright.

Figure 11.3: Additional Training Programs FY05



Further, to open new avenues and generate clientele from the financial sector, NIBAF designed customized training program for UBL (1 week), SECP (2.5 weeks) and Bank Alfalah in the areas of audit of consumer finance, international accounting standards, credit, foreign trade, general banking, AML and Know Your Customer (**Figure 11.3**). Moreover NIBAF's facilities were utilized to host workshops, seminars and training of other institutions, namely Khushhali Bank, Institute of Bankers Pakistan, Askari Commercial Bank, SME Bank, NBP, Bolan Bank, Ministry of Finance, NAB, COMSATS, and Central Board of Revenue.

11.4 Qualitative Developments

To carry out training programs in a yet more professional and systematic manner, NIBAF took a number of initiatives during the year:

- Training calendars, both for domestic and international programs, were developed to facilitate the stakeholders in identifying the areas of their interest and process nominations accordingly.
- Joint biannual meetings were held with Departmental Training Coordinators of SBP and SBP BSC with a view to get feedback and to further improve the quality and productivity of trainings. The trainee evaluation criteria was also revisited by introducing some modes of evaluation including group projects, presentation, assignment and developing of case studies.
- Curriculum up-dation committees comprising of experienced bankers, professionals and academics have been formed to review the existing curricula and recommend necessary changes in line with recent developments and trends in the banking and financial industry.
- A database of experienced trainers in the areas of economics, banking and management has been developed for contracting the best available trainers for different training programs.
- A draft-training catalogue has been prepared that highlights NIBAF capacity to offer different modules to meet the need of its stakeholders and the financial sector other than the regular programs. The objective of this catalogue is to provide comprehensive information on course objective, contents, target group, pre-requisite, duration, location and training methods.
- Establishment of NIBAF Alumni network has been initiated and profile of a number of trainees attended our international training programs have been computerized. This will be placed on NIBAF website and will be updated on regular basis.
- An Islamic banking certification course has been designed to cater to development needs of potential and exiting workforce of Islamic banking. The course is aimed at building the capacity of bankers to deliver Islamic banking products and services.
- A Memorandum of Understanding with Shore Bank of United States has been signed for assistance and capacity building of commercial banks in micro and rural finance under the United States Agency for International Development's Widened Harmonized Action for Micro Finance program.

Finances of SBP and its Subsidiaries

12 Annual Budget Review

12.1 Overview

Budget is an important part of business planning exercise conducted annually and reviewed quarterly. While the business plan envisages the activities and tasks planned for the next financial year, the budget provides estimates of financial resources required to perform these tasks and activities. The Business Planning and Budgeting Division was established in Accounts Department in 2001, to oversee and consolidate business planning and budgeting exercise being conducted in SBP.

The Business Planning and Budgeting Division facilitates the departments in budget preparation process, prepares corporate budget that comprises of the outlays which don't fall under the purview of any specific department and consolidates the departmental budget to make overall budget for SBP. In order to facilitate the budgeting exercise at SBP, a Budget Manual was prepared during the year and disseminated to all the departments. The Manual guides the departments in charting out their budgetary needs for the upcoming year. The main features of the manual are detailed in **Box 12.1**.

Box 12.1: Budget Manual Features

- The manual defines the linkage between business plans and the budget. It explains how the business plans are translated into monetary terms and form part of the budgetary allocation (requirements of HR, IT and training or office equipments for example).
- It guides the user through the whole process of budgeting by defining each step along the way at the micro level (department level) and how the budget consolidates at the institutional level.
- The manual defines the process of the budget through a process flow chart which makes it more user-friendly and easy to understand.
- The manual helps in budgeting different heads of account by classifying every head of account into variable, semi variable and fixed costs. It also identifies linkage of various heads of account to a specific department. Further the Accounts department provides the rate lists of the items concerned for the facilitation of the departments in making estimation of budgets for certain heads of accounts.
- To standardize the budget review process, it defines how the presentation on budget review is made at the end of each quarter and which heads of account are of main concern at those review meetings.

Review of financial performance of SBP and SBP BSC against the budget for FY05 shows a negative variance of Rs610.222 million (7.2 percent) as the total consolidated expenditure remained at Rs9,142.700 million against the yearly budget of Rs8,532.478 million. The major expenditure was the corporate cost, at Rs4,565.434 million it constituted about 50 percent of the overall expenditure. Analysis of major costs is narrated hereunder.

12.2 Corporate Expenses

Corporate Expenses consist of Agency Commission Charges, Notes and Cheque Printing Charges and special drawing rights (SDR) charges. The corporate expenses at Rs4,565.434 million were 7.9 percent higher than the budgetary allocation of Rs4,230.000 million. The negative variance of Rs335.434 million is attributable to rise in Agency Commission and SDR charges. The Agency Commission Charges rose due to enhanced Government transactions of receipts and payments, whereas the SDR charges reflected negative variance due to the dual impact of increased SDR interest rates and depreciation of PKR *vis-à-vis* SDR.

12.3 Establishment Expenses

Establishment Expenses include Salaries, staff benefits, medical expenses and training expenses. The total establishment expenses for the year under consideration were Rs3,328.552 million (36.4 percent of total expenditure) as against the budget of Rs3,293.302 million resulting in a slight negative variance of Rs35.250 million (1.1 percent).

12.4 Operating Expenses

Operating Expense were Rs1,248.714 million (13.7 percent of total expenditure) as against budget of Rs1,009.176 million hence reflected a negative variance of Rs239.538 million (23.7 percent). The negative variance would be ascribed to the fees paid to Fund Managers amounting to Rs252.491 million which were not budgeted originally on the premise that these expenses will be netted off against income from the portfolio. However, the amount has been reclassified as expenditure as required by the International Accounting Standards.

A consolidated statement of SBP and SBP BSC regarding expenditure *vis-à-vis* budget is placed in **Table 12.1**.

Table 12.1: SBP Annual Review of the Budget FY05

		STATE BANK OF PAKISTAN				SBP BANKING SERVICES CORPORATION				CONSOLIDATED			
	Head of Account	**Budget 2004-05**	**Actual Expenses 2004-05**	**Budget Variance**	**Bud/Act Variance %age**	**Budget 2004-05**	**Actual Expenses 2004-05**	**Budget Variance**	**Bud/Act Variance %age**	**Budget 2004-05**	**Actual Expenses 2004-05**	**Budget Variance**	**Bud/Act Variance %age**
1)	**Corporate Expenses**	**4230.000**	**4565.434**	**-335.434**	**-7.9%**	-	-	-	-	**4230.000**	**4565.434**	**-335.434**	**-7.9%**
1.1	**Agency Commission Charges**	**1500.000**	**1743.991**	**-243.991**	**-16.3%**					**1500.000**	**1743.991**	**-243.991**	**-16.3%**
1.2	**Notes Printing Charges**	**2500.000**	**2486.249**	**13.751**	**0.6%**					**2500.000**	**2486.249**	**13.751**	**0.6%**
1.3	**Charges on Allocation of SDRs**	**230.000**	**335.194**	**-105.194**	**-45.7%**					**230.000**	**335.194**	**-105.194**	**-45.7%**
2)	**Establishment Expenses**	**837.812**	**832.234**	**5.578**	**0.7%**	**2455.490**	**2496.318**	**-40.828**	**-1.7%**	**3293.302**	**3328.552**	**-35.25**	**-1.1%**
2.1	**Salaries**	**638.000**	**615.191**	**22.809**	**3.6%**	**2079.990**	**2078.328**	**1.662**	**0.1%**	**2717.990**	**2693.519**	**24.471**	**0.9%**
2.2	**Rest and Recreation**	**17.500**	**16.560**	**0.940**	**5.4%**	**62.000**	**60.575**	**1.425**	**2.3%**	**79.500**	**77.135**	**2.365**	**3.0%**
2.3	**Other benefits**	**82.312**	**60.548**	**21.764**	**26.4%**	**68.000**	**125.959**	**-57.959**	**-85.2%**	**150.312**	**186.507**	**-36.195**	**-24.1%**
2.4	**Medical Expenditure:**	**94.000**	**133.761**	**-39.761**	**-42.3%**	**240.500**	**218.634**	**21.866**	**9.10%**	**334.500**	**352.395**	**-17.895**	**5.35%**
i)	In Service employees	42.594	48.816	-6.222	-14.6%	195.500	194.264	1.236	0.6%	238.094	243.080	-4.986	-2.1%
ii)	Retired employees	51.406	84.945	-33.539	-65.2%	45.000	24.370	20.630	45.8%	96.406	109.315	-12.909	-13.4%
2.5	**Training Expenditures**	**6.000**	**6.174**	**-0.174**	**-2.9%**	**5.000**	**12.822**	**-7.822**	**-156.4%**	**11.000**	**18.996**	**-7.996**	**-72.7%**
3)	**Operational Expenses**	**688.746**	**957.245**	**-268.499**	**-39.0%**	**320.430**	**291.469**	**28.961**	**9.0%**	**1009.176**	**1248.714**	**-239.538**	**-23.7%**
3.1	**Rent Taxes Insurance and lighting**	**38.500**	**32.485**	**6.015**	**15.6%**	**113.750**	**102.667**	**11.083**	**9.7%**	**152.250**	**135.152**	**17.098**	**11.2%**
	Rent Taxes and Insurance	26.000	20.005	5.995	23.1%	8.750	8.317	0.433	4.9%	34.750	28.322	6.428	18.5%
	Utilities charges	12.500	12.480	0.020	0.2%	105.000	94.350	10.650	10.1%	117.500	106.830	10.67	9.1%
3.2	**Fees Paid to outsiders**	**36.308**	**291.173**	**-254.865**	**-702.0%**	**3.760**	**4.533**	**-0.773**	**-20.6%**	**40.068**	**295.706**	**-255.638**	**-638.0%**
	Directors	2.000	2.052	-0.052	-2.6%	0.000	0.000	0.000	0.000	2.00	2.052	-0.052	-2.6%
	Auditors	1.300	1.480	-0.180	-13.8%	1.500	1.750	-0.250	-16.7%	2.800	3.230	-0.43	-15.4%
	Legal	6.600	13.493	-6.893	-104.4%	2.260	2.783	-0.523	-23.1%	8.860	16.276	-7.416	-83.7%
	Professional	26.408	21.657	4.751	18.0%	0.000	0.000	0.000		26.408	21.657	4.751	18.0%
	Fund Managers Expenses	0.000	252.491	-252.491		0.000	0.000	0.000		0.000	252.491	-252.491	

Table 12.1: SBP Annual Review of the Budget FY05

		STATE BANK OF PAKISTAN				SBP BANKING SERVICES CORPORATION				CONSOLIDATED			
	Head of Account	Budget 2004-05	Actual Expenses 2004-05	Budget Variance	Bud/Act Variance %age	Budget 2004-05	Actual Expenses 2004-05	Budget Variance	Bud/Act Variance %age	Budget 2004-05	Actual Expenses 2004-05	Budget Variance	Bud/Act Variance %age
3.3	**Stationery and Publication**	**7.250**	**6.379**	**0.871**	**12.0%**	**8.500**	**7.931**	**0.569**	**6.7%**	**15.750**	**14.310**	**1.44**	**9.1%**
	Stationery	2.750	2.360	0.390	14.2%	8.500	7.931	0.569	6.7%	11.250	10.291	0.959	8.5%
	Publication	4.500	4.019	0.481	10.7%					4.500	4.019	0.481	10.7%
3.4	**Depreciation**	**412.000**	**392.992**	**19.008**	**4.6%**	**50.000**	**47.122**	**2.878**	**5.8%**	**462.000**	**440.114**	**21.886**	**4.7%**
	Depreciation to Bank Property	400.000	379.333	20.667	5.2%	47.000	44.782	2.218	4.7%	447.000	424.115	22.885	5.1%
	Depreciation - Vehicles	12.000	13.659	-1.659	-13.8%	3.000	2.340	0.660	22.0%	15.000	15.999	-0.999	-6.7%
3.5	**Traveling Expenditures**	**61.700**	**52.437**	**9.263**	**15.0%**	**23.600**	**17.461**	**6.139**	**26.0%**	**85.300**	**69.898**	**15.402**	**18.1%**
	Traveling	22.000	14.864	7.136	32.4%	5.100	3.896	1.204	23.6%	27.100	18.760	8.34	30.8%
	Daily Allowance	34.000	31.453	2.547	7.5%	11.500	8.180	3.320	28.9%	45.500	39.633	5.867	12.9%
	Conveyance & Fuel Charges	5.700	6.120	-0.420	-7.4%	7.000	5.385	1.615	23.1%	12.700	11.505	1.195	9.4%
3.7	**Communication**	**61.500**	**57.613**	**3.887**	**6.3%**	**12.345**	**11.205**	**1.140**	**9.2%**	**73.845**	**68.818**	**5.027**	**6.8%**
	Postage/Tele/Fax/Internet/Site Charges	22.000	29.035	-7.035	-32.0%	12.345	11.205	1.140	9.2%	34.345	40.240	-5.895	-17.2%
	V-SAT, other network charges	25.500	12.468	13.032	51.1%					25.500	12.468	13.032	51.1%
	Swift, Reuter's, Bloomberg Charges	14.000	16.110	-2.110	-15.1%					14.000	16.110	-2.11	-15.1%
3.8	**EDP Maintenance**	**5.869**	**42.365**	**-36.496**	**-621.8%**					**5.869**	**42.365**	**-36.496**	**-621.8%**
3.9	**Computer Consumables**	**4.131**	**5.646**	**-1.515**	**-36.7%**	**10.000**	**4.798**	**5.202**	**52.0%**	**14.131**	**10.444**	**3.687**	**26.1%**
3.10	**Repairs and Maintenance Bank**	**30.000**	**46.158**	**-16.158**	**-53.9%**	**8.500**	**9.881**	**-1.381**	**-16.2%**	**38.500**	**56.039**	**-17.539**	**-45.6%**
3.11	**Miscellaneous Expenses**	**31.488**	**29.997**	**1.491**	**4.7%**	**89.975**	**85.871**	**4.104**	**4.6%**	**121.463**	**115.868**	**5.595**	**4.6%**
	GRAND TOTAL	**5756.558**	**6354.913**	**-598.355**	**-10.4%**	**2775.92**	**2787.787**	**-11.867**	**-0.4%**	**8532.478**	**9142.700**	**-610.222**	**-7.2%**

13 Annual Financial Performance Review

13.1 Overview

SBP earned a net profit of Rs31,049 million in FY05 as compared to the profit of Rs6,108 million in FY04. The phenomenal increase in net profit is attributable to enhanced exchange earnings, interest income on foreign currency reserves, markup and discount on local currency assets. A detailed analysis of expenditure and income is given below.

13.2 Expenditure

SBP's expenditure may be classified into the following broad categories:

- Corporate cost
- Establishment cost
- Operating expenses

The principal head of expenditure ie establishment cost consists of two major items; current staff salaries and benefits (68.8 percent), and retirement benefits (31.2 percent). This cost decreased by Rs643 million (from Rs5,078 million in FY04 to Rs4,441 million in FY05) mainly due to one-off provisioning against employees benefits last year. The operating expenses registered increase of Rs346 million (from Rs994 million last year to Rs1,338 million in FY05) due to fees of fund managers and custodian and increase in amortization/depreciation charged for the year. The corporate cost (comprising note printing charges, SDR charges and agency commission to NBP) increased by Rs819 million (from Rs3,746 million to Rs4,565 million) due to enhanced volume of Government transactions, introduction of new notes and increase in charges on allocation of SDR because of depreciation of PKR *vis-à-vis* SDR (from Rs85.2253 as at June 30, 2004 to Rs87.3675 on June 30, 2005).

13.3 Income

13.3.1 Net Interest Income

The net Interest income has grown four time this year from Rs6,532 in FY04 million to Rs27,473 million in FY05. The growth is attributable to rising yields.

Discount, Interest/ Markup and/or Return Earned

The interest/markup and return income registered a phenomenal increase due to increase in interest rate on foreign exchange reserves (Federal Reserve Bank discount rate increased gradually from 1.25 percent per annum to 3 percent per annum during the year) as well as depreciation of PKR *vis-à-vis* US Dollar. The breakup of the interest/markup income in terms of foreign and domestic assets is given in **Table 13.1**.

Table 13.1: Interest/Discount/Return Income on Foreign and Domestic Assets
(Million Rupee)

	2005	2004
Interest/discount income on foreign assets	15,023	6,979
Interest/discount income on domestic assets	14,734	4,755
Interest/Discount/Return Income on Foreign and Domestic Assets	**29,757**	**11,734**

The breakup of foreign currency reserves is given in **Table 13.2**:

Table 13.2: Foreign Currency Reserves

Equivalent PKR in million

	2005	2004
Investments	180,149	138,313
Deposit Accounts	424,008	490,622
Current accounts	7,870	3,398
SDR with IMF	13,569	13,827
Total	**625,596**	**646,160**

The primary interest bearing domestic currency assets comprise of SBP's lending to the Government and banks as tabulated in **Table 13.3**:

Table 13.3: Lending to Government and Financial System

(Million Rupee)

	2005	2004
Government securities	332,129	134,515
Overdraft to Governments	22,814	17,533
Banks and financial institutions	215,180	187,906
Total	**570,123**	**339,954**
Yield on Treasury Bills	**2.08% to 7.94%**	**1.21% to 4.32%**
Markup on Export finance	**1.5% to 6.5%**	**1.5% to 2.0%**

Lending to the Government and banks registered an increase of 67 percent during the year. This coupled with increase in the yield on Treasury Bills and increase in rate of markup on export finance were the major reasons for more than two hundred percent increase in the income on domestic currency assets.

Interest and Markup Expense

Interest markup expense increased from Rs1,387 million (excluding one-off expense relating to ZTBL) to Rs2,284 million. The increase in interest cost was due to increase in deposits held under capital reserve requirements and the rate of remuneration thereon which ranged from 0.87 percent to 2.13 percent during the year as compared to the last year band of 0.59 percent to 0.67 percent. Moreover, interest on deposits of foreign central banks and international organizations also escalated and ranged from 1.79 to 4.74 percent as compared to previous year's range of 1.36 to 3.1 percent.

13.3.2 Commission Income

SBP derives commission income from management of public debt, issuance of drafts and payment orders, Prize Bonds and National Saving Certificates. The commission income for the year worked out at Rs693 million thereby registering an increase of Rs197 million over the last year's commission income of Rs496 million.

13.3.3 Exchange Gain/(Loss) – Net

The loss/gain under this head represents the amount of exchange difference on sale and purchase of foreign currencies, SDR transactions and revaluation of forex assets and liabilities. The gain/loss under this head depends on exchange rate of PKR *vis-à-vis* US Dollar and other international currencies. During the year FY05, the PKR depreciated by Rs1.53 against US Dollar (from Rs58.16 at June 30, 2004 to Rs59.69 as at June 30, 2005) and by Rs2.14 against SDR (from Rs85.23 as at June 30, 2004 to Rs87.37 on June 30, 2005). The comparative exchange rate of major currencies with PKR as at June 30, 2004 and 2005 is given in **Table 13.4**:

Table 13.4: Exchange Rate

	PKR		Appreciation(+) Depreciation(-)	
	June 30, 2005	**June 30, 2004**	**FY05**	**FY04**
US Dollar	59.69	58.16	(-) 2.56%	(-) 0.60%
Pound Sterling	108.27	105.95	(-) 2.14%	(-) 9.62%
Japanese Yen	0.54	0.54	-	(-) 11.11%
Euro	71.96	70.69	(-) 1.76 %	(-) 6.73%
SDR	87.37	85.23	(-) 2.45%	(-) 4.97%

The exchange income for FY05 is Rs13,828 million as against last year's income of Rs755 million showing an increase of Rs13,073 million.

The detailed breakup of the exchange account is given in **Table 13.5**:

Table 13.5: Breakup of the Exchange Account
(Million Rupee)

Gain / (loss) on:	**2005**	**2004**
- Foreign currency placements, deposits and other accounts - net	15,692	3,797
- Open market operations (including currency swap arrangements)	185	(39)
- Forward covers under Exchange Risk Coverage	(106)	180
- Payable to the IMF	(1,943)	(3,183)
	13,828	**755**

13.3.4 Dividend Income

SBP has a significant equity investment portfolio valued at Rs30.342 billion (at cost). The portfolio comprises shares of banks and financial institutions. Dividend income on investments increased from Rs1,422.1 million during the previous year to Rs1,502.6 million during the year FY05, yielding an average return of 4.95 percent on the equity investment portfolio.

13.3.5 Other Operating Income

The other operating income for the year amounted to Rs328 million as compared to income of Rs368 million last year. Income under this head represents income derived from penalties on banks and financial institutions, fee from CIB services, profit on sale of securities and gain or loss on mark to markets of securities and derivatives.

13.3.6 Other income

Income derived by SBP from other than normal operations stood at Rs4,203 million for FY05. Other income includes income from sale of investments in banks and financial institutions and profit on disposal of fixed assets. There was a decline in other income mainly due to sale of only 12.5 percent stake in Habib Bank Limited as compared to 26 percent last year, to Agha Khan Fund for Economic Development through the Privatization Commission.

13.4 Distributable Profit

After accounting for provision against loans and advances, investments and other assets to the tune of Rs6,634 million, SBP utilized the available profit of Rs31,492 million (including Rs443 million transferred from surplus on fixed assets to the profit) for a dividend of Rs10 million, transfer of Rs10,000 million to Reserve Fund, Incentive Bonus of Rs60 million to employees and payment of surplus profit to federal government amounting to Rs21,422 million subject to adjustment of receivables from Government of Pakistan (**Table 13.6**).

Table 13.6: Summary Statement of Profit and Loss
(Million Rupee)

	FY05	FY04
Income		
Net Interest income	27,473	6,532
Exchange gain	13,828	755
Dividend Income	1,502	1,422
Commission	693	496
Other Operating income	328	368
Other income	4,203	7,242
Gross income	48,027	16,815
Expenditure		
Corporate costs	4,565	3,746
Establishment costs	4,441	5,079
Other operating costs	1,338	994
Other expenditure	-	321
Provisions	6,634	567
	16,978	10,707
Net Profit	**31,049**	**6,108**

14 Consolidated Financial Statements of SBP and its Subsidiaries

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CHARTERED ACCOUNTANTS
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SHAHRAH-E-FAISAL
KARACHI

TASEER HADI KHALID & CO.
CHARTERED ACCOUNTANTS
1st FLOOR, SHEIKH SULTAN TRUST
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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, 2005 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 and Accounting Policy for Investments as stated in note 2.5 to the financial statements 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.
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:

During the year, Bank has made provision of Rs. 1,551 million relating to net assets recoverable from Reserve Bank of India, the Government of India and those pertaining to transactions in former East Pakistan. This provision has been recorded as other liability of the Banking Department and relevant assets and liabilities have not been netted off. Accordingly, assets of Issue Department and Banking Department are overstated by Rs. 2,028 million and Rs. 4,082 million respectively and liabilities and unrealized appreciation on gold reserve of the Banking Department are overstated by Rs. 5,236 and Rs. 874 million respectively.

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 and Accounting Policy for Investment as stated in note 2.5 to the financial statements approved for adoption by the Central Board of the Bank and are further in accordance with accounting policies consistently applied except for change in accounting policy as stated in note 2.5 to the financial statements; 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 and Accounting Policy for Investment as stated in note 2.5 to the financial statements 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, 2005 and of the profit, their cash flows and changes in equity for the year then ended.

M. Yousuf Adil Saleem & Co.
Chartered Accountants
Karachi
Date : 30 Aug 2005

Taseer Hadi Khalid & Co.
Chartered Accountants
Karachi
Date : 30 Aug 2005

State Bank of Pakistan and its Subsidiaries - Issue Department

Consolidated Balance Sheet

As at June 30, 2005

	Note	**2005**	2004
		(Rupees in '000)	
ASSETS			
Gold reserves held by the Bank	*3*	**53,870,004**	47,532,115
Foreign currency reserves	*4*	**472,513,815**	500,312,132
Special Drawing Rights of the International Monetary Fund	*5*	**11,794,613**	13,826,690
Notes and rupee coins:			
- Indian notes representing assets receivable from the Reserve Bank of India	*7*	**592,981**	543,793
- Rupee coins	*8*	**2,961,213**	2,799,163
		3,554,194	3,342,956
Investments	*10*	**162,802,630**	45,671,523
Commercial papers	*11*	**78,500**	78,500
Assets held with the Reserve Bank of India	*12*	**1,251,952**	1,139,741
		705,865,708	611,903,657
LIABILITY			
Bank notes issued	*13*	**705,865,708**	611,903,657

The annexed notes 1 to 48 form an integral part of these financial statements.

Ishrat Husain	**Mansur-ur-Rehman Khan**	**Aftab Mustafa Khan**
Governor	**Deputy Governor**	**Director Accounts**

State Bank of Pakistan and its Subsidiaries - Banking Department
Consolidated Balance Sheet
As at June 30, 2005

	Note	**2005**	2004
		(Rupees in '000)	
ASSETS			
Local currency	*8*	**145,618**	160,830
Foreign currency reserves	*4*	**139,513,286**	132,021,383
Earmarked foreign currency balances	*6*	**11,937,000**	3,780,277
Special Drawing Rights of the International Monetary Fund	*5*	**1,774,629**	-
		153,370,533	135,962,490
Reserve tranche with the International Monetary Fund under quota arrangements	*14*	**10,315**	10,062
Securities purchased under agreement to resale	*9*	**9,115,545**	-
Current account of the Government of Balochistan	*20.5*	**2,114,045**	5,533,119
Investments	*10*	**199,272,646**	124,986,262
Loans, advances and bills of exchange	*15*	**224,254,125**	200,225,826
Balances due from the Governments of India and Bangladesh (former East Pakistan)	*16*	**4,082,161**	3,846,494
Property, plant and equipment	*17*	**7,111,835**	7,475,666
Intangible assets	*18*	**20,871**	370
Other assets	*19*	**7,938,056**	12,911,864
Total assets		**607,290,132**	490,952,153
LIABILITIES			
Bills payable		**1,099,683**	494,365
Current accounts of the Government	*20*	**104,917,734**	48,889,002
Securities sold under agreement to repurchase	*21*	**1,208,613**	-
Deposits of banks and financial institutions	*22*	**196,312,269**	156,170,805
Other deposits and accounts	*23*	**86,622,086**	83,028,804
Payable to the International Monetary Fund	*24*	**96,653,981**	102,405,234
Other liabilities	*25*	**24,010,325**	20,313,153
		510,824,691	411,301,363
Deferred liability - staff retirement benefits	*26*	**9,779,959**	9,151,321
Deferred income	*27*	**414,061**	286,195
Total liabilities		**521,018,711**	420,738,879
Net assets		**86,271,421**	70,213,274
Share capital	*28*	**100,000**	100,000
Allocation of special drawing rights of the International Monetary Fund		**1,525,958**	1,525,958
Reserves		**16,714,474**	16,714,474
Unappropriated profit		**10,060,000**	-
		28,400,432	18,340,432
Unrealised appreciation on gold reserves	*30*	**51,646,593**	45,205,621
Surplus on revaluation of property, plant and equipment	*17.2*	**6,194,503**	6,637,328
Minority interest		**29,893**	29,893
		86,271,421	70,213,274

CONTINGENCIES AND COMMITMENTS *31*

The annexed notes 1 to 48 form an integral part of these financial statements.

Ishrat Husain **Governor**	**Mansur-ur-Rehman Khan** **Deputy Governor**	**Aftab Mustafa Khan** **Director Accounts**

State Bank of Pakistan and its Subsidiaries
Consolidated Profit and Loss Account
For the year ended June 30, 2005

	Note	2005	2004
		(Rupees in '000)	
Discount, interest / mark-up and / or return earned	32	**29,757,649**	11,734,111
Interest / mark-up expense	33	**2,284,108**	5,202,091
		27,473,541	6,532,020
Commission income	34	**692,958**	496,454
Exchange gain- net	35	**13,827,713**	755,172
Dividend income		**1,502,639**	1,422,058
Other operating income-net	36	**327,904**	367,824
		43,824,755	9,573,528
Direct operating expenses			
Note printing charges	37	**2,486,249**	1,963,777
Agency commission	38	**1,743,991**	1,554,969
Provision for:			
- loans, advances and other assets		**4,687,861**	566,906
- diminution in value of investments		**395,129**	-
- other doubtful assets		**1,551,419**	-
		6,634,409	566,906
		32,960,106	5,487,876
General administrative and other expenses	39	**5,779,637**	6,073,234
OPERATING PROFIT/ (LOSS)		**27,180,469**	(585,358)
Other income	40	**4,203,976**	7,241,967
		31,384,445	6,656,609
Other charges	41	**335,209**	548,111
NET PROFIT FOR THE YEAR		**31,049,236**	6,108,498

The annexed notes 1 to 48 form an integral part of these financial statements.

Ishrat Husain	**Mansur-ur-Rehman Khan**	**Aftab Mustafa Khan**
Governor	**Deputy Governor**	**Director Accounts**

State Bank of Pakistan and its Subsidiaries
Consolidated Cash Flow Statement
For the year ended June 30, 2005

	Note	**2005**	2004
		(Rupees in '000)	
Profit for the year after non-cash items	*42*	**41,289,935**	15,075,209
(Increase) / decrease in assets			
Reserve tranche with the International Monetary Fund under quota arrangements		**(253)**	(502)
Investments		**(155,428,609)**	(17,894,456)
Discount income received		**18,590**	-
Securities purchased under agreement to resell		**(9,115,545)**	-
Loans, advances and bills of exchange		**(28,106,793)**	(26,057,979)
Foreign currency reserves not included in cash and cash equivalents		**(138,799)**	(1,528,452)
Indian notes representing assets receivable from the Reserve Bank of India		**(49,188)**	(8,631)
Assets held with the Reserve Bank of India		**(9,129)**	(33,929)
Other assets - net		**(4,043,773)**	1,035,362
		(196,873,499)	(44,488,587)
Increase / (decrease) in liabilities			
Notes in circulation		**93,962,051**	89,012,613
Bills payable		**605,318**	(177,566)
Current accounts of the Government		**59,447,806**	(38,362,020)
Deposits of banks and financial institutions		**40,141,464**	14,505,757
Securities sold under agreement to re-purchase		**(68,109,552)**	-
Other deposits and accounts		**3,593,282**	2,060,651
Payable to the International Monetary Fund		**(5,751,253)**	(18,528,150)
Other liabilities - net		**17,658,252**	(240,555)
		141,547,368	48,270,730
		(14,036,196)	18,857,352
Payment of retirement benefits and employees' compensated absences		**(479,566)**	(2,123,594)
Receipt of dividend income		**1,502,639**	1,431,808
Gold purchased		**-**	(64,589)
Fixed capital expenditure		**(352,766)**	(264,026)
Proceeds from property, plant and equipment		**976,789**	272,923
		1,647,096	(747,478)
Dividend paid		**(10,000)**	(10,000)
Increase in cash and cash equivalents		**(12,399,100)**	18,099,874
Cash and cash equivalents at beginning of the year		**650,298,878**	632,199,004
Cash and cash equivalents at end of the year	*43*	**637,899,778**	650,298,878

The annexed notes 1 to 48 form an integral part of these financial statements.

Ishrat Husain	**Mansur-ur-Rehman Khan**	**Aftab Mustafa Khan**
Governor	**Deputy Governor**	**Director Accounts**

State Bank of Pakistan

Consolidated Statement of Changes in Equity

For the year ended June 30, 2005

(Rupees in '000)

			Reserves									
	Share capital	**Allocation of SDR of the IMF**	**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 Property, Plant and Equipment**	**Unappropriated profit**	**Total**
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 property, plant and equipment realised on disposal	-	-	-	-	-	-	-	-	-	(112,444)	112,444	-
Dividend	-	-	-	-	-	-	-	-	-	-	(10,000)	(10,000)
Unrealised appreciation on gold reserves during the year	-	-	-	-	-	-	-	-	6,322,390	-	-	6,322,390
Balance profit transferred to the Government of Pakistan	-	-	-	-	-	-	-	-	-	-	(6,210,942)	(6,210,942)
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
Net profit for the year ended June 30, 2005	-	-	-	-	-	-	-	-	-	-	31,049,236	31,049,236
Surplus on revaluation of property, plant and equipment realised on disposal	-	-	-	-	-	-	-	-	-	(442,825)	442,825	-
Dividend	-	-	-	-	-	-	-	-	-	-	(10,000)	(10,000)
Unrealised appreciation on gold reserves during the year	-	-	-	-	-	-	-	-	6,440,972	-	-	6,440,972
Balance transferable to the Government of Pakistan	-	-	-	-	-	-	-	-	-	-	(21,422,061)	(21,422,061)
Balance at June 30, 2005	100,000	1,525,958	5,414,474	2,600,000	1,600,000	1,500,000	900,000	4,700,000	51,646,593	6,194,503	10,060,000 *	86,241,528

***** The Central Board has proposed to transfer the Rs. 10,000 million to the Reserve fund after approval of the Federal Government. Further, as per Board's decision an amount of Rs. 60 million has been earmarked for incentive bonus to employees of the Bank, to be decided by management of the Bank.

The annexed notes 1 to 48 form an integral part of these financial statements.

Ishrat Husain
Governor

Mansur-ur-Rehman Khan
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, 2005

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 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 Statement of compliance

- These financial statements have been prepared in accordance with the requirements of the International Accounting Standards (IASs) and investment policy as stated in note 2.5 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 and policy for investments as stated in note 2.5 for adoption by the Bank.

- 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 investments, gold reserves and certain fixed assets, as referred to in notes 2.5, 2.6 and 2.7 have been included at revalued amounts.

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 profit and loss account as and when incurred. 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 (GoP). These coins are purchased from the GoP at their respective face values. The unissued coins form part of the assets of the Issue Department.

2.4 Impairment

The carrying amounts of the Bank's assets are 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. An impairment loss is recognised in profit and loss account whenever the carrying amount of an asset or a group of assets exceeds its recoverable amount. 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 in the profit and loss account.

2.5 Investments

During the year, the Bank has changed its accounting policy regarding investments. This change has been made in order to give a more appropriate presentation and measurement of investments. Earlier Bank measured investment in debt securities at cost and other securities at lower of cost or market value. In revised policy, these are initially measured at cost being the fair value of consideration given. Transaction costs are included in the initial measurement of investments. Subsequent to initial measurement, the Bank measures and classifies its investments under the following categories:

Held for trading:

These securities are either acquired for generating a profit from short term fluctuation in market price, interest rate movements, dealer's margin or securities included in a portfolio in which a pattern of short term profit making exists. These instruments are subsequently re-measured to fair value. All related realized and unrealized gains and losses are recognised in the profit and loss account.

All purchases and sales of investments categorised as held-for-trading that required delivery with the time frame established by regulation or market convention (‘regular way’ purchases and sale’) are recognised at the trade date, which is the date bank commits to purchase or sell the investment. Other wise transactions are treated as derivative until settlement occurs.

In accordance with the allowed alternative treatment specified in International Accounting Standard 8 “Net Profit or Loss for the period, Fundamental Errors and Changes in Accounting Policies”, the effect of this change in accounting policies has been recognised in the current year and the comparative information has not been restated. Had the accounting policy not been changed, the net profit for the year and the carrying value of trading portfolio would have been higher by an amount of Rs. 1,153 million. Restated proforma information assumes that the new policy had always been in use is given in note 45 to these financial statements.

Held to maturity:

These are financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to maturity other than loans and receivables. These securities are carried at amortized cost, less impairment losses, if any and premiums and/or discounts are accounted for using effective interest method.

All regular way purchases and sale are recognised at the trade date, which is the date bank commits to purchase or sell the investment. Other wise transactions are treated as derivative until settlement occurs.

A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount. The amount of impairment loss for assets carried at amortised cost is calculated as the difference between the asset’s carrying amount and present value of expected future cash flows discounted at the financial statement’s original effective interest rate.

The change in policy has no impact on the value of these securities and profit and loss of the Bank.

Loans and receivables:

These are financial assets created by the Bank by providing money directly to a debtor. Subsequent to initial recognition, these investments are carried at amortized cost and premiums and/or discounts are accounted for effective interest method.

All loans and advances are recognised when cash is advanced to borrowers. When a loan is uncollectible, it is written off against the related provision for impairment. Subsequent recoveries are credited to the provision for loan losses in the profit and loss account.

An allowance for impairment is established if there is evidence that the Bank will not be able to collect all amounts due according to the original contractual terms of loans and advances. The amount of the provision is the difference between the carrying amount and the amount recoverable from guarantees and collateral, discounted at the original effective interest rate of loans and advances.

The change in policy has no impact on the value of these securities and profit and loss of the Bank.

Available for sale securities (AFS):

These are the securities which do not fall in any of the above three categories. Subsequent to initial recognition the changes in fair value of these securities is taken to equity except the strategic investments including investments in National Bank of Pakistan and United Bank of Pakistan and investments in securities the fair value of which cannot be determined reliably. Gain or loss on changes in fair value is kept in equity until the investments are sold or disposed off, or until the investments are determined to be impaired, at that time cumulative gain or loss previously reported in the equity is included in profit and loss account. The strategic investments and investments in securities the fair value of which cannot be determined reliably are stated at cost.

The change in policy has no impact on the valuation of securities and profit and loss of the Bank.

Fair value of the financial instruments classified as held-for-trading and available for sale is their quoted bid price at the balance sheet date.

Financial instruments classified as held-for-trading or available-for-sale are de-recognised by the Bank on the date it commits to sell the investments. Securities held-to-maturity is derecognised on the day these are transferred by the Bank. Gains and losses on de-recognition of held for trading, held to maturity and AFS securities are taken to profit and loss account.

Derivative financial instruments:

The Bank enters into derivative financial instruments, which include forwards and currency swaps. Derivatives are initially recorded at cost and are re-measured to fair value on subsequent reporting dates. Forwards are shown under Commitments in the note 31 while the asset and liability portion of a currency swap are presented in Other assets and Other liabilities in notes 19 and 25 to the financial statements. The resultant gains or losses from derivatives are included in the profit and loss account.

Collateralised borrowings / lending

During the year the Bank has changed its accounting policy regarding collateralised borrowings / lending. This change has been made in order to give a more appropriate presentation and measurement of investments. Earlier in case of outright sale or sale under repurchase (Repo) obligations, the securities were being 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 were being reinstated at their respective original cost and in case of purchase under resale obligations, the securities were being 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.

In revised policy where securities are sold subject to a commitment to purchase them at a pre-determined price, they remain on the balance sheet and a liability is recorded in respect of the consideration received in "Securities sold under agreement to repurchase". Conversely, securities purchased under analogous commitment to resell are not recognised on the balance sheet and a consideration paid is recorded in "Securities purchased under agreement to resell". The difference between the sell and repurchase price in the repurchase transactions and the purchase price and sale price in reverse repurchase transaction represents an expense and income respectively and recognised in the profit and loss account on an accrual basis.

The change in policy has no impact on the profit and loss of the Bank.

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 equity under the head of "unrealised appreciation on gold reserves" account. Appreciation realised on disposal of gold is credited to the profit and loss account.

2.7 Property, plant and equipment

Property, plant and equipment 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 on property, plant and equipment are charged to profit and loss account applying the straight-line method whereby the cost of an asset is written off over its estimated useful life.

Depreciation on additions is charged to the profit and loss account 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 / disposed off. 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.

2.8 Intangibles

Intangible assets are amortised using straight-line method over the period of three years. Where the carrying amount of an asset exceeds its estimated recoverable amount it is written down immediately to its recoverable amount.

Intangible assets are carried at cost less accumulated amortisation and accumulated impairment losses, if any.

2.9 Compensated absences

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

2.10 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.

Obligations for contributions to defined contribution provident plans are recognised as an expense in the profit and loss account as incurred.

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.

2.11 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.

2.12 Revenue recognition

- Discount, interest / mark-up and / or return on loans and advances and investments are recorded on time proportion basis that takes into account the effective yield on the asset. 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.

2.13 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.

2.14 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.

2.15 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 2.16, 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.

Commitments for outstanding forward foreign exchange contracts disclosed in note 31 to the financial statements are translated at forward rates applicable to their respective maturities. Contingent liabilities / commitments for letters of credit and letters of guarantee denominated in foreign currencies are expressed in rupee terms at the rates of exchange ruling on the balance sheet date.

2.16 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.

2.17 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 will be required to settle the obligation and a reliable estimate of the amount can be made.

2.18 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.

2.19 Financial instruments

Financial assets and liabilities are recognised at the time when the Group becomes a party to the contractual provisions of the instrument. The Group derecognises financial asset when the enterprise loses control of the contractual rights that comprise the financial asset. The Group derecognises a financial liability when the liability is extinguished, discharged, cancelled or expired.

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.

2.20 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	2005	2004
			(Rupees in '000)	
3. GOLD RESERVES HELD BY THE BANK				
Opening balance		**2,046,910**	**47,532,115**	41,246,479
Additions during the year		**-**	**-**	64,589
Appreciation during the year due to revaluation	*30*	**-**	**6,337,889**	6,221,047
		2,046,910	**53,870,004**	47,532,115

4. FOREIGN CURRENCY RESERVES

		2005	2004
Investments	*4.1*	**180,148,679**	138,313,415
Deposit accounts	*4.3 & 4.4*	**424,007,949**	490,621,651
Current accounts	*4.3*	**7,870,473**	3,398,449
		612,027,101	632,333,515

The above foreign currency reserves are held as follows:

	2005	2004
- Issue Department	**472,513,815**	500,312,132
- Banking Department	**139,513,286**	132,021,383
	612,027,101	632,333,515

4.1 Investments

		2005	2004
Held for trading	*4.4*	**178,482,597**	57,121,116
Held to maturity		**1,484,500**	1,446,523
Available for sale		**181,582**	79,745,776
		180,148,679	138,313,415

4.2 At June 30, 2005, above assets included Rs. 183.167 million (2004: Rs. 167.974 million) recoverable from the Government of India. Realisability of these assets is subject to final settlement between the Governments of Pakistan and India.

4.3 The balance in current and deposit accounts carry interest at various rates ranging between 1.04 to 4.77 (2004: 0.97 to 4.52) percent per annum.

4.4 These include investments made in international market through reputable Fund Managers. The activities of the Fund Managers are being monitored through custodians. Market value of these investments as at June 30, 2005 is equivalent to USD 3,263.8 million.

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, 2005. 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, 2005, the SDRs were held as follows:	**2005**	2004
	(Rupees in '000)	
By the Issue Department	**11,794,613**	13,826,690
By the Banking Department	**1,774,629**	-
	13,569,242	13,826,690

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.

8. LOCAL CURRENCY

Bank notes held by the Banking Department	*13*	**145,618**	160,830
Rupee coins		**2,961,213**	2,799,163
		3,106,831	2,959,993
Rupee coins held as assets of the Issue Department	*8.1*	**(2,961,213)**	(2,799,163)
		145,618	160,830

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, 2005.

9. SECURITIES PURCHASED UNDER AGREEMENT TO RESALE

This represents repurchase agreement lendings and carry markup at the rate of 5.65 to 7.98 (2004: Nil). percent per annum.

10. INVESTMENTS

	Note	2005	2004
		(Rupees in '000)	
Loans and receivables originated by the Bank - Government securities	*10.1*		
Market Treasury Bills (MTBs)	*10.2*	**329,003,605**	129,240,662
Federal Investment Bonds		**-**	2,150,000
Federal Government scrip		**2,740,000**	2,740,000
		331,743,605	134,130,662
Available for sale investments			
Investment in Banks and other financial institutions			
Ordinary shares			
- Listed		**15,892,481**	1,100,807
- Unlisted		**14,449,809**	35,041,806
	10.3	**30,342,290**	36,142,613
Term Finance Certificates		**282,400**	282,400
Certificates of Deposits		**112,351**	112,351
		30,737,041	36,537,364
Investment held to maturity-Pakistan Investment Bonds		**384,506**	384,506
		362,865,152	171,052,532
Provision against diminution in value of investments		**(789,876)**	(394,747)
		362,075,276	170,657,785
Investment - MTBs held as assets of the issue department		**(162,802,630)**	(45,671,523)
		199,272,646	124,986,262

10.1 Investment in Government securities

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

	2005	2004
	(% per annum)	
Market Treasury Bills	**2.0756 to 7.9447**	1.2116 to 4.3247
Federal Investment Bonds	**15**	15
Federal Government scrip	**3**	3 to 16

10.2 This includes securities having carrying value of Rs. 1,234.030 million (2004: Rs. 69,740.461 million) given as collateral under repurchase agreement borrowing arrangements.

10.3 Investments in shares of banks and other financial institutions *10.3.1*

	2005 %	2004 %		**2005**	2004
				(Rupees in '000)	
Listed					
National Bank of Pakistan	**75.18**	75.18	*10.3.2*	**1,100,807**	1,100,807
United Bank Limited	**48.69**	-	*10.3.3*	**14,791,674**	-
				15,892,481	1,100,807
Unlisted					
Habib Bank Limited	**60.55**	73.05	*10.3.4*	**12,217,465**	14,739,777
Zarai Taraqiati Bank Limited	**-**	99.69		**-**	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
				12,469,465	18,196,100
Other investments with holding less than or equal to 50%				**1,980,344**	16,845,706
				14,449,809	35,041,806
				30,342,290	36,142,613

10.3.1 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, or joint ventures.

10.3.2 Market value of the Bank's investment in the shares of National Bank of Pakistan at June 30, 2005 amounted to Rs. 47,966.850 million (2004: Rs. 24,604.850 million).

10.3.3 The market value of the Bank's investment in the shares of United Bank Limited (listed during the year) as at June 30, 2005 as per recent available quotation amounted to Rs. 17,023.116 million (2004: Cost of Rs. 14,791.674 million).

10.3.4 Last 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 had transferred ownership of 26% of HBL's total paid up capital last year. Further ownership of 12.5% shares has been transferred during the year proceeds of which amounting to USD 102.956 million have been received during the year resulting in a gain of Rs. 3,587.239 million, as mentioned in note 40.1 to the financial statements. Under the terms of this agreement, the title of remaining 12.5% shares will be transferred to AKFED after payment of USD 95.571 million due there against has been received. This payment is due by February 25, 2006 and carry mark-up at 2.5% above London Inter Bank offer rate on the unpaid amount.

The remaining 12.5% 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 12.5% 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 the shares of HBL amounted to Rs. 18,883.430 million at 31 December 2004 based on the financial statements of HBL for the year then ended.

10.4 The investment in SBP Banking Services Corporation has been made in 1,000 (2004: 1,000) ordinary shares of Rs. 1 million each.

11. COMMERCIAL PAPERS

These represent face value of certain commercial papers amounting to Rs. 78.5 million (2004: 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).

12. ASSETS HELD WITH THE RESERVE BANK OF INDIA

	Note	2005	2004
		(Rupees in '000)	
Gold reserves			
- Opening balance		**773,079**	671,736
- Appreciation from revaluation during the year	*30*	**103,083**	101,343
		876,162	773,079
Sterling securities		**357,794**	350,140
Government of India securities		**13,910**	12,757
Rupee coins		**4,086**	3,765
		1,251,952	1,139,741

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.

13. BANK NOTES ISSUED

	Note	2005	2004
Notes held with the Banking Department	*8*	**145,618**	160,830
Notes in circulation		**705,720,090**	611,742,827
		705,865,708	611,903,657

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

	2005	2004
Quota allocated by the International Monetary Fund	**90,311,785**	88,097,392
Liability under quota arrangements	**(90,301,470)**	(88,087,330)
	10,315	10,062

15. LOANS, ADVANCES AND BILLS OF EXCHANGE

	Note	2005	2004
Government	*15.1*	**20,700,000**	12,000,000
Government owned / controlled financial institutions	*15.2*	**113,234,829**	110,623,197
Private sector financial institutions	*15.3*	**92,829,411**	77,283,785
		206,064,240	187,906,982
Employees		**6,309,198**	5,059,663
		233,073,438	204,966,645
Provision against doubtful balances		**(8,740,813)**	(4,662,319)
		224,332,625	200,304,326
Commercial papers held in issue department	*11*	**(78,500)**	(78,500)
		224,254,125	200,225,826

15.1 Loans and advances to the Governments

	2005	2004
	(Rupees in '000)	
Federal Government	**12,000,000**	12,000,000
Provincial Government - Balochistan	**8,700,000**	-
	20,700,000	12,000,000

15.1.1 During the year, mark-up on above was charged at various rates ranging between 2.0581 to 6.9282 (2004: 1.3795 to 1.9197) percent per annum.

15.2 Loans and advances to Government owned / controlled financial institutions

		Scheduled banks		Non-banking financial institutions		Total	
		2005	2004	**2005**	2004	**2005**	2004
		(Rupees in '000)					
Agricultural sector	*15.2.2*	**60,590,768**	58,005,280	**-**	-	**60,590,768**	58,005,280
Industrial sector	*15.2.2*	**2,158,045**	2,381,409	**595,007**	840,261	**2,753,052**	3,221,670
Export sector		**21,780,804**	16,424,361	**-**	786,123	**21,780,804**	17,210,484
Housing sector		**66,907**	66,907	**11,242,300**	12,607,300	**11,309,207**	12,674,207
Others		**12,985,936**	10,629,456	**3,815,062**	8,882,100	**16,800,998**	19,511,556
		97,582,460	87,507,413	**15,652,369**	23,115,784	**113,234,829**	110,623,197

15.2.1 Above balances include Rs. 518.806 million (2004: Rs. 515.056 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).

15.2.2 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 (2004: Rs. 51,257.213 million) to Zarai Taraqiati Bank Limited (ZTBL).

15.3 Loans and advances to private sector financial institutions

	Scheduled banks		Non-banking financial institutions		Total	
	2005	2004	**2005**	2004	**2005**	2004
	(Rupees in '000)					
Industrial sector	-	499,796	**3,577,792**	3,577,792	**3,577,792**	4,077,588
Export sector	**87,744,637**	69,409,072	**-**	587,000	**87,744,637**	69,996,072
Others	**1,506,982**	3,210,125	**-**	-	**1,506,982**	3,210,125
	89,251,619	73,118,993	**3,577,792**	4,164,792	**92,829,411**	77,283,785

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

	2005	2004
	(% per annum)	
Government owned / controlled and private sector financial institutions	**1.5 to 12**	1.5 to 12
Staff loans	**10**	10

			2005	2004
16.	**BALANCES DUE FROM THE GOVERNMENTS OF INDIA AND BANGLADESH (FORMER EAST PAKISTAN)**		**(Rupees in '000)**	
	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	*16.1*	**3,221,784**	2,986,117
			4,041,708	3,806,041
			4,082,161	3,846,494

16.1 These represent loans and advances provided to the Government of Bangladesh (former East Pakistan).

16.2 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.

17. PROPERTY, PLANT AND EQUIPMENT

		2005	2004
Operating fixed assets	*17.1*	**6,588,659**	7,110,464
Capital work-in-progress	*17.3*	**523,176**	365,202
		7,111,835	7,475,666

17.1 Operating fixed assets

	Cost / revalued amount at July 1, 2004	Additions / (deletions) / transfers* during the year	Cost / revalued amount at June 30, 2005	Accumulated depreciation at July 1, 2004	Depreciation for the year on deletions) / transfers*	Accumulated depreciation at June 30, 2005	Net book value at June 30, 2005	Annual rate of depreciation %
	-----	-----	-----	-----	(Rupees in '000)	-----	-----	
Freehold land	807,882	19,500 -	827,382	-	- -	-	827,382	-
Leasehold land	4,996,893	- (393,566)	4,603,327	338,397	109,086 (19,007)	428,476	4,174,851	over the term of lease
Building on freehold land	779,969	1,993 -	781,962	240,478	44,973 -	285,451	496,511	5
Building on leasehold land	1,129,773	5,202 (70,299)	1,064,676	272,039	70,651 (31,598)	311,092	753,584	5
Furniture and fixtures	132,441	9,645 (5,464)	136,622	56,340	11,732 (2,346)	65,726	70,896	10
Office equipment	738,793	79,828 (50,998)	767,623	671,084	33,002 (50,967)	653,119	114,504	20
EDP equipment	530,418	216,502 (1,258) (51,194) *	694,468	487,331	111,867 (816) -	598,382	96,086	33.33
Motor vehicles	110,011	16,659 (13,259)	113,411	50,047	16,001 (7,482)	58,566	54,845	20
Library Book	726	-	726	726		726	-	
2005	**9,226,906**	**349,329** **(534,844)** **(51,194)**	**8,990,197**	**2,116,442**	**397,312** **(112,216)** **-**	**2,401,538**	**6,588,659**	
2004	9,179,054	184,095 (136,243)	9,226,906	1,718,559	410,434 (12,551)	2,116,442	7,110,464	

17.2 Surplus on revaluation of property, plant and equipment

	2005	2004
	(Rupees in '000)	
Opening balance	**6,637,328**	6,749,772
Surplus realised on disposal	**(442,825)**	(112,444)
	6,194,503	6,637,328

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, an independent valuer, 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. 5,718.411 million remains undepreciated at June 30, 2005 (2004: Rs. 6,121.173 million) and has been included in the carrying value of the related assets.

17.3 Capital work-in-progress

	2005	2004
Building on freehold land	**-**	2,943
Building on leasehold land	**141,103**	44,529
Furniture and fixtures	**31,843**	15,830
Office equipment	**69,576**	34,944
EDP equipment	**15,721**	2,023
Intangible assets	**264,933**	264,933
	523,176	365,202

18. INTANGIBLE ASSETS

		Cost / revalued amount at July 1, 2004	Additions / (deletions) during the year	Cost / revalued amount at June 30, 2005	Accumulated amortisation at July 1, 2004	Amortisation for the year / on deletions)	Accumulated amortisation at June 30, 2005	Net book value at June 30, 2005	Annual rate of amortisation %
		---(Rupees in '000)---							
Software	**2005**	**32,467**	**65,864**	**98,331**	**32,097**	**45,363**	**77,460**	**20,871**	**33.33**
	2004	32,260	207	32,467	21,344	10,753	32,097	370	

19. OTHER ASSETS

		2005	2004
		(Rupees in '000)	
Amounts due from financial institutions under currency swap arrangements	*19.1*	**2,710,157**	2,674,429
Accrued interest / mark-up and return		**2,309,390**	935,986
Exchange gain recoverable under exchange risk coverage scheme		**7,691**	7,691
Stationery and stamps on hand		**49,732**	8,681
Other advances, deposits and prepayments		**1,303,194**	532,322
Balance receivable from the Government of Pakistan		**343,805**	5,692,379
Others		**1,214,087**	3,060,376
		7,938,056	12,911,864

19.1 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 25.

20. CURRENT ACCOUNTS OF THE GOVERNMENTS

		2005	2004
Federal Government	*20.1*	**59,285,743**	14,681,524
Provincial Governments			
- Punjab	*20.2*	**19,606,971**	13,913,754
- Sindh	*20.3*	**22,971,702**	13,206,367
- North West Frontier Province (NWFP)	*20.4*	**2,484,464**	4,134,839
- Balochistan	*20.5*	**-**	-
		45,063,137	31,254,960
Government of Azad Jammu and Kashmir		**568,854**	2,952,518
		104,917,734	48,889,002

			2005	2004
			(Rupees in '000)	
20.1	**Federal Government**			
	Non-food account		**184,642**	484,991
	Food account		**13,616**	20,693
	Zakat fund account		**13,867,615**	15,857,448
	Railways - ways and means advances	*20.6*	**(3,211,416)**	(2,798,603)
	Fertilizer account		**34,399**	44,137
	Saudi Arab special loan account		**4,124**	4,124
	Pakistan Baitul Mal fund account		**253,366**	85
	Pakistan Railways special account		**1,736,538**	1,063,373
	Government deposit account no. XII		**5,276**	5,276
	Special transfer account		**37,616,343**	-
	UN reimbursement account		**8,781,240**	-
			59,285,743	14,681,524
20.2	**Provincial Government - Punjab**			
	Non-food account		**(2,134,153)**	(4,365,339)
	Food account		**1,004,477**	1,254,266
	Zakat fund account		**101,542**	50,117
	District Government account no. IV		**20,635,105**	16,974,710
			19,606,971	13,913,754
20.3	**Provincial Government - Sindh**			
	Non-food account		**17,578,105**	9,483,511
	Food account		**35,901**	108,558
	Zakat fund account		**75,084**	75,083
	District Government account no. IV		**5,282,612**	3,539,215
			22,971,702	13,206,367
20.4	**Provincial Government - NWFP**			
	Non-food account		**1,072,476**	3,054,159
	Food account		**760,235**	203,073
	Zakat fund account		**412**	2,007
	District Government account no. IV		**651,341**	875,600
			2,484,464	4,134,839
20.5	**Provincial Government - Balochistan**			
	Non-food account		**(3,840,510)**	(9,865,206)
	Food account		**58,481**	463,836
	Zakat fund account		**2**	5
	District Government account no. IV		**1,667,982**	3,868,246
			(2,114,045)	(5,533,119)
	Classified as a receivable balance	*20.6*	**2,114,045**	5,533,119
	Net credit balance		**-**	-

20.6 At the year end, these balances carried mark-up at 6.93 (2004: 1.92) percent per annum.

21. SECURITIES SOLD UNDER AGREEMENT TO REPURCHASE

This represents repurchase agreement borrowings and carry markup at the rate of 4.1584 to 7.4790 (2004: 3.6858 to 4.3230) percent per annum.

22. DEPOSITS OF BANKS AND FINANCIAL INSTITUTIONS

Foreign currency		
Scheduled banks	**15,920,332**	14,212,278
Held under Capital Reserve Requirement scheme	**41,135,858**	32,020,008
	57,056,190	46,232,286
Local currency		
Scheduled banks	**137,804,690**	108,946,952
Non-banking financial institutions	**1,450,434**	991,567
Others	**955**	-
	139,256,079	109,938,519
	196,312,269	156,170,805

22.1 The above deposits are free of interest except deposits under capital reserve requirements to the extent of eighty percent which are remunerated at the rates given below:

	2005	2004
	(% per annum)	
Foreign currency	**0.87 to 2.13**	0.59 to 0.67
Local currency	**1.98 to 2.59**	0.99 to 1.70

23. OTHER DEPOSITS AND ACCOUNTS

	Note	2005	2004
		(Rupees in '000)	
Foreign currency			
Foreign central banks		**26,858,250**	26,172,872
International organisations		**14,921,250**	14,539,525
		41,779,500	40,712,397
Local currency			
Special debt repayment	*23.2*	**23,755,341**	22,108,042
Government	*23.3*	**11,012,500**	17,952,963
Others		**10,074,745**	2,255,402
		44,842,586	42,316,407
		86,622,086	83,028,804

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

	2005	2004
	(% per annum)	
Foreign central banks	**1.79 to 3.6**	1.36 to 1.79
International organisation	**2.96 to 4.74**	2.96 to 3.1

23.2 These are free of interest and represent amounts kept in separate special accounts to meet forthcoming foreign currency debt repayment obligations of the Government of Pakistan.

23.3 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.

24. PAYABLE TO INTERNATIONAL MONETARY FUND

	Note	2005	2004
		(Rupees in '000)	
Borrowings under:			
- Fund facilities	*24.1*	**7,814,222**	25,041,465
- Other credit schemes	*24.2*	**88,839,730**	77,363,692
		96,653,952	102,405,157
Current account for administrative charges		**29**	77
		96,653,981	102,405,234

24.1 These facilities are secured by demand promissory notes issued by the Government of Pakistan and periodic charges thereon are chargeable to the Government of Pakistan.

24.2 This includes Rs. Nil (2004: Rs. 255.676 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.

24.3 Interest profile of payable to IMF is as under:

	2005	2004
	(% per annum)	
Fund facilities	**1.72 to 2.40**	1.39 to 1.72
Other credit schemes	**0.5**	0.5

25. OTHER LIABILITIES

Foreign currency		**2005**	2004
		(Rupees in '000)	
Amounts due to financial institutions under currency swap arrangements	*19.1*	**2,685,825**	2,617,115
Accrued interest and discount on deposits		**463,941**	243,021
Charges on allocation of Special Drawing Rights of IMF		**62,372**	42,000
Others		**14,557**	4,603
		3,226,695	2,906,739
Local currency			
Overdue mark-up and return		**3,512,589**	3,444,098
Unearned exchange risk fee		**12,328**	12,183
Remittance clearance account		**556,497**	607,501
Exchange loss payable under exchange risk coverage scheme		**5,217**	45,721
Balance payable to the Government of Pakistan		**3,935,947**	-
Share of loss under profit and loss sharing arrangements		**-**	3,274,752
Dividend payable		**10,000**	10,000
Payable to Government in respect of privatisation proceeds		**2,929,066**	2,929,066
Other accruals and provisions	*25.1*	**6,141,836**	3,744,498
Others		**3,680,150**	3,338,595
		20,783,630	17,406,414
		24,010,325	20,313,153

25.1 Other accruals and provisions

Interest payable		**18,201**	18,451
Printing charges		**173,138**	10,064
Agency commission		**418,469**	362,115
Provision for employees' compensated absences	*39.3*	**2,031,000**	1,739,000
Provision for other doubtful assets		**1,551,419**	-
Other provisions	*25.2*	**1,205,895**	1,499,308
Others		**743,714**	115,560
		6,141,836	3,744,498

25.2 Movement of other provisions

	2005	2004
	(Rupees in '000)	
Opening balance	**1,124,308**	400,000
Provision during the year	**110,400**	1,267,019
Reversed during the year	**(28,813)**	(542,711)
Closing balance	**1,205,895**	1,124,308

	Home remittance	**Agriculture loan**	**Others (note 25.2.1)**	**Total**
	(Rupees in '000)			
Opening balance	150,000	232,289	742,019	1,124,308
Provision during the year	110,363	-	37	110,400
Reversed during the year	-	(28,813)	-	(28,813)
Closing balance	260,363	203,476	742,056	1,205,895

25.2.1 This represent provision made against various contingencies comprising litigation against the Bank.

26. DEFERRED LIABILITY - STAFF RETIREMENT BENEFITS

		2005	2004
		(Rupees in '000)	
Gratuity		**86,471**	106,579
Pension		**7,397,000**	6,980,000
Benevolent fund scheme		**866,000**	814,000
Post retirement medical benefits		**441,000**	344,000
	39.1.3	**8,790,471**	8,244,579
Provident fund scheme		**989,488**	906,742
		9,779,959	9,151,321

27. DEFERRED INCOME

Opening balance	**286,195**	415,106
Grants received during the year	**220,402**	6,579
Amortisation during the year	**(92,536)**	(135,490)
Closing balance	**414,061**	286,195

This represents grant received for capital expenditure and, as indicated in note 2.11 to these financial statements, is being amortised over the useful lives of the related assets.

28. 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.

29. RESERVES

29.1 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.

29.2 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.

30. UNREALISED APPRECIATION ON GOLD RESERVES

		2005	2004
		(Rupees in '000)	
Opening balance		**45,205,621**	38,883,231
Appreciation on revaluation during the year:			
- held by the Bank	*3*	**6,337,889**	6,221,047
- held with the Reserve Bank of India	*12*	**103,083**	101,343
		6,440,972	6,322,390
		51,646,593	45,205,621

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.

31. CONTINGENCIES AND COMMITMENTS

31.1 Contingencies

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

	2005	2004
i) Government	**23,406,428**	32,059,794
ii) Government owned / controlled bodies and authorities	**104,019,357**	73,620,783
	127,425,785	105,680,577

Above guarantees 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. 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.

c) A claim of Rs. 1,600 million has been lodged against the Bank which has not been acknowledged by the Bank. The Bank has a counter claim of Rs. 493 million. With the mutual agreement of both the parties, matter has been referred to the Arbitrator. Management is confident that the Bank will not incur any liability on this account; as such no provision has been made against the claim.

	2005	2004
d) Other claims against the Bank not acknowledged as debts	**685,603**	702,624

31.2 Commitments

	2005	2004
	(Rupees in '000)	
Forward exchange contracts - sales	**78,643,672**	35,140,553
Forward exchange contracts - purchases	**58,229,197**	13,253,350
Repurchase and outright sale of securities	**1,258,632**	69,740,400
Import letters of credit	**81,205,385**	82,306,585
ESAF commitment with IMF	**173,528**	227,081

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

Market Treasury Bills - net	**9,892,132**	1,727,576
Other Government securities	**255,845**	439,911
Loans and advances to Government	**997,720**	358,734
Share of profit on finances under profit and loss sharing arrangements	**3,578,551**	2,210,247
Foreign currency deposits	**9,245,706**	6,067,452
Foreign currency securities	**5,778,084**	911,286
Others	**9,611**	18,905
	29,757,649	11,734,111

33. INTEREST / MARK-UP EXPENSE

Deposits	**2,235,276**	1,346,406
Share of loss on finances under profit and loss sharing arrangements	**-**	3,815,121
Others	**48,832**	40,564
	2,284,108	5,202,091

34. COMMISSION INCOME

Market Treasury Bills	**103,373**	50,885
Draft / payment orders	**284,216**	238,509
Prize Bonds and National Saving Certificates	**149,410**	119,171
Management of public debts	**66,343**	68,238
Others	**89,616**	19,651
	692,958	496,454

35. EXCHANGE GAIN - net

	2005	2004
	(Rupees' 000)	
Gain / (loss) on:		
- Foreign currency placements, deposits, securities and other accounts - net	**15,815,128**	3,372,849
- Open market operations (including currency swap arrangements)	**185,266**	(38,963)
- Forward covers under Exchange Risk Coverage Scheme	**(360,255)**	(156,485)
- Payable to the International Monetary Fund (IMF)	**(2,240,929)**	(3,853,758)
- Special Drawing Rights of IMF	**297,653**	669,601
- Others	**(123,712)**	424,750
	13,573,151	417,994
Exchange risk fee income	**254,562**	337,178
	13,827,713	755,172

36 OTHER OPERATING INCOME- net

Penalties levied on banks and financial institutions	**444,416**	360,677
License / Credit Information Bureau fee recovered	**26,807**	1,966
Profit on sale of securities	**399,537**	-
Gain / (loss) on remeasurement of securities	**(543,336)**	-
Others	**480**	5,181
	327,904	367,824

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% (2004: 0.15%) of the total amount of collection and remittances handled by NBP.

39. GENERAL ADMINISTRATIVE AND OTHER EXPENSES

	Note	2005	2004
		(Rupees in '000)	
Salaries, wages and other benefits		**2,956,438**	2,621,575
Retirement benefits and employees' compensated absences		**1,385,001**	2,376,564
Contribution to SBP Employees' Welfare Trust		**10,000**	-
Rent and taxes		**21,714**	29,483
Insurance		**5,551**	4,516
Electricity, gas and water charges		**114,920**	119,527
Depreciation	*17.1*	**397,312**	410,434
Amortisation of intangible assets		**45,363**	10,753
Repairs and maintenance		**105,327**	34,782
Auditors' remuneration	*39.4*	**3,292**	2,832
Legal and professional charges		**291,403**	58,449
Traveling and recreation expenses		**102,874**	100,076
Daily expenses		**36,952**	39,844
Fuel charges		**8,292**	7,475
Conveyance charges		**9,662**	6,287
Postages, telegram / telex and telephone		**76,335**	57,020
Training		**22,977**	10,886
Examination/ testing services		**66**	1,249
Remittance of treasure		**31,972**	31,773
Stationery		**16,355**	21,024
Books and newspapers		**9,476**	7,518
Advertisement		**5,715**	4,542
Uniforms		**17,632**	16,138
Others		**105,008**	100,487
		5,779,637	6,073,234

39.1 Staff retirement benefits

39.1.1 As mentioned in note 2.10, 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, 2005 under the projected Unit Credit Method using following significant assumptions:

- Expected rate of increase in salary 9.5 (2004: 5.94) percent per annum
- Expected rate of discount 11.6 (2004: 8.00) percent per annum
- Medical cost increase 6.3 (2004: 2.86) percent per annum

39.1.2 Present value of the obligations

Present values of obligations under the retirement benefit schemes and liabilities recognised there against for the past services of the employees at June 30, 2005 based on actuarial valuation as of that date was as follows:

	2005		
	Present value of the defined benefit obligation	**Unrecognised actuarial gain / (loss)**	**Provision made in respect of the staff retirement benefits**
	---------------- (Rupees in '000) ----------------		
Gratuity	92,000	(5,000)	87,000
Pension	8,247,000	(850,000)	7,397,000
Benevolent	1,008,000	(142,000)	866,000
Post retirement medical benefits	2,221,000	(1,790,000)	431,000
	11,568,000	(2,787,000)	8,781,000

39.1.3 The following is a movement in the net recognised liability in respect of the defined benefit schemes

	Net recognised liability at 1 July 2004	**Charge for the year (note 39.2)**	**Payments during the year**	**Employees contribution**	**Net liability at 30 June 2005**
	---------------------------- (Rupees in '000) ----------------------------				
Gratuity	106,579	3,000	(23,108)	-	86,471
Pension	6,980,000	780,000	(363,000)	-	7,397,000
Benevolent	814,000	106,000	(56,000)	2,000	866,000
Post retirement medical benefits	344,000	207,000	(110,000)	-	441,000
	8,244,579	1,096,000	(552,108)	2,000	8,790,471

39.2 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:

	Current service cost	Interest cost	Actuarial (gain) / loss recognised	Employees contributions	Total
	(Rupees in '000)				
Gratuity	2,000	6,000	(5,000)	-	3,000
Pension	217,000	554,000	9,000	-	780,000
Benevolent	34,000	74,000	-	(2,000)	106,000
Post retirement medical benefits	29,000	110,000	68,000	-	207,000
	282,000	744,000	72,000	(2,000)	1,096,000

39.3 Employees' compensated absences

As at June 30, 2005, the Bank's liability for employees' compensated absences determined through an actuarial valuation carried out under the projected unit credit method amounted to Rs. 2,031 million (2004: Rs. 1,739 million). An amount of Rs. 295 million (2004: 181 million) has been charged to the profit and loss account in the current period based on the actuarial advice.

39.4 Auditors' remuneration

	Taseer Hadi Khalid & Co.	M. Yousuf Adil Saleem & Co.	Syed Hussain & Co.	2005	2004
	(Rupees in '000)				
State Bank of Pakistan					
Audit fee	625	625	-	**1,250**	1,000
Special certifications / examinations and sundry advisory services	-	-	-	-	45
Out of pocket expenses	100	100	-	**200**	200
	725	**725**	-	**1,450**	1,245
SBP Banking Services Corporation					
Audit fee	625	625	-	**1,250**	1,000
Out of pocket expenses	250	250	-	**500**	500
	875	**875**	-	**1,750**	1,500
National Institute of Banking and Finance (Guarantee) Limited					
Audit fee	-	-	60	**60**	60
Out of pocket expenses	-	-	32	**32**	27
	-	-	92	**92**	87
	1,600	**1,600**	**92**	**3,292**	**2,832**

40. OTHER INCOME

	Note	2005	2004
		(Rupees in '000)	
Gain on disposal of property, plant and equipment		**504,227**	149,231
Liabilities and provisions written back - net		**-**	275
Gain on disposal of investments	*40.1*	**3,559,403**	6,928,678
Amortisation of deferred income	*27*	**92,536**	135,490
Others		**47,810**	28,293
		4,203,976	7,241,967

40.1 This includes Rs. 3,587.239 million (2004: Rs. 6,086.171 million) in respect of the gain realised during the year on disposal of 12.5% (2004: 26%) of HBL's total paid-up capital to the Aga Khan Fund for Economic Development S.A., as mentioned in detail in note 10.3.4.

41. OTHER CHARGES

	2005	2004
Charges on allocation of Special Drawing Rights	**335,194**	227,295
Others	**15**	320,816
	335,209	548,111

42. PROFIT FOR THE YEAR AFTER NON-CASH ITEMS

	2005	2004
Profit for the year	**31,049,236**	6,108,498
Adjustments for:		
Depreciation	**397,313**	410,434
Amortisation of intangible assets	**45,363**	10,753
Amortisation of deferred income	**(92,536)**	(135,490)
Provision for:		
- retirement benefits and employees' compensated absences	**1,385,001**	2,376,564
- loans, advances and other assets	**4,687,861**	566,906
- share of loss / (profit) under profit and loss sharing arrangements	**-**	5,303,335
- other doubtful assets	**1,551,419**	-
- investments	**395,129**	-
Gain on disposal of property, plant and equipment	**(504,227)**	(149,231)
Dividend income	**(1,502,639)**	(1,422,058)
Other accruals and provisions - net	**3,878,015**	2,005,498
	41,289,935	15,075,209

43. CASH AND CASH EQUIVALENTS

	2005	2004
Local currency	**3,106,831**	2,959,993
Foreign currency reserves	**609,286,705**	629,731,918
Earmarked foreign currency balances	**11,937,000**	3,780,277
Special Drawing Rights of International Monetary Fund	**13,569,242**	13,826,690
	637,899,778	650,298,878

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)	-	-	-	3,106,831	-	3,106,831	3,106,831
Foreign currency reserves	602,006,472	2,150,157	604,156,629	7,463,400	407,072	7,870,472	612,027,101
Earmarked foreign currency balances	11,937,000	-	11,937,000	-	-	-	11,937,000
Special Drawing Rights of International Monetary Fund	13,569,242	-	13,569,242	-	-	-	13,569,242
Reserve tranche with the International Monetary Fund under quota arrangements	-	-	-	10,315	-	10,315	10,315
Securities purchased under an agreement to resale	9,115,549	-	9,115,549	-	-	-	9,115,549
Current account of the Government of Balochistan	-	-	-	2,114,045	-	2,114,045	2,114,045
Investments	329,003,605	3,124,506	332,128,111	-	29,947,165	29,947,165	362,075,276
Loans, advances and bills of exchange	72,885,430	17,812,893	90,698,323	62,989,234	70,567,191	133,556,425	224,254,748
Indian notes representing assets receivable from the Reserve Bank of India	-	-	-	-	592,891	592,891	592,891
Assets held with the Reserve Bank of India	-	375,791	375,791	-	-	-	375,791
Balances due from the Governments of India and Bangladesh (former East Pakistan)	-	3,221,784	3,221,784	-	-	-	3,221,784
Other assets	-	-	-	5,892,452	1,769,463	7,661,915	7,661,915
	1,038,517,298	26,685,131	1,065,202,429	81,576,277	103,283,782	184,860,059	1,250,062,488
Financial liabilities							
Bank notes in circulation	-	-	-	3,941,642	701,924,066 *	705,865,708	705,865,708
Bills payable	-	-	-	1,099,683	-	1,099,683	1,099,683
Current accounts of the Government	-	-	-	104,917,734	-	104,917,734	104,917,734
Securities sold under an agreement to repurchase	1,208,613	-	1,208,613	-	-	-	1,208,613
Deposits of banks and financial institutions	-	30,005,462	30,005,462	79,687,556	86,619,251	166,306,807	196,312,269
Other deposits and accounts	51,815,966	-	51,815,966	34,806,120	-	34,806,120	86,622,086
Payable to International Monetary Fund	8,586,565	88,067,416	96,653,981	-	-	-	96,653,981
Other liabilities	-	-	-	13,902,836	6,966,139	20,868,975	20,868,975
	61,611,144	118,072,878	179,684,022	238,355,571	795,509,456	1,033,865,027	1,213,549,049
On balance sheet gap - 2005	976,906,154	(91,387,747)	885,518,407	(156,779,294)	(692,225,674)	(849,004,968)	36,513,439

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

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.

44.2 Portfolio risk management

The Bank has appointed external managers to invest a part of the foreign exchange reserves in international fixed income securities. The external managers are selected after conducting a thorough due diligence by the Bank and externally hired investment consultants, and appointed after the approval of the Board. The mandates awarded to the managers require them to out form the benchmarks which are based on fixed income global aggregate indices. The benchmarks are customized to exclude certain securities, currencies, and maturities to bring it to an acceptable level of risk and within the Bank's approved risk appetite. Managers are provided investment guidelines within which they have to generate excess returns over the benchmark. Such investment guidelines define acceptable level of risk by setting levels and permitting types of fixed income securities, duration, currencies, maximum issuer limits by issuer types and credit ratings, and other risk parameters. The volatility and quality of portfolio performance is managed through ex-ante and ex-post tracking error, and information ratio, which is part of the investment guidelines. Safe custody of the portfolio is provided through carefully selected global custodians who are independent of the portfolio managers. The custodians also provide valuation, compliance, corporate actions, tax reclamation and recovery, and other value added services which are typically provided by such custodians. The valuations provided by the custodians are reconciled with the portfolio managers, and recorded accordingly.

44.3 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 and certain fixed assets which were revalued in the year 2001, is estimated to approximate their carrying values.

45. PROFORMA INFORMATION

Restated proforma information as referred in note 2.5 of the financial statements is presented below:

45.1 Extract of the profit and loss account

	For the year ended		Restated For the year ended	
	June 30, 2005	June 30, 2004	**June 30, 2005**	June 30, 2004
Discount, interest / mark-up and / or return earned	**29,757,649**	11,734,111	**29,745,154**	11,746,606
Interest / mark-up expense	**2,284,108**	5,202,091	**2,284,108**	5,202,091
	27,473,541	6,532,020	**27,461,046**	6,544,515
Commission income	**692,958**	496,454	**692,958**	496,454
Exchange gain - net	**13,827,713**	755,172	**13,796,322**	786,563
Dividend income	**1,502,639**	1,422,058	**1,502,639**	1,422,058
Other operating income	**327,904**	367,824	**332,387**	363,341
	43,824,755	9,573,528	**43,785,352**	9,612,931
Direct operating expenses	**10,864,649**	4,085,652	**10,864,649**	4,085,652
	32,960,106	5,487,876	**32,920,703**	5,527,279
General administrative and other expenses	**5,779,637**	6,073,234	**5,779,637**	6,073,234
OPERATING PROFIT / (LOSS)	**27,180,469**	(585,358)	**27,141,066**	(545,955)
Other income	**4,203,976**	7,241,967	**4,203,976**	7,241,967
	31,384,445	6,656,609	**31,345,042**	6,696,012
Other charges	**335,209**	548,111	**335,209**	548,111
NET PROFIT FOR THE YEAR	**31,049,236**	6,108,498	**31,009,833**	6,147,901

45.2 Extract of the statement of unappropriated profit

	For the year ended		Restated For the year ended	
	June 30, 2005	June 30, 2004	**June 30, 2005**	June 30, 2004
		(Rupees in '000)		
Opening unappropriated profit as previously reported	-	-	39,403	-
Profit for the year	31,049,236	6,108,498	31,009,833	6,147,901
Appropriations	432,825	102,444	432,825	102,444
Unappropriated profit and loss restated	31,482,061	6,210,942	31,482,061	6,250,345
Balance transferable/ transferred to the Government	(21,422,061)	(6,210,942)	(21,422,061)	(6,210,942)
Unappropriated profit and loss restated	10,060,000	-	10,060,000	39,403

46. NUMBER OF EMPLOYEES

	2005	2004
Number of employees at June 30,	**6,851**	6,850

47. DATE OF AUTHORISATION

These financial statements were authorised for issue on August 30, 2005 by the Central Board of Directors of the Bank.

48. GENERAL

Figures have been rounded off to the nearest thousand rupees.

Ishrat Husain **Governor**	**Mansur-ur-Rehman Khan** **Deputy Governor**	**Aftab Mustafa Khan** **Director Accounts**

15 Financial Statements of SBP

M. YOUSUF ADIL SALEEM & CO.
CHARTERED ACCOUNTANTS
CAVISH COURT
A-35, BLOCK 7 & 8, KCSHU
SHAHRAH-E-FAISAL
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, 2005 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 and Accounting Policy for Investments as stated in note 2.5 to the financial statements approved for adoption by the Central Board of the Bank. 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 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:

During the year, Bank has made a provision of Rs. 1,551 million relating to net assets recoverable from Reserve Bank of India, the Government of India and those pertaining to transactions in former East Pakistan. This provision has been recorded as other liability of the Banking Department and relevant assets and liabilities have not been netted off. Accordingly, assets of Issue Department and Banking Department are overstated by Rs. 2,028 million and Rs. 4,082 million respectively and liabilities and unrealized appreciation on gold reserve of the Banking Department are overstated by Rs. 5,236 and Rs. 874 million respectively.

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 and Accounting Policy for Investment as stated in note 2.5 to the financial statements approved for adoption by the Central Board of the Bank and are further in accordance with accounting policies consistently applied except for change in accounting policy as stated in note 2.5 to the financial statements; 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 and Accounting Policy for Investment as stated in note 2.5 to the financial statements 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, 2005 and of the profit, the cash flows and changes in equity for the year then ended.

M. Yousuf Adil Saleem & Co.
Chartered Accountants
Karachi
Date : 30 Aug 2005

Taseer Hadi Khalid & Co.
Chartered Accountants
Karachi
Date : 30 Aug 2005

State Bank of Pakistan - Issue Department

Balance Sheet

As at June 30, 2005

	Note	**2005**	2004
		(Rupees in '000)	
ASSETS			
Gold reserves held by the Bank	*3*	**53,870,004**	47,532,115
Foreign currency reserves	*4*	**472,513,815**	500,312,132
Special Drawing Rights of the International Monetary Fund	*5*	**11,794,613**	13,826,690
Notes and rupee coins:			
- Indian notes representing assets receivable from the Reserve Bank of India	*7*	**592,981**	543,793
- Rupee coins	*8*	**2,961,213**	2,799,163
		3,554,194	3,342,956
Investments	*10*	**162,802,630**	45,671,523
Commercial papers	*11*	**78,500**	78,500
Assets held with the Reserve Bank of India	*12*	**1,251,952**	1,139,741
		705,865,708	611,903,657
LIABILITY			
Bank notes issued	*13*	**705,865,708**	611,903,657

The annexed notes 1 to 50 form an integral part of these financial statements.

Ishrat Husain	**Mansur-ur-Rehman Khan**	**Aftab Mustafa Khan**
Governor	**Deputy Governor**	**Director Accounts**

State Bank of Pakistan - Banking Department
Balance Sheet
As at June 30, 2005

	Note	**2005**	2004
		(Rupees in '000)	
ASSETS			
Local currency	*8*	**145,618**	160,830
Foreign currency reserves	*4*	**139,513,286**	132,021,383
Earmarked foreign currency balances	*6*	**11,937,000**	3,780,277
Special Drawing Rights of the International Monetary Fund	*5*	**1,774,629**	-
		153,370,533	135,962,490
Reserve tranche with the International Monetary Fund under quota arrangements	*14*	**10,315**	10,062
Securities purchased under agreement to resale	*9*	**9,115,545**	-
Current account of the Government of Balochistan	*20.5*	**2,114,045**	5,533,119
Current account with National Institute of Banking and Finance (Guarantee) Limited		**1,521**	-
Investments	*10*	**199,368,400**	125,119,093
Loans, advances and bills of exchange	*15*	**219,092,298**	196,058,152
Balances due from the Governments of India and Bangladesh (former East Pakistan)	*16*	**4,082,161**	3,846,494
Property, plant and equipment	*17*	**6,943,113**	7,370,053
Intangible assets	*18*	**20,871**	370
Other assets	*19*	**7,799,971**	12,471,989
Total assets		**601,918,773**	486,371,822
LIABILITIES			
Bills payable		**1,099,683**	494,365
Current accounts of the Government	*20*	**104,917,734**	48,889,002
Current accounts with subsidiaries	*21*	**3,445,805**	3,068,656
Securities sold under agreement to repurchase	*22*	**1,208,613**	-
Deposits of banks and financial institutions	*23*	**196,312,269**	156,170,805
Other deposits and accounts	*24*	**86,622,086**	83,028,804
Payable to the International Monetary Fund	*25*	**96,653,981**	102,405,234
Other liabilities	*26*	**21,473,518**	18,326,441
		511,733,689	412,383,307
Deferred liability - staff retirement benefits	*27*	**3,543,969**	3,533,413
Deferred income	*28*	**414,061**	286,195
Total liabilities		**515,691,719**	416,202,915
Net assets		**86,227,054**	70,168,907
Share capital	*29*	**100,000**	100,000
Allocation of special drawing rights of the International Monetary Fund		**1,525,958**	1,525,958
Reserves		**16,700,000**	16,700,000
Unappropriated profit		**10,060,000**	-
		28,385,958	18,325,958
Unrealised appreciation on gold reserves	*31*	**51,646,593**	45,205,621
Surplus on revaluation of property, plant and equipment	*17.2*	**6,194,503**	6,637,328
		86,227,054	70,168,907
CONTINGENCIES AND COMMITMENTS	*32*		

The annexed notes 1 to 50 form an integral part of these financial statements.

Ishrat Husain	**Mansur-ur-Rehman Khan**	**Aftab Mustafa Khan**
Governor	**Deputy Governor**	**Director Accounts**

State Bank of Pakistan

Profit and Loss Account

For the year ended June 30, 2005

	Note	2005	2004
		(Rupees in '000)	
Discount, interest / mark-up and / or return earned	*33*	**29,733,360**	11,708,491
Interest / mark-up expense	*34*	**2,284,108**	5,202,091
		27,449,252	6,506,400
Commission income	*35*	**692,958**	496,454
Exchange gain- net	*36*	**13,827,713**	755,172
Dividend income		**1,502,639**	1,422,058
Profit transferred from subsidiaries	*37*	**51,383**	42,841
Other operating income-net	*38*	**327,904**	367,824
		43,851,849	9,590,749
Direct operating expenses			
Note printing charges	*39*	**2,486,249**	1,963,777
Agency commission	*40*	**1,743,991**	1,554,969
Provision for:			
- loans, advances and other assets		**4,687,861**	566,906
- diminution in value of investments		**395,129**	-
- other doubtful assets		**1,551,419**	-
		6,634,409	566,906
		32,987,200	5,505,097
General administrative and other expenses	*41*	**5,779,637**	6,073,234
OPERATING PROFIT/ (LOSS)		**27,207,563**	(568,137)
Other income	*42*	**4,176,882**	7,224,746
		31,384,445	6,656,609
Other charges	*43*	**335,209**	548,111
NET PROFIT FOR THE YEAR		**31,049,236**	6,108,498

The annexed notes 1 to 50 form an integral part of these financial statements.

Ishrat Husain	Mansur-ur-Rehman Khan	Aftab Mustafa Khan
Governor	**Deputy Governor**	**Director Accounts**

State Bank of Pakistan

Cash Flow Statement

For the year ended June 30, 2005

	Note	2005	2004
		(Rupees in '000)	
Profit for the year after non-cash items	*44*	**39,722,038**	14,248,169
(Increase) / decrease in assets			
Reserve tranche with the International Monetary Fund under quota arrangements		**(253)**	(502)
Investments		**(162,758,209)**	(17,171,626)
Securities purchased under agreement to resell		**(9,115,545)**	-
Loans, advances and bills of exchange		**(27,112,640)**	(25,805,249)
Foreign currency reserves not included in cash and cash equivalents		**(138,799)**	(1,528,452)
Indian notes representing assets receivable from the Reserve Bank of India		**(49,188)**	(8,631)
Assets held with the Reserve Bank of India		**(9,129)**	(33,929)
		4,062,651	1,043,773
		(195,121,112)	(43,504,616)
Increase / (decrease) in liabilities			
Notes in circulation		**93,962,051**	89,012,613
Bills payable		**605,318**	(177,566)
Current accounts of the Government		**59,447,806**	(38,362,020)
Current account with subsidiaries		**332,287**	(623,820)
Deposits of banks and financial institutions		**40,141,464**	14,505,757
Securities sold under agreement to re-purchase		**(68,109,552)**	-
Other deposits and accounts		**3,593,282**	2,060,651
Payable to the International Monetary Fund		**(5,751,253)**	(18,528,150)
Other liabilities - net		**16,979,158**	(639,267)
		141,200,561	47,248,198
		(14,198,513)	17,991,751
Payment of retirement benefits and employees' compensated absences		**(426,972)**	(1,305,008)
Receipt of dividend income		**1,502,639**	1,431,808
Gold purchased		**-**	(64,589)
Fixed capital expenditure		**(235,036)**	(215,760)
Proceeds from disposal of property, plant and equipment		**968,782**	271,672
		1,809,413	118,123
Dividend paid		**(10,000)**	(10,000)
Increase in cash and cash equivalents		**(12,399,100)**	18,099,874
Cash and cash equivalents at beginning of the year		**650,298,878**	632,199,004
Cash and cash equivalents at end of the year	*45*	**637,899,778**	650,298,878

The annexed notes 1 to 50 form an integral part of these financial statements.

Ishrat Husain	**Mansur-ur-Rehman Khan**	**Aftab Mustafa Khan**
Governor	**Deputy Governor**	**Director Accounts**

State Bank of Pakistan

Statement of Changes in Equity

For the year ended June 30, 2005

(Rupees in '000)

	Share capital	**Allocation of SDR of the IMF**	**Reserves: Reserve fund**	**Reserves: Rural credit fund**	**Reserves: Industrial credit fund**	**Reserves: Export credit fund**	**Reserves: Loans guarantee fund**	**Reserves: Housing credit fund**	**Unrealised appreciation on gold reserves**	**Surplus on revaluation of property, plant and equipment**	**Unappropriated profit**	**Total**
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 property, plant and equipment realised on disposal	-	-	-	-	-	-	-	-	-	(112,444)	112,444	-
Dividend	-	-	-	-	-	-	-	-	-	-	(10,000)	(10,000)
Unrealised appreciation on gold reserves during the year	-	-	-	-	-	-	-	-	6,322,390	-	-	6,322,390
Balance profit transferred to the Government of Pakistan	-	-	-	-	-	-	-	-	-	-	(6,210,942)	(6,210,942)
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
Net profit for the year ended June 30, 2005	-	-	-	-	-	-	-	-	-	-	31,049,236	31,049,236
Surplus on revaluation of property, plant and equipment realised on disposal	-	-	-	-	-	-	-	-	-	(442,825)	442,825	-
Dividend	-	-	-	-	-	-	-	-	-	-	(10,000)	(10,000)
Unrealised appreciation on gold reserves during the year	-	-	-	-	-	-	-	-	6,440,972	-	-	6,440,972
Balance transferable to the Government of Pakistan	-	-	-	-	-	-	-	-	-	-	(21,422,061)	(21,422,061)
Balance at June 30, 2005	100,000	1,525,958	5,400,000	2,600,000	1,600,000	1,500,000	900,000	4,700,000	51,646,593	6,194,503	10,060,000 *	86,227,054

***** The Central Board has proposed to transfer Rs. 10,000 million to the Reserve fund after approval of the Federal Government. Further, as per Board's decision an amount of Rs. 60 million has been earmarked for incentive bonus to employees of the Bank, to be decided by management of the Bank.

The annexed notes 1 to 50 form an integral part of these financial statements.

Ishrat Husain
Governor

Mansur-ur-Rehman Khan
Deputy Governor

Aftab Mustafa Khan
Director Accounts

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 Statement of compliance

These financial statements have been prepared in accordance with the requirements of the International Accounting Standards (IASs) and investment policy as stated in note 2.5 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 and policy for investments as stated in note 2.5 for adoption by the Bank.

2.2 Accounting convention

These financial statements have been prepared under the historical cost convention, except that investments, gold reserves and certain fixed assets, as referred to in notes 2.5, 2.6 and 2.7 have been included at revalued amounts.

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 profit and loss account as and when incurred. 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 (GoP). These coins are purchased from the GoP at their respective face values. The unissued coins form part of the assets of the Issue Department.

2.4 Impairment

The carrying amounts of the bank's assets are 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. An impairment loss is recognised in profit and loss account whenever the carrying amount of an asset or a group of assets exceeds its recoverable amount. 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 in the profit and loss account.

2.5 Investments

During the year, the Bank has changed its accounting policy regarding investments. This change has been made in order to give a more appropriate presentation and measurement of investments. Earlier Bank measured investment in debt securities at cost and other securities at lower of cost or market value. In revised policy, these are initially measured at cost being the fair value of consideration given. Transaction costs are included in the initial measurement of investments. Subsequent to initial measurement, the Bank measures and classifies its investments under the following categories:

Held for trading:

These securities are either acquired for generating a profit from short term fluctuation in market price, interest rate movements, dealer's margin or securities included in a portfolio in which a pattern of short term profit making exists. These instruments are subsequently re-measured to fair value. All related realized and unrealized gains and losses are recognised in the profit and loss account.

All purchases and sales of investments categorised as held-for-trading that required delivery with the time frame established by regulation or market convention ('regular way' purchases and sale') are recognised at the trade date, which is the date bank commits to purchase or sell the investment. Other wise transactions are treated as derivative until settlement occurs.

In accordance with the allowed alternative treatment specified in International Accounting Standard 8 "Net Profit or Loss for the period, Fundamental Errors and Changes in Accounting Policies", the effect of this change in accounting policies has been recognised in the current year and the comparative information has not been restated. Had the accounting policy not been changed, the net profit for the year and the carrying value of trading portfolio would have been higher by an amount of Rs. 1,153 million. Restated proforma information assumes that the new policy had always been in use is given in note 47 to these financial statements.

Held to maturity:

These are financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to maturity other than loans and receivables. These securities are carried at amortized cost, less impairment losses, if any and premiums and/or discounts are accounted for using effective interest method.

All regular way purchases and sale are recognised at the trade date, which is the date bank commits to purchase or sell the investment. Other wise transactions are treated as derivative until settlement occurs.

A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount. The amount of impairment loss for assets carried at amortised cost is calculated as the difference between the asset's carrying amount and present value of expected future cash flows discounted at the financial statement's original effective interest rate.

The change in policy has no impact on the value of these securities and profit and loss of the Bank.

Loans and receivables:
These are financial assets created by the Bank by providing money directly to a debtor. Subsequent to initial recognition, these investments are carried at amortized cost and premiums and/or discounts are accounted for effective interest method

All loans and advances are recognised when cash is advanced to borrowers. When a loan is uncollectible, it is written off against the related provision for impairment. Subsequent recoveries are credited to the provision for loan losses in the profit and loss account.

An allowance for impairment is established if there is evidence that the Bank will not be able to collect all amounts due according to the original contractual terms of loans and advances. The amount of the provision is the difference between the carrying amount and the recoverable from guarantees and collateral, discounted at the original effective interest rate of loans and advances.

The change in policy has no impact on the value of these securities and profit and loss of the Bank.

Available for sale securities (AFS):
These are the securities which do not fall in any of the above three categories. Subsequent to initial recognition the changes in fair value of these securities is taken to equity except the strategic investments including investments in National Bank of Pakistan and United Bank of Pakistan and investments in securities the fair value of which cannot be determined reliably. Gain or loss on changes in fair value is kept in equity until the investments are sold or disposed off, or until the investments are determined to be impaired, at that time cumulative gain or loss previously reported in the equity is included in profit and loss account.

The change in policy has no impact on the valuation of securities and profit and loss of the Bank.

Fair value of the financial instruments classified as held-for-trading and available for sale is their quoted bid price at the balance sheet date.

Financial instruments classified as held-for-trading or available-for-sale are de-recognised by the Bank on the date it commits to sell the investments. Securities held-to-maturity is derecognised on the day these are transferred by the Bank. Gains and losses on de-recognition of held for trading, held to maturity and AFS securities are taken to profit and loss account.

Derivative financial instruments:
The Bank enters into derivative financial instruments, which include forwards and currency swaps. Derivatives are initially recorded at cost and are re-measured to fair value on subsequent reporting dates. Forwards are shown under Commitments in the note 32 while the asset and liability portion of a currency swap are presented in Other Assets and Other Liabilities in notes 19 and 26 to the financial statements. The resultant gains or losses from derivatives are included in the profit and loss account

Collateralised borrowings / lending:

During the year the Bank has changed its accounting policy regarding collateralised borrowings / lending. This change has been made in order to give a more appropriate presentation and measurement of investments. Earlier in case of outright sale or sale under repurchase (Repo) obligations, the securities were being 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 were being reinstated at their respective original cost and in case of purchase under resale obligations, the securities were being 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.

In revised policy where securities are sold subject to a commitment to purchase them at a pre-determined price, they remain on the balance sheet and a liability is recorded in respect of the consideration received in "Securities sold under agreement to repurchase". Conversely, securities purchased under analogous commitment to resell are not recognised on the balance sheet and a consideration paid is recorded in "Securities purchased under agreement to resell". The difference between the sell and repurchase price in the repurchase transactions and the purchase price and sale price in reverse repurchase transaction represents an expense and income respectively and recognised in the profit and loss account on an accrual basis.

The change in policy has no impact on the profit and loss of the Bank.

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 equity under the head of "unrealised appreciation on gold reserves" account. Appreciation realised on disposal of gold is credited to the profit and loss account.

2.7 Property, plant and equipment

Property, plant and equipment 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 on property, plant and equipment are charged to profit and loss account applying the straight-line method whereby the cost of an asset is written off over its estimated useful life.

Depreciation on additions is charged to the profit and loss account 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 / disposed off. 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.

2.8 Intangibles

Intangible assets are amortised using straight-line method over the period of three years. Where the carrying amount of an asset exceeds its estimated recoverable amount it is written down immediately to its recoverable amount.

Intangible assets are carried at cost less accumulated amortisation and accumulated impairment losses, if any.

2.9 Compensated absences

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

2.10 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.

Obligations for contributions to defined contribution provident plans are recognised as an expense in the profit and loss account as incurred.

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.

2.11 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.

2.12 Revenue recognition

- Discount, interest / mark-up and / or return on loans and advances and investments are recorded on time proportion basis that takes into account the effective yield on the asset. 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.

2.13 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.

2.14 Taxation

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

2.15 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.

Commitments for outstanding forward foreign exchange contracts disclosed in note 32 to the financial statements are translated at forward rates applicable to their respective maturities. Contingent liabilities / commitments for letters of credit and letters of guarantee denominated in foreign currencies are expressed in rupee terms at the rates of exchange ruling on the balance sheet date.

2.16 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.

2.17 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.

2.18 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.

2.19 Financial instruments

Financial assets and liabilities are recognised at the time when the Bank becomes a party to the contractual provisions of the instrument. The Bank derecognises financial asset when the enterprise loses control of the contractual rights that comprise the financial asset. The Bank derecognises a financial liability when the liability is extinguished, discharged, cancelled or expired

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.

2.20 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	2005	2004
3.	**GOLD RESERVES HELD BY THE BANK**		**(Rupees in '000)**	
	Opening balance	**2,046,910**	**47,532,115**	41,246,479
	Additions during the year	**-**	**-**	64,589
	Appreciation during the year due to revaluation *31*	**-**	**6,337,889**	6,221,047
		2,046,910	**53,870,004**	47,532,115

		Note	2005	2004
4.	**FOREIGN CURRENCY RESERVES**			
	Investments	*4.1*	**180,148,679**	138,313,415
	Deposit accounts	*4.3 & 4.4*	**424,007,949**	490,621,651
	Current accounts	*4.3*	**7,870,473**	3,398,449
			612,027,101	632,333,515

The above foreign currency reserves are held as follows:

	2005	2004
- Issue Department	**472,513,815**	500,312,132
- Banking Department	**139,513,286**	132,021,383
	612,027,101	632,333,515

4.1 Investments

	Note	2005	2004
Held for trading	*4.4*	**178,482,597**	57,121,116
Held to maturity		**1,484,500**	1,446,523
Available for sale		**181,582**	79,745,776
		180,148,679	138,313,415

4.2 At June 30, 2005, above assets included Rs. 183.167 million (2004: Rs. 167.974 million) recoverable from the Government of India. Realisability of these assets is subject to final settlement between the Governments of Pakistan and India.

4.3 The balance in current and deposit accounts carry interest at various rates ranging between 1.04 to 4.77 (2004: 0.97 to 4.52) percent per annum.

4.4 These include investments made in international market through reputable Fund Managers. The activities of the Fund Managers are being monitored through custodians. Market value of these investments as at June 30, 2005 is equivalent to USD 3,263.8 million.

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, 2005. 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, 2005, the SDRs were held as follows:	**2005**	2004
	(Rupees in '000)	
By the Issue Department	**11,794,613**	13,826,690
By the Banking Department	**1,774,629**	-
	13,569,242	13,826,690

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.

8. LOCAL CURRENCY

Bank notes held by the Banking Department	*13*	**145,618**	160,830
Rupee coins		**2,961,213**	2,799,163
		3,106,831	2,959,993
Rupee coins held as assets of the Issue Department	*8.1*	**(2,961,213)**	(2,799,163)
		145,618	160,830

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, 2005.

9. SECURITIES PURCHASED UNDER AGREEMENT TO RESALE

This represents repurchase agreements lendings and carry markup at the rate of 5.65 to 7.98 (2004: Nil). percent per annum.

10. INVESTMENTS

		2005	2004
		(Rupees in '000)	
Loans and receivables originated by the Bank - Government securities	*10.1*		
Market Treasury Bills (MTBs)	*10.2*	**328,454,605**	128,728,739
Federal Investment Bonds		**-**	2,150,000
Federal Government scrip		**2,740,000**	2,740,000
		331,194,605	133,618,739
Available for sale investments			
Investment in Banks and other financial institutions			
Ordinary shares			
- Listed		**15,892,481**	1,100,807
- Unlisted		**14,449,809**	35,041,806
	10.3	**30,342,290**	36,142,613
Term Finance Certificates		**282,400**	282,400
Certificates of Deposits		**112,351**	112,351
		30,737,041	36,537,364
		361,931,646	170,156,103
Provision against diminution in value of investments		**(789,876)**	(394,747)
		361,141,770	169,761,356
Investment in subsidiaries			
SBP Banking Services Corporation - wholly owned subsidiary	*10.4*	**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
		362,171,030	170,790,616
Investment - MTBs held as assets of the issue department		**(162,802,630)**	(45,671,523)
		199,368,400	125,119,093

10.1 Investment in Government securities

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

	2005	2004
	(% per annum)	
Market Treasury Bills	**2.0756 to 7.9447**	1.2116 to 4.3247
Federal Investment Bonds	**15**	15
Federal Government scrip	**3**	3 to 16

10.2 This includes securities having carrying value of Rs. 1,234.030 million (2004: Rs. 69,740.461 million) given as collateral under repurchase agreement borrowing arrangements.

10.3 Investments in shares of banks and other financial institutions *10.3.1*

	2005 %	2004 %		**2005**	2004
				(Rupees in '000)	
Listed					
National Bank of Pakistan	**75.18**	75.18	*10.3.2*	**1,100,807**	1,100,807
United Bank Limited	**48.69**	-	*10.3.3*	**14,791,674**	-
				15,892,481	1,100,807
Unlisted					
Habib Bank Limited	**60.55**	73.05	*10.3.4*	**12,217,465**	14,739,777
Zarai Taraqiati Bank Limited	**-**	99.69		**-**	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
				12,469,465	18,196,100
Other investments with holding less than or equal to 50%				**1,980,344**	16,845,706
				14,449,809	35,041,806
				30,342,290	36,142,613

10.3.1 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, or joint ventures.

10.3.2 Market value of the Bank's investment in the shares of National Bank of Pakistan at June 30, 2005 amounted to Rs. 47,966.850 million (2004: Rs. 24,604.850 million).

10.3.3 The market value of the Bank's investment in the shares of United Bank Limited (listed during the year) as at June 30, 2005 as per recent available quotation amounted to Rs. 17,023.116 million (2004: Cost of Rs. 14,791.674 million).

10.3.4 Last 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 had transferred ownership of 26% of HBL's total paid up capital last year. Further ownership of 12.5% shares has been transferred during the year proceeds of which amounting to USD 102.956 million have been received during the year resulting in a gain of Rs. 3,587.239 million, as mentioned in note 42.1 to the financial statements. Under the terms of this agreement, the title of remaining 12.5% shares will be transferred to AKFED after payment of USD 95.571 million due there against has been received. This payment is due by February 25, 2006 and carries mark-up at 2.5% above London Inter Bank offer rate on the unpaid amount.

The remaining 12.5% 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 12.5% 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 the shares of HBL amounted to Rs. 18,883.430 million at 31 December 2004 based on the financial statements of HBL for the year then ended.

10.4 The investment in SBP Banking Services Corporation has been made in 1,000 (2004: 1,000) ordinary shares of Rs. 1 million each.

11. COMMERCIAL PAPERS

These represent face value of certain commercial papers amounting to Rs. 78.5 million (2004: 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).

12. ASSETS HELD WITH THE RESERVE BANK OF INDIA

		2005	2004
		(Rupees in '000)	
Gold reserves			
- Opening balance		**773,079**	671,736
- Appreciation from revaluation during the year	*31*	**103,083**	101,343
		876,162	773,079
Sterling securities		**357,794**	350,140
Government of India securities		**13,910**	12,757
Rupee coins		**4,086**	3,765
		1,251,952	1,139,741

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.

13. BANK NOTES ISSUED

Notes held with the Banking Department	*8*	**145,618**	160,830
Notes in circulation		**705,720,090**	611,742,827
		705,865,708	611,903,657

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

Quota allocated by the International Monetary Fund	**90,311,785**	88,097,392
Liability under quota arrangements	**(90,301,470)**	(88,087,330)
	10,315	10,062

15. LOANS, ADVANCES AND BILLS OF EXCHANGE

Government	*15.1*	**20,700,000**	12,000,000
Government owned / controlled financial institutions	*15.2*	**113,234,829**	110,623,197
Private sector financial institutions	*15.3*	**92,829,411**	77,283,785
		206,064,240	187,906,982
Employees		**1,147,371**	891,989
		227,911,611	200,798,971
Provision against doubtful balances		**(8,740,813)**	(4,662,319)
		219,170,798	196,136,652
Commercial papers held in issue department	*11*	**(78,500)**	(78,500)
		219,092,298	196,058,152

15.1 Loans and advances to the Governments

	2005	2004
	(Rupees in '000)	
Federal Government	**12,000,000**	12,000,000
Provincial Government - Balochistan	**8,700,000**	-
	20,700,000	12,000,000

15.1.1 During the year, mark-up on above balances was charged at various rates ranging between 2.0581 to 6.9282 (2004: 1.3795 to 1.9197) percent per annum.

15.2 Loans and advances to Government owned / controlled financial institutions

		Scheduled banks		Non-banking financial institutions		Total	
		2005	2004	**2005**	2004	**2005**	2004
		(Rupees in '000)					
Agricultural sector	*15.2.2*	**60,590,768**	58,005,280	**-**	-	**60,590,768**	58,005,280
Industrial sector	*15.2.2*	**2,158,045**	2,381,409	**595,007**	840,261	**2,753,052**	3,221,670
Export sector		**21,780,804**	16,424,361	**-**	786,123	**21,780,804**	17,210,484
Housing sector		**66,907**	66,907	**11,242,300**	12,607,300	**11,309,207**	12,674,207
Others		**12,985,936**	10,629,456	**3,815,062**	8,882,100	**16,800,998**	19,511,556
		97,582,460	87,507,413	**15,652,369**	23,115,784	**113,234,829**	110,623,197

15.2.1 Above balances include Rs. 518.806 million (2004: Rs. 515.056 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).

15.2.2 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 (2004: Rs. 51,257.213 million) to Zarai Taraqiati Bank Limited (ZTBL).

15.3 Loans and advances to private sector financial institutions

	Scheduled banks		Non-banking financial institutions		Total	
	2005	2004	**2005**	2004	**2005**	2004
	(Rupees in '000)					
Industrial sector	**-**	499,796	**3,577,792**	3,577,792	**3,577,792**	4,077,588
Export sector	**87,744,637**	69,409,072	**-**	587,000	**87,744,637**	69,996,072
Others	**1,506,982**	3,210,125	**-**	-	**1,506,982**	3,210,125
	89,251,619	73,118,993	**3,577,792**	4,164,792	**92,829,411**	77,283,785

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

	2005	2004
	(% per annum)	
Government owned / controlled and private sector financial institutions	**1.5 to 12**	1.5 to 12
Staff loans	**10**	10

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

		2005	2004
		(Rupees in '000)	
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	*16.1*	**3,221,784**	2,986,117
		4,041,708	3,806,041
		4,082,161	3,846,494

16.1 These represent loans and advances provided to the Government of Bangladesh (former East Pakistan).

16.2 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.

17. PROPERTY, PLANT AND EQUIPMENT

Operating fixed assets	*17.1*	**6,429,272**	7,022,027
Capital work-in-progress	*17.3*	**513,841**	348,026
		6,943,113	7,370,053

17.1 Operating fixed assets

	Cost / revalued amount at July 1, 2004	Additions / (deletions) / transfers* during the year	Cost / revalued amount at June 30, 2005	Accumulated depreciation at July 1, 2004	Depreciation for the year on deletions) / transfers*	Accumulated depreciation at June 30, 2005	Net book value at June 30, 2005	Annual rate of depreciation %
	-------	-------	-------	-------	(Rupees in '000)	-------	-------	
Freehold land	807,882	19,500 -	827,382	-	- -	-	827,382	-
Leasehold land	4,996,893	- (393,566)	4,603,327	338,397	109,086 (19,007)	428,476	4,174,851	over the term of lease
Building on freehold land	779,969	1,993 -	781,962	240,478	44,973 -	285,451	496,511	5
Building on leasehold land	1,129,773	5,202 (70,299)	1,064,676	272,039	70,651 (31,598)	311,092	753,584	5
Furniture and fixtures	61,525	4,260 -	65,785	13,029	6,268 -	19,297	46,488	10
Office equipment	100,467	17,615 (48)	118,034	72,879	11,379 (47)	84,211	33,823	20
EDP equipment	458,279	160,485 (427) (51,194) *	567,143	424,745	91,613 (42) -	516,316	50,827	33.33
Motor vehicles	77,625	14,703 (9,657)	82,671	28,819	13,659 (5,613)	36,865	45,806	20
2005	**8,412,413**	**223,758** **(473,997)** **(51,194)**	**8,110,980**	**1,390,386**	**347,629** **(56,307)** **-**	**1,681,708**	**6,429,272**	
2004	8,395,871	150,902 (134,360)	8,412,413	1,021,197	380,593 (11,404)	1,390,386	7,022,027	

17.2 Surplus on revaluation of property, plant and equipment

	2005	2004
	(Rupees in '000)	
Opening balance	**6,637,328**	6,749,772
Surplus realised on disposal	**(442,825)**	(112,444)
	6,194,503	6,637,328

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, an independent valuer, 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. 5,718.411 million remains undepreciated at June 30, 2005 (2004: Rs. 6,121.173 million) and has been included in the carrying value of the related assets.

17.3 Capital work-in-progress

	2005	2004
Building on freehold land	**-**	2,943
Building on leasehold land	**141,103**	44,529
Furniture and fixtures	**28,138**	6,432
Office equipment	**65,689**	27,346
EDP equipment	**13,978**	1,843
Intangible assets	**264,933**	264,933
	513,841	348,026

18. INTANGIBLE ASSETS

		Cost / revalued amount at July 1, 2004	Additions / (deletions) during the year	Cost / revalued amount at June 30, 2005	Accumulated amortisation at July 1, 2004	Amortisation for the year / on deletions)	Accumulated amortisation at June 30, 2005	Net book value at June 30, 2005	Annual rate of amortisation %
		(Rupees in '000)							
Software	**2005**	**32,467**	**65,864**	**98,331**	**32,097**	**45,363**	**77,460**	**20,871**	**33.33**
	2004	32,260	207	32,467	21,344	10,753	32,097	370	

19. OTHER ASSETS

	Note	2005	2004
		(Rupees in '000)	
Amounts due from financial institutions under currency swap arrangements	*19.1*	**2,710,157**	2,674,429
Accrued interest / mark-up and return		**2,300,140**	935,986
Exchange gain recoverable under exchange risk coverage scheme		**7,691**	7,691
Stationery and stamps on hand		**297**	8,310
Other advances, deposits and prepayments		**1,277,671**	521,238
Balance receivable from the Government of Pakistan		**343,805**	5,692,379
Others		**1,160,210**	2,631,956
		7,799,971	12,471,989

19.1 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 26.

20. CURRENT ACCOUNTS OF THE GOVERNMENTS

	Note	2005	2004
Federal Government	*20.1*	**59,285,743**	14,681,524
Provincial Governments			
- Punjab	*20.2*	**19,606,971**	13,913,754
- Sindh	*20.3*	**22,971,702**	13,206,367
- North West Frontier Province (NWFP)	*20.4*	**2,484,464**	4,134,839
- Balochistan	*20.5*	**-**	-
		45,063,137	31,254,960
Government of Azad Jammu and Kashmir		**568,854**	2,952,518
		104,917,734	48,889,002

		Note	2005	2004
			(Rupees in '000)	
20.1	**Federal Government**			
	Non-food account		**184,642**	484,991
	Food account		**13,616**	20,693
	Zakat fund account		**13,867,615**	15,857,448
	Railways - ways and means advances	*20.6*	**(3,211,416)**	(2,798,603)
	Fertilizer account		**34,399**	44,137
	Saudi Arab special loan account		**4,124**	4,124
	Pakistan Baitul Mal fund account		**253,366**	85
	Pakistan Railways special account		**1,736,538**	1,063,373
	Government deposit account no. XII		**5,276**	5,276
	Special transfer account		**37,616,343**	-
	UN reimbursement account		**8,781,240**	-
			59,285,743	14,681,524
20.2	**Provincial Government - Punjab**			
	Non-food account		**(2,134,153)**	(4,365,339)
	Food account		**1,004,477**	1,254,266
	Zakat fund account		**101,542**	50,117
	District Government account no. IV		**20,635,105**	16,974,710
			19,606,971	13,913,754
20.3	**Provincial Government - Sindh**			
	Non-food account		**17,578,105**	9,483,511
	Food account		**35,901**	108,558
	Zakat fund account		**75,084**	75,083
	District Government account no. IV		**5,282,612**	3,539,215
			22,971,702	13,206,367
20.4	**Provincial Government - NWFP**			
	Non-food account		**1,072,476**	3,054,159
	Food account		**760,235**	203,073
	Zakat fund account		**412**	2,007
	District Government account no. IV		**651,341**	875,600
			2,484,464	4,134,839
20.5	**Provincial Government - Balochistan**			
	Non-food account		**(3,840,510)**	(9,865,206)
	Food account		**58,481**	463,836
	Zakat fund account		**2**	5
	District Government account no. IV		**1,667,982**	3,868,246
			(2,114,045)	(5,533,119)
	Classified as a receivable balance	*20.6*	**2,114,045**	5,533,119
	Net credit balance		**-**	-

20.6 At the year end, these balances carried mark-up at 6.93 (2004: 1.92) percent per annum.

21. CURRENT ACCOUNTS WITH SUBSIDIARIES

	2005	2004
	(Rupees in '000)	
SBP Banking Services Corporation	**3,445,805**	3,065,457
National Institute of Banking and Finance (Guarantee) Limited	**-**	3,199
	3,445,805	3,068,656

22. SECURITIES SOLD UNDER AGREEMENT TO REPURCHASE

This represents repurchase agreement borrowings and carry markup at the rate of 4.1584 to 7.4790 (2004: 3.6858 to 4.3230) percent per annum.

23. DEPOSITS OF BANKS AND FINANCIAL INSTITUTIONS

	2005	2004
Foreign currency		
Scheduled banks	**15,920,332**	14,212,278
Held under Capital Reserve Requirement scheme	**41,135,858**	32,020,008
	57,056,190	46,232,286
Local currency		
Scheduled banks	**137,804,690**	108,946,952
Non-banking financial institutions	**1,450,434**	991,567
Others	**955**	-
	139,256,079	109,938,519
	196,312,269	156,170,805

23.1 The above deposits are free of interest except deposits under capital reserve requirements to the extent of eighty percent which are remunerated at the rates given below:

	2005	2004
	(% per annum)	
Foreign currency	**0.87 to 2.13**	0.59 to 0.67
Local currency	**1.98 to 2.59**	0.99 to 1.70

24. OTHER DEPOSITS AND ACCOUNTS

	Note	2005	2004
		(Rupees in '000)	
Foreign currency			
Foreign central banks		**26,858,250**	26,172,872
International organisations		**14,921,250**	14,539,525
		41,779,500	40,712,397
Local currency			
Special debt repayment	*24.2*	**23,755,341**	22,108,042
Government	*24.3*	**11,012,500**	17,952,963
Others		**10,074,745**	2,255,402
		44,842,586	42,316,407
		86,622,086	83,028,804

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

	2005	2004
	(% per annum)	
Foreign central banks	**1.79 to 3.6**	1.36 to 1.79
International organisations	**2.96 to 4.74**	2.96 to 3.1

24.2 These are free of interest and represent amounts kept in separate special accounts to meet forthcoming foreign currency debt repayment obligations of the Government of Pakistan.

24.3 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.

25. PAYABLE TO INTERNATIONAL MONETARY FUND

	Note	2005	2004
		(Rupees in '000)	
Borrowings under:			
- Fund facilities	*25.1*	**7,814,222**	25,041,465
- Other credit schemes	*25.2*	**88,839,730**	77,363,692
		96,653,952	102,405,157
Current account for administrative charges		**29**	77
		96,653,981	102,405,234

25.1 These facilities are secured by demand promissory notes issued by the Government of Pakistan and periodic charges thereon are chargeable to the Government of Pakistan.

25.2 This includes Rs. Nil (2004: Rs. 255.676 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.

25.3 Interest profile of payable to IMF is as under:

	2005	2004
	(% per annum)	
Fund facilities	**1.72 to 2.40**	1.39 to 1.72
Other credit schemes	**0.5**	0.5

26. OTHER LIABILITIES

	Note	2005	2004
		(Rupees in '000)	
Foreign currency			
Amounts due to financial institutions under currency swap arrangements	*19.1*	**2,685,825**	2,617,115
Accrued interest and discount on deposits		**463,941**	243,021
Charges on allocation of Special Drawing Rights of IMF		**62,372**	42,000
Others		**14,557**	4,603
		3,226,695	2,906,739
Local currency			
Overdue mark-up and return		**3,512,589**	3,444,098
Unearned exchange risk fee		**12,328**	12,183
Remittance clearance account		**556,497**	607,501
Exchange loss payable under exchange risk coverage scheme		**5,217**	45,721
Balance payable to the Government of Pakistan		**3,935,947**	-
Share of loss under profit and loss sharing arrangements		-	3,274,752
Dividend payable		**10,000**	10,000
Payable to Government in respect of privatisation proceeds		**2,929,066**	2,929,066
Other accruals and provisions	*26.1*	**4,207,554**	1,949,340
Others		**3,077,625**	3,147,041
		18,246,823	15,419,702
		21,473,518	18,326,441

26.1 Other accruals and provisions

	Note	2005	2004
Interest payable		**18,201**	18,451
Printing charges		**173,138**	10,064
Agency commission		**418,469**	362,115
Provision for employees' compensated absences	*41.6*	**368,000**	322,000
Provision for other doubtful assets		**1,551,419**	-
Other provisions	*26.2*	**1,205,895**	1,124,308
Others		**472,432**	112,402
		4,207,554	1,949,340

26.2 Movement of other provisions

	2005	2004
	(Rupees in '000)	
Opening balance	**1,124,308**	400,000
Provision during the year	**110,400**	1,267,019
Reversed during the year	**(28,813)**	(542,711)
Closing balance	**1,205,895**	1,124,308

	Home remittance	Agriculture loan	Others (note 26.2.1)	Total
	(Rupees in '000)			
Opening balance	150,000	232,289	742,019	1,124,308
Provision during the year	110,363	-	37	110,400
Reversed during the year	-	(28,813)	-	(28,813)
Closing balance	260,363	203,476	742,056	1,205,895

26.2.1 This represents provision made against various contingencies comprising litigation against the Bank.

27. DEFERRED LIABILITY - STAFF RETIREMENT BENEFITS

		2005	2004
		(Rupees in '000)	
Gratuity		**15,471**	22,471
Pension		**2,961,000**	2,991,000
Benevolent fund scheme		**239,000**	247,000
Post retirement medical benefits		**164,000**	124,000
	41.4.3	**3,379,471**	3,384,471
Provident fund scheme		**164,498**	148,942
		3,543,969	3,533,413

28. DEFERRED INCOME

	2005	2004
Opening balance	**286,195**	415,106
Grants received during the year	**220,402**	6,579
Amortisation during the year	**(92,536)**	(135,490)
Closing balance	**414,061**	286,195

This represents grant received for capital expenditure and, as indicated in note 2.11 to these financial statements, is being amortised over the useful lives of the related assets.

29. SHARE CAPITAL

Number of shares		2005	2004
	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.

30. RESERVES

30.1 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.

30.2 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.

31. UNREALISED APPRECIATION ON GOLD RESERVES

		2005	2004
		(Rupees in '000)	
Opening balance		**45,205,621**	38,883,231
Appreciation on revaluation during the year:			
- held by the Bank	*3*	**6,337,889**	6,221,047
- held with the Reserve Bank of India	*12*	**103,083**	101,343
		6,440,972	6,322,390
		51,646,593	45,205,621

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.

32. CONTINGENCIES AND COMMITMENTS

32.1 Contingencies

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

	2005	2004
i) Government	**23,406,428**	32,059,794
ii) Government owned / controlled bodies and authorities	**104,019,357**	73,620,783
	127,425,785	105,680,577

Above guarantees 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. 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.

c) A claim of Rs. 1,600 million has been lodged against the Bank which has not been acknowledged by the Bank. The Bank has a counter claim of Rs. 493 million. With the mutual agreement of both the parties, matter has been referred to the Arbitrator. Management is confident that the Bank will not incur any liability on this account; as such no provision has been made against the claim.

	2005	2004
d) Other claims against the Bank not acknowledged as debts	**685,603**	702,624

32.2 Commitments

	2005	2004
	(Rupees in '000)	
Forward exchange contracts - sales	**78,643,672**	35,140,553
Forward exchange contracts - purchases	**58,229,197**	13,253,350
Repurchase and outright sale of securities	**1,258,632**	69,740,400
Import letters of credit	**81,205,385**	82,306,585
ESAF commitment with IMF	**173,528**	227,081

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

Market Treasury Bills - net	**9,876,465**	1,714,976
Other Government securities	**255,845**	439,911
Loans and advances to Government	**997,720**	358,734
Share of profit on finances under profit and loss sharing arrangements	**3,578,551**	2,210,247
Foreign currency deposits	**9,245,706**	6,067,452
Foreign currency securities	**5,778,084**	911,286
Others	**989**	5,885
	29,733,360	11,708,491

34. INTEREST / MARK-UP EXPENSE

Deposits	**2,235,276**	1,346,406
Share of loss on finances under profit and loss sharing arrangements	**-**	3,815,121
Others	**48,832**	40,564
	2,284,108	5,202,091

35. COMMISSION INCOME

Market Treasury Bills	**103,373**	50,885
Draft / payment orders	**284,216**	238,509
Prize Bonds and National Saving Certificates	**149,410**	119,171
Management of public debts	**66,343**	68,238
Others	**89,616**	19,651
	692,958	496,454

36. EXCHANGE GAIN - net

Gain / (loss) on:		
- Foreign currency placements, deposits, securities and other accounts - net	**15,815,128**	3,372,849
- Open market operations (including currency swap arrangements)	**185,266**	(38,963)
- Forward covers under Exchange Risk Coverage Scheme	**(360,255)**	(156,485)
- Payable to the International Monetary Fund (IMF)	**(2,240,929)**	(3,853,758)
- Special Drawing Rights of IMF	**297,653**	669,601
- Others	**(123,712)**	424,750
	13,573,151	417,994
Exchange risk fee income	**254,562**	337,178
	13,827,713	755,172

37. PROFIT TRANSFERRED FROM SUBSIDIARIES

	2005	2004
	(Rupees' 000)	
SBP Banking Services Corporation	**28,618**	26,135
National Institute of Banking and Finance (Guarantee) Limited	**22,765**	16,706
	51,383	42,841

The above represents the net profit of subsidiaries for the year ended June 30, 2005 transferred to the Bank in accordance with the arrangements mentioned in note 41.3.

38. OTHER OPERATING INCOME- net

Penalties levied on banks and financial institutions	**444,416**	360,677
License / Credit Information Bureau fee recovered	**26,807**	1,966
Profit on sale of securities	**399,537**	-
Gain / (loss) on remeasurement of securities	**(543,336)**	-
Others	**480**	5,181
	327,904	367,824

39. NOTE PRINTING CHARGES

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

40. AGENCY COMMISSION

Agency commission is payable to National Bank of Pakistan (NBP) under an agreement at the rate of 0.15% (2004: 0.15%) of the total amount of collection and remittances handled by NBP.

41. GENERAL ADMINISTRATIVE AND OTHER EXPENSES

	Note	2005	2004
		(Rupees in '000)	
Salaries, wages and other benefits		**656,925**	580,468
Retirement benefits and employees' compensated absences		**468,325**	1,582,008
Contribution to SBP Employees' Welfare Trust		**10,000**	-
Rent and taxes		**15,505**	23,621
Insurance		**4,082**	3,285
Electricity, gas and water charges		**12,480**	15,323
Depreciation	*17.1*	**347,629**	380,593
Amortisation of intangible assets		**45,363**	10,753
Repairs and maintenance		**88,941**	24,406
Auditors' remuneration	*41.7*	**1,450**	1,245
Legal and professional charges		**288,222**	55,844
Traveling and recreation expenses		**38,445**	35,592
Daily expenses		**29,840**	29,825
Fuel charges		**5,606**	5,281
Conveyance charges		**5,063**	3,039
Postages, telegram / telex and telephone		**64,776**	43,496
Training		**6,174**	7,179
Examination/ testing services		**66**	1,249
Remittance of treasure		**979**	1,001
Stationery		**8,802**	12,594
Books and newspapers		**8,536**	5,062
Advertisement		**5,361**	2,930
Uniforms		**1,957**	1,987
Others		**37,676**	38,775
		2,152,203	2,865,556
Expenses allocated by:			
- SBP Banking Services Corporation	*41.1*	**963,403**	821,202
- National Institute of Banking and Finance (Guarantee) Limited		**2,960**	3,196
		966,363	824,398
Expenses reimbursed to:			
- SBP Banking Services Corporation	*41.2*	**2,612,607**	2,340,526
- National Institute of Banking and Finance (Guarantee) Limited		**48,464**	42,754
		2,661,071	2,383,280
		5,779,637	6,073,234

41.1 Expenses allocated by SBP Banking Services Corporation

	2005	2004
Retirement benefits and employees' compensated absences	**916,679**	794,556
Depreciation	**46,724**	26,646
	963,403	821,202

41.2 Expenses reimbursed to SBP Banking Services Corporation

	Note	2005	2004
		(Rupees in '000)	
Salaries, wages and other benefits		**2,279,555**	2,022,629
Rent and taxes		**6,199**	5,857
Insurance		**1,376**	1,142
Electricity, gas and water charges		**94,439**	96,099
Repairs and maintenance		**9,698**	6,466
Auditors' remuneration	*41.7*	**1,750**	1,500
Legal and professional charges		**2,776**	2,237
Traveling expenses		**3,856**	6,154
Daily expenses		**7,113**	10,019
Recreation allowance		**60,573**	57,022
Fuel charges		**2,057**	2,194
Conveyance charges		**2,802**	3,145
Postage and telephone		**10,280**	12,627
Training		**12,892**	-
Remittance of treasure		**30,994**	30,772
Stationery		**6,396**	8,430
Books and newspapers		**874**	2,340
Advertisement		**354**	1,612
Bank guards		**51,510**	34,733
Uniforms		**3,201**	14,151
Others		**23,912**	21,397
		2,612,607	2,340,526

41.3 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, 2005, as mentioned in note 37, 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.

41.4 Staff retirement benefits

41.4.1 As mentioned in note 2.10, 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, 2005 under the projected Unit Credit Method using following significant assumptions:

- Expected rate of increase in salary 9.5 (2004: 5.94) percent per annum
- Expected rate of discount 11.6 (2004: 8.00) percent per annum
- Medical cost increase 6.3 (2004: 2.86) percent per annum

41.4.2 Present value of the obligations

Present values of obligations under the retirement benefit schemes and liabilities recognised there against for the past services of the employees at June 30, 2005 based on actuarial valuation as of that date was as follows:

	2005		
	Present value of the defined benefit obligation	**Unrecognised actuarial gain / (loss)**	**Provision made in respect of the staff retirement benefits**
	----------------- (Rupees in '000) -----------------		
Gratuity	18,000	(2,000)	16,000
Pension	3,482,000	(521,000)	2,961,000
Benevolent	381,000	(142,000)	239,000
Post retirement medical benefits	1,415,000	(1,261,000)	154,000
	5,296,000	(1,926,000)	3,370,000

41.4.3 The following is a movement in the net recognised liability in respect of the defined benefit schemes

	Net recognised liability at 1 July 2004	**Charge for the year (note 41.5)**	**Payments during the year**	**Employees contribution**	**Net liability at 30 June 2005**
	---------------------------- (Rupees in '000) ----------------------------				
Gratuity	22,471	(1,000)	(6,000)	-	15,471
Pension	2,991,000	282,000	(312,000)	-	2,961,000
Benevolent	247,000	42,000	(52,000)	2,000	239,000
Post retirement medical benefits	124,000	126,000	(86,000)	-	164,000
	3,384,471	449,000	(456,000)	2,000	3,379,471

41.5 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:

	2005				
	Current service cost	Interest cost	Actuarial (gain) / loss recognised	Employees contributions	Total
	(Rupees in '000)				
Gratuity	-	1,000	(2,000)	-	(1,000)
Pension	44,000	233,000	5,000	-	282,000
Benevolent	6,000	29,000	9,000	(2,000)	42,000
Post retirement medical benefits	5,000	72,000	49,000	-	126,000
	55,000	335,000	61,000	(2,000)	449,000

41.6 Employees' compensated absences

As at June 30, 2005, the Bank's liability for employees' compensated absences determined through an actuarial valuation carried out under the projected unit credit method amounted to Rs. 368 million (2004: Rs. 322 million). An amount of Rs. 46 million (2004: 40 million) has been charged to the profit and loss account in the current period based on the actuarial advice.

41.7 Auditors' remuneration

	Taseer Hadi Khalid & Co.	M. Yousuf Adil Saleem & Co.	2005	2004
	(Rupees in '000)			
State Bank of Pakistan				
Audit fee	**625**	**625**	**1,250**	1,000
Special certifications / examinations and sundry advisory services	**-**	**-**	**-**	45
Out of pocket expenses	**100**	**100**	**200**	200
	725	**725**	**1,450**	1,245
SBP Banking Services Corporation				
Audit fee	**625**	**625**	**1,250**	1,000
Out of pocket expenses	**250**	**250**	**500**	500
	875	**875**	**1,750**	1,500
	1,600	**1,600**	**3,200**	2,745

42. OTHER INCOME

	Note	2005	2004
		(Rupees in '000)	
Gain on disposal of property, plant and equipment		**499,898**	148,716
Liabilities and provisions written back - net		**-**	275
Gain on disposal of investments	*42.1*	**3,559,403**	6,928,678
Amortisation of deferred income	*28*	**92,536**	135,490
Others		**25,045**	11,587
		4,176,882	7,224,746

42.1 This includes Rs. 3,587.239 million (2004: Rs. 6,086.171 million) in respect of the gain realised during the year on disposal of 12.5% (2004: 26%) of HBL's total paid-up capital to the Aga Khan Fund for Economic Development S.A., as mentioned in detail in note 10.3.4.

43. OTHER CHARGES

	2005	2004
Charges on allocation of Special Drawing Rights	**335,194**	227,295
Others	**15**	320,816
	335,209	548,111

44. PROFIT FOR THE YEAR AFTER NON-CASH ITEMS

	2005	2004
Profit for the year	**31,049,236**	6,108,498
Adjustments for:		
Depreciation	**347,629**	380,593
Amortisation of intangible assets	**45,363**	10,753
Amortisation of deferred income	**(92,536)**	(135,490)
Provision for:		
- retirement benefits and employees' compensated absences	**467,972**	1,582,008
- loans, advances and other assets	**4,687,861**	566,906
- share of loss / (profit) under profit and loss sharing arrangements	**-**	5,303,335
- investments	**395,129**	-
- other doubtful assets	**1,551,419**	-
Gain on disposal of property, plant and equipment	**(499,898)**	(148,716)
Dividend income	**(1,502,639)**	(1,422,058)
Other accruals and provisions - net	**3,272,502**	2,002,340
	39,722,038	14,248,169

45. CASH AND CASH EQUIVALENTS

	2005	2004
Local currency	**3,106,831**	2,959,993
Foreign currency reserves	**609,286,705**	629,731,918
Earmarked foreign currency balances	**11,937,000**	3,780,277
Special Drawing Rights of International Monetary Fund	**13,569,242**	13,826,690
	637,899,778	650,298,878

46. 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:

2005

(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)	-	-	-	3,106,831	-	3,106,831	3,106,831
Foreign currency reserves	602,006,472	2,150,157	604,156,629	7,463,400	407,072	7,870,472	612,027,101
Earmarked foreign currency balances	11,937,000	-	11,937,000	-	-	-	11,937,000
Special Drawing Rights of International Monetary Fund	13,569,242	-	13,569,242			-	13,569,242
Reserve tranche with the International Monetary Fund under quota arrangements	-	-	-	10,315	-	10,315	10,315
Securities purchased under an agreement to resale	9,115,549	-	9,115,549	-	-	-	9,115,549
Current account of the Government of Balochistan	-	-	-	2,114,045	-	2,114,045	2,114,045
Current account with National Institute of Banking and Finance (Guarantee) Limited	-	-	-	1,521	-	1,521	1,521
Investments	328,454,605	2,740,000	331,194,605	-	29,947,165	29,947,165	361,141,770
Loans, advances and bills of exchange	72,871,678	17,688,000	90,559,678	62,546,299	65,986,321	128,532,620	219,092,298
Indian notes representing assets receivable from the Reserve Bank of India	-	-	-	-	592,891	592,891	592,891
Assets held with the Reserve Bank of India	-	375,791	375,791	-	-	-	375,791
Balances due from the Governments of India and Bangladesh (former East Pakistan)	-	3,221,784	3,221,784	-	-	-	3,221,784
Other assets	-	-	-	6,030,508	1,769,463	7,799,971	7,799,971
	1,037,954,546	26,175,732	1,064,130,278	81,272,919	98,702,912	179,975,831	1,244,106,109
Financial liabilities							
Bank notes in circulation	-	-	-	3,941,642	701,924,066 *	705,865,708	705,865,708
Bills payable	-	-	-	1,099,683	-	1,099,683	1,099,683
Current accounts of the Government	-	-	-	104,917,734	-	104,917,734	104,917,734
Securities sold under an agreement to repurchase	1,208,613	-	1,208,613	-	-	-	1,208,613
Current account with subsidiaries	3,455,805	-	3,455,805	-	-	-	3,455,805
Deposits of banks and financial institutions	-	30,005,462	30,005,462	79,687,556	86,619,251	166,306,807	196,312,269
Other deposits and accounts	51,815,966	-	51,815,966	34,806,120	-	34,806,120	86,622,086
Payable to International Monetary Fund	8,586,565	88,067,416	96,653,981	-	-	-	96,653,981
Other liabilities	-	-	-	13,032,737	5,303,139	18,335,876	18,335,876
	65,066,949	118,072,878	183,139,827	237,485,472	793,846,456	1,031,331,928	1,214,471,755
On balance sheet gap	972,887,597	(91,897,146)	880,990,451	(156,212,553)	(695,143,544)	(851,356,097)	29,634,354

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

46.1 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 46.1.1 to 46.1.4. 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.

46.1.1 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.

46.1.2 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.

46.1.3 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.

46.1.4 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.

46.2 Portfolio risk management

The Bank has appointed external managers to invest a part of the foreign exchange reserves in international fixed income securities. The external managers are selected after conducting a thorough due diligence by the Bank and externally hired investment consultants, and appointed after the approval of the Board. The mandates awarded to the managers require them to outform the benchmarks which are based on fixed income global aggregate indices. The benchmarks are customized to exclude certain securities, currencies, and maturities to bring it to an acceptable level of risk and within the Bank's approved risk appetite. Managers are provided investment guidelines within which they have to generate excess returns over the benchmark. Such investment guidelines define acceptable level of risk by setting levels and permitting types of fixed income securities, duration, currencies, maximum issuer limits by issuer types and credit ratings, and other risk parameters. The volatility and quality of portfolio performance is managed through ex-ante and ex-post tracking error, and information ratio, which is part of the investment guidelines. Safe custody of the portfolio is provided through carefully selected global custodians who are independent of the portfolio managers. The custodians also provide valuation, compliance, corporate actions, tax reclamation and recovery, and other value added services which are typically provided by such custodians. The valuations provided by the custodians are reconciled with the portfolio managers, and recorded accordingly.

46.3 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 and certain fixed assets which were revalued in the year 2001, is estimated to approximate their carrying values.

47. PROFORMA INFORMATION

Restated proforma information as referred in note 2.5 of the financial statements is presented below:

47.1 Extract of the profit and loss account

	For the year ended		Restated For the year ended	
	June 30, 2005	June 30, 2004	**June 30, 2005**	June 30, 2004
Discount, interest / mark-up and / or return earned	**29,733,360**	11,708,491	**29,720,865**	11,720,986
Interest / mark-up expense	**2,284,108**	5,202,091	**2,284,108**	5,202,091
	27,449,252	6,506,400	**27,436,757**	6,518,895
Commission income	**692,958**	496,454	**692,958**	496,454
Exchange gain - net	**13,827,713**	755,172	**13,796,322**	786,563
Dividend income	**1,502,639**	1,422,058	**1,502,639**	1,422,058
Profit transferred from subsidiaries	**51,383**	42,841	**51,383**	42,841
Other operating income	**327,904**	367,824	**332,387**	363,341
	43,851,849	9,590,749	**43,812,446**	9,630,152
Direct operating expenses	**10,864,649**	4,085,652	**10,864,649**	4,085,652
	32,987,200	5,505,097	**32,947,797**	5,544,500
General administrative and other expenses	**5,779,637**	6,073,234	**5,779,637**	6,073,234
OPERATING PROFIT / (LOSS)	**27,207,563**	(568,137)	**27,168,160**	(528,734)
Other income	**4,176,882**	7,224,746	**4,176,882**	7,224,746
	31,384,445	6,656,609	**31,345,042**	6,696,012
Other charges	**335,209**	548,111	**335,209**	548,111
NET PROFIT FOR THE YEAR	**31,049,236**	6,108,498	**31,009,833**	6,147,901

47.2 Extract of the statement of unappropriated profit

	For the year ended		Restated For the year ended	
	June 30, 2005	June 30, 2004	**June 30, 2005**	June 30, 2004
		(Rupees in '000)		
Opening unappropriated profit as previously reported	-	-	39,403	-
Profit for the year	31,049,236	6,108,498	31,009,833	6,147,901
Appropriations	432,825	102,444	432,825	102,444
Unappropriated profit and loss restated	31,482,061	6,210,942	31,482,061	6,250,345
Balance transferable/ transferred to the Government	(21,422,061)	(6,210,942)	(21,422,061)	(6,210,942)
Unappropriated profit	10,060,000	-	10,060,000	39,403

48. NUMBER OF EMPLOYEES

	2005	2004
Number of employees at June 30,	**1,351**	1,275

49. DATE OF AUTHORISATION

These financial statements were authorised for issue on August 30, 2005 by the Central Board of Directors of the Bank.

50. GENERAL

Figures have been rounded off to the nearest thousand rupees.

Ishrat Husain	**Mansur-ur-Rehman Khan**	**Aftab Mustafa Khan**
Governor	**Deputy Governor**	**Director Accounts**

16 Financial Statements of SBP BSC

M. YOUSUF ADIL SALEEM & CO.
CHARTERED ACCOUNTANTS
CAVISH COURT
A-35, BLOCK 7 & 8, KCSHU
SHAHRAH-E-FAISAL
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, 2005 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, 2005 and of the profit, its cash flows and changes in equity for the year then ended.

M. Yousuf Adil Saleem & Co.
Chartered Accountants
Karachi
Date : 30 Aug 2005

Taseer Hadi Khalid & Co.
Chartered Accountants
Karachi
Date : 30 Aug 2005

SBP Banking Services Corporation
Balance Sheet
As at June 30, 2005

	Note	**2005**	2004
		(Rupees in '000)	
ASSETS			
Investments	*3*	**933,506**	896,429
Employee loans and advances		**5,161,827**	4,167,674
Other assets		**70,706**	5,682
Balance in current account with the State Bank of Pakistan		**3,445,805**	3,065,457
Property, plant and equipment	*4*	**157,245**	92,109
Total assets		**9,769,089**	8,227,351
LIABILITIES			
Other liabilities	*5*	**2,533,099**	1,609,443
Deferred liabilities - staff retirement benefits	*6*	**6,235,990**	5,617,908
Total liabilities		**8,769,089**	7,227,351
Net assets		**1,000,000**	1,000,000
REPRESENTED BY:			
Share capital	*7*	**1,000,000**	1,000,000

The annexed notes 1 to 13 form an integral part of these financial statements.

Liaqat Durrani
Managing Director

Taslim Kazi
Director Accounts

SBP Banking Services Corporation
Profit and Loss Account
For the year ended June 30, 2005

	Note	**2005**	2004
		(Rupees in '000)	
Discount and interest earned	*8*	**24,289**	12,600
Net operating expenses - establishment costs	*9*		
Total expenses		**3,576,011**	3,161,728
Reimbursed by the State Bank of Pakistan		**(2,612,611)**	(2,340,526)
Allocated to the State Bank of Pakistan		**(963,400)**	(821,202)
		-	-
Gain on disposal of fixed assets		**4,329**	13,535
BALANCE PROFIT TRANSFERRED TO THE STATE BANK OF PAKISTAN		**28,618**	26,135

The annexed notes 1 to 13 form an integral part of these financial statements.

Liaqat Durrani
Managing Director

Taslim Kazi
Director Accounts

SBP Banking Services Corporation
Cash Flow Statement
For the year ended June 30, 2005

	Note	2005	2004
		(Rupees in '000)	
Cash flow from operating activities			
Loss after non-cash items	*10*	**(1,640,589)**	(1,506,304)
Expenses reimbursed by the State Bank of Pakistan		**2,612,611**	2,340,526
Balance profit transferred to the State Bank of Pakistan		**(28,618)**	(26,135)
Retirement benefits and employees' compensated absences paid		**(52,594)**	(775,975)
Discount income received		**18,590**	13,497
		909,400	45,609
(Increase) in assets			
- Loans to employees		**(994,153)**	(252,730)
- Other assets		**(65,024)**	(3,253)
Increase in liabilities			
- Other liabilities - net		**677,656**	23,758
Net cash from / (used to) operating activities		**527,879**	(186,616)
Cash flow from investing activities			
Fixed capital expenditure		**(115,538)**	(46,603)
Investment made		**(40,000)**	(384,507)
Proceeds from disposal of fixed assets		**8,007**	1,251
Net cash (used to) investing activities		**(147,531)**	(429,859)
Net increase / (decrease) in cash and cash equivalents		**380,348**	(616,475)
Cash and cash equivalents at beginning of the year		**3,065,457**	3,681,932
Cash and cash equivalents at end of the year		**3,445,805**	3,065,457

The annexed notes 1 to 13 form an integral part of these financial statements.

Liaqat Durrani
Managing Director

Taslim Kazi
Director Accounts

SBP Banking Services Corporation
Statement of Changes in Equity
For the year ended June 30, 2005

	Share capital	Profit and loss account	Total
	------------------ (Rupees in '000) ------------------		
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
Profit for the year ended June 30, 2005	-	28,618	28,618
Balance profit transferred to the State Bank of Pakistan	-	(28,618)	(28,618)
Balance as at June 30, 2005	1,000,000	-	1,000,000

The annexed notes 1 to 13 form an integral part of these financial statements.

Liaqat Durrani
Managing Director

Taslim Kazi
Director Accounts

SBP Banking Services Corporation
Notes to the Financial Statements
For the year ended June 30, 2005

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.

2.2 Accounting convention

These financial statements have been prepared under the historical cost convention.

2.3 Investments

Investment in Government securities are stated at cost less impairment, if any. The cost of securities is adjusted for any amortisation of premiums on a straight-line basis over the period of maturity.

2.4 Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and any accumulated impairment losses while capital work-in-progress is stated at cost.

Depreciation on property, plant and equipment is charged to profit and loss account applying the straight-line method whereby the cost of an asset is written off over its estimated useful life.

Depreciation on additions is charged to the profit and loss account 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, the 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.

3. INVESTMENTS

		2005	2004
		(Rupees in '000)	
Government securities			
Market Treasury Bills	*3.1*	**549,000**	511,923
Pakistan Investment Bonds	*3.2*	**384,506**	384,506
		933,506	896,429

3.1 Market Treasury Bills carry mark-up at the rate of 5.7 percent per annum (2004: 2.0 percent per annum) and is due to maturity on March 2005.

3.2 Pakistan Investment Bonds carry mark-up at the rate of 8.0 percent per annum (2004: 8.0 percent per annum) and is due to mature in 2013.

4. PROPERTY, PLANT AND EQUIPMENT

Operating fixed assets	*4.1*	**147,910**	74,933
Capital work-in-progress	*4.2*	**9,335**	17,176
		157,245	92,109

4.1 Operating fixed assets

The following is a statement of operating assets:

	Cost at July 1, 2004	Additions / (deletions) during the year	Cost at June 30, 2005	Accumulated depreciation at July 1, 2004	Charge for the year / (accumulated depreciation on deletions)	Accumulated depreciation at June 30, 2005	Net book value at June 30, 2005	Annual rate of depreciation %
	(Rupees in '000)							
Furniture and fixtures	27,366	5,155 (2,716)	29,805	9,650	3,848 (826)	12,672	17,133	10
Office equipment	195,363	61,916 (50,335)	206,944	158,063	20,638 (50,335)	128,366	78,578	20
EDP equipment	36,887	54,352 (112)	91,127	27,653	20,038 (57)	47,634	43,493	33.33
Motor vehicles	13,352	1,956 (3,465)	11,843	2,669	2,200 (1,732)	3,137	8,706	20
2005	**272,968**	**123,379** **(56,628)**	**339,719**	**198,035**	**46,724** **(52,950)**	**191,809**	**147,910**	
2004	243,321	31,530 (1,883)	272,968	172,536	26,646 (1,147)	198,035	74,933	

			2005	2004
			(Rupees in '000)	
4.2	**Capital work-in-progress**			
	Furniture and fixtures		**3,705**	9,398
	Office equipment		**3,887**	7,598
	EDP equipment		**1,743**	180
			9,335	17,176

5. OTHER LIABILITIES

	Note	2005	2004
Accruals and provisions	*5.1*	**1,934,282**	1,419,834
Others		**598,817**	189,609
		2,533,099	1,609,443

5.1 Accruals and provisions

	2005	2004
Provision for employees' compensated absences	**1,663,000**	1,417,000
Others	**271,282**	2,834
	1,934,282	1,419,834

6. DEFERRED LIABILITIES - STAFF RETIREMENT BENEFITS

	2005	2004
Gratuity	**71,000**	84,108
Pension	**4,436,000**	3,989,000
Benevolent fund scheme	**627,000**	567,000
Post retirement medical benefits	**277,000**	220,000
	5,411,000	4,860,108
Provident fund scheme	**824,990**	757,800
	6,235,990	5,617,908

7. SHARE CAPITAL

Number of shares 2005	Number of shares 2004		2005	2004
		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		
		Fully paid-up ordinary shares of		
1,000	1,000	Rs 1,000,000 each	**1,000,000**	1,000,000

8.	**Discount and interest earned**		**2005**	2004
			(Rupees in '000)	
	Discount on Government securities		**15,667**	12,600
	Interest on staff loans		**7,646**	13,020
	Others		**976**	-
			24,289	25,620

9. NET OPERATING EXPENSES - ESTABLISHMENT COSTS

Reimbursable from the State Bank of Pakistan

	Note	2005	2004
Salaries, wages and other benefits		**2,279,552**	2,022,629
Rent and taxes		**6,200**	5,857
Insurance		**1,378**	1,142
Electricity, gas and water charges		**94,440**	96,099
Repair and maintenance		**9,699**	6,466
Auditors' remuneration	*9.5*	**1,750**	1,500
Legal and professional charges		**2,776**	2,237
Travelling expenses		**3,855**	6,154
Daily expenses		**7,112**	10,019
Passages		**60,574**	57,022
Fuel charges		**2,056**	2,194
Conveyance charges		**2,803**	3,145
Postages, telegram /telex and telephone		**10,563**	12,627
Training		**12,891**	-
Remittance of treasure		**30,993**	30,772
Stationery		**6,395**	8,430
Books and newspapers		**874**	2,340
Advertisement		**354**	1,612
Bank guards		**39,036**	34,733
Uniforms		**15,675**	14,151
Others		**23,635**	21,397
		2,612,611	2,340,526
Allocable to the State Bank of Pakistan			
Retirement benefits and employees' compensated absences		**916,676**	794,556
Depreciation	*4.1*	**46,724**	26,646
		963,400	821,202
		3,576,011	3,161,728

9.1 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, 2005:

	Percent per annum
- Expected rate of increase in salary level	9.50%
- Expected rate of discount	11.60%
- Medical cost trend	6.30%

9.2 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, 2004	Charge for the year	Payments during the year	Recognised liability as at June 30, 2005
	-------------------(Rupees in '000)-------------------			
Gratuity	84,108	4,000	17,108	71,000
Pension	3,989,000	498,000	51,000	4,436,000
Benevolent fund scheme	567,000	64,000	4,000	627,000
Post retirement medical benefits	220,000	81,000	24,000	277,000
	4,860,108	647,000	96,108	5,411,000

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 in '000)-------------------		
Gratuity	74,000	71,000	(3,000)
Pension	4,765,000	4,436,000	(329,000)
Benevolent fund scheme	627,000	627,000	-
Post retirement medical benefits	806,000	277,000	(529,000)
	6,272,000	5,411,000	(861,000)

9.3 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 in '000)-------------------------			
Gratuity	2,000	(3,000)	5,000	4,000
Pension	173,000	4,000	321,000	498,000
Benevolent fund scheme	28,000	(9,000)	45,000	64,000
Post retirement medical benefits	24,000	19,000	38,000	81,000
	227,000	11,000	409,000	647,000

9.4 **Employees' compensated absences**

During the year, actuarial valuation of employees' compensated absences has been carried out as at June 30, 2005 using the Projected Unit Credit Method. An amount of Rs. 249 million (2004: Rs. 141 million) has been charged to the profit and loss account in this respect based on actuarial recommendations.

9.5 Auditors' remuneration	M. Yousuf Adil Saleem & Co.	Taseer Hadi Khalid & Co.	2005	2004
	(Rupees in '000)			
Audit fee	625	625	**1,250**	1,000
Out of pocket expenses	250	250	**500**	500
	875	875	**1,750**	1,500

10. LOSS AFTER NON-CASH ITEMS

	2005	2004
Net profit for the year	**28,618**	26,135
Expenses reimbursed by the State Bank of Pakistan	**(2,612,611)**	(2,340,526)
Expenses allocated to the State Bank of Pakistan	**(963,400)**	(821,202)
	(3,547,393)	(3,135,593)
Adjustments for:		
Depreciation	**46,724**	26,646
Provision for retirement benefits and employees' compensated absences	**916,676**	794,556
Expenses allocated to the State Bank of Pakistan	**963,400**	821,202
Discount on Government securities	**(15,667)**	(12,600)
Profit on disposal of fixed assets	**(4,329)**	(515)
	1,906,804	1,629,289
	(1,640,589)	(1,506,304)

11. FINANCIAL ASSETS AND LIABILITIES

	Interest rate %	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 in '000)						
Financial assets								
Investments	5.7% - 8%	549,000	384,506	933,506	-	-	-	933,506
Employee loans and advances	10%	13,752	124,893	138,645	442,935	4,580,247	5,023,182	5,161,827
Balance in current account with the State Bank of Pakistan		-	-	-	3,445,805	-	3,445,805	3,445,805
		562,752	509,399	1,072,151	3,888,740	4,580,247	8,468,987	9,541,138
Financial liabilities								
Other liabilities		-	-	-	870,099	1,663,000	2,533,099	2,533,099
		-	-	-	870,099	1,663,000	2,533,099	2,533,099
On balance sheet gap		562,752	509,399	1,072,151	3,018,641	2,917,247	5,935,888	7,008,039

11.1 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.

11.2 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.

11.3 Fair value of financial assets and liabilities

The fair value of all financial assets and financial liabilities is estimated to approximate their carrying values.

12. NUMBER OF EMPLOYEES

	2005	2004
Number of employees as at June 30	**5,452**	5,510

13. DATE OF AUTHORISATION FOR ISSUE

These financial statements were authorised for issue on 30 August 2005 by the Board of Directors of the Corporation.

Liaqat Durrani
Managing Director

Taslim Kazi
Director Accounts

17 Financial Statements of NIBAF

SYED HUSAIN & CO.
Chartered Accountants

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, 2005, 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, 2005 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: 06 September 2005

SYED HUSAIN & CO.
Chartered Accountants

NATIONAL INSTITUTE OF BANKING AND FINANCE (GUARANTEE) LIMITED

BALANCE SHEET AS AT JUNE 30, 2005

	Note	2005 Rupees	2004 Rupees
ASSETS			
NON CURRENT ASSETS			
Tangible operating fixed assets - at cost less accumulated depreciation	3	11,478,123	13,505,168
Balance in current account with State Bank of Pakistan		(1,521,434)	3,199,083
		9,956,689	16,704,251
CURRENT ASSETS			
Stocks - Stationary and other consumables		686,778	370,738
Advances, deposits, prepayments and other receivables	4	12,815,539	5,401,719
Cash and bank balances	5	53,875,753	53,420,346
		67,378,070	59,192,803
TOTAL ASSETS		**77,334,759**	**75,897,054**
EQUITY AND LIABILITIES			
EQUITY			
Authorized share capital			
20,000,000 (2004: 20,000,000) ordinary shares of Rupees 10 each		200,000,000	200,000,000
Issued, subscribed and paid up share capital			
07 (2004: 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	3,235,234	2,268,957
Unearned Income		471,428	-
		3,706,662	2,268,957
CONTINGENCIES AND COMMITMENTS		-	-
TOTAL EQUITY AND LIABILITIES		**77,334,759**	**75,897,054**

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, 2005

	Notes	2005 Rupees	2004 Rupees
INCOME	8	22,764,866	16,705,586
EXPENDITURE	9	51,423,265	45,949,758
DEFICIT BEFORE ALLOCATION TO STATE BANK OF PAKISTAN		(28,658,400)	(29,244,172)
EXPENSES REIMBURSABLE FROM / ALLOCATED TO STATE BANK OF PAKISTAN		51,423,265	45,949,758
LESS: INCOME ALLOCATED TO STATE BANK OF PAKISTAN		22,764,866	16,705,586
		28,658,400	29,244,172
EXCESS OF INCOME OVER EXPENDITURE - BEFORE TAX		-	-
TAXATION:			
Current		-	-
Prior		-	-
		-	-
EXCESS OF INCOME OVER EXPENDITURE - AFTER TAX		-	-
ACCUMULATED EXCESS OF INCOME OVER EXPENDITURE		24,367,267	24,367,267
ACCUMULATED EXCESS OF INCOME OVER EXPENDITURE		**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, 2005

	2005	2004
	Rupees	Rupees
CASH FLOW FROM OPERATING ACTIVITIES		
Excess of income over expenditure	-	-
Adjustments for non-cash items and other charges		
Expenses allocated to State Bank of Pakistan	2,959,595	3,195,921
Reclassification of Fixed Assets Accounts	1,259,970	-
Cash flow from operating activities before working capital changes	4,219,565	3,195,921
Cash flow from working capital changes		
Increase/(Decrease) in Current Liabilities:		
Creditors, accrued and other liabilities	966,277	(2,217,838)
Advance fee received	-	(1,500,000)
Unearned Income	471,428	-
(Increase)/Decrease in Current Assets:		
Stocks	(316,040)	(125,119)
Advances, deposits, prepayments and other receivables	(7,413,820)	(4,501,569)
	(6,292,155)	(8,344,526)
Income tax paid	-	-
NET CASH OUTFLOW FROM OPERATING ACTIVITIES	(2,072,590)	(5,148,605)
CASH FLOW FROM INVESTING ACTIVITIES		
Addition/transfer of fixed assets	(2,192,520)	(1,665,247)
NET CASH OUTFLOW FROM INVESTING ACTIVITIES	(2,192,520)	(1,665,247)
CASH FLOW FROM FINANCING ACTIVITIES		
Current accounts with State Bank of Pakistan	4,720,517	7,345,815
NET CASH INFLOW FROM FINANCING ACTIVITIES	4,720,517	7,345,815
NET INCREASE/(DECREASE) IN CASH AND CASH AND CASH EQUIVALENTS	455,407	531,963
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR	53,420,346	52,888,383
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	53,875,753	53,420,346

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, 2005

	Advance for Issue of Shares	Share Capital	Accumulated Surplus	Total
	Rupees	Rupees	Rupees	Rupees
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
Net profit for the year	-	-	-	-
Balance as at June 30, 2005	**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, 2005

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 and training in the field of banking, finance and allied areas. State Bank of Pakistan and National Bank of Pakistan hold 85.71% and 14.29% share capital, respectively.

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 of the Income Tax Ordinance, 2001.

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, 2004	Adjustments / Transfers	Additions	As at June 30, 2005		As at July 1, 2004	Adjustments / Transfers	Depreciation for the year	As at June 30, 2005	Value as on June 30, 2005
	Rupees	Rupees	Rupees	Rupees		Rupees	Rupees	Rupees	Rupees	Rupees
Furniture and fixtures	18,894,564	(2,747,605)	230,430	16,377,389	10%	9,005,944	(1,519,472)	1,615,791	9,102,263	7,275,126
EDP equipment	1,389,093	(719,041)	1,664,946	2,334,998	33.33%	1,070,346	(717,028)	216,287	569,605	1,765,393
Office equipment	30,964,959	(615,267)	296,764	30,646,456	20%	28,142,807	(585,453)	985,114	28,542,468	2,103,988
Vehicles	3,041,902	(137,398)	-	2,904,504	20%	2,566,253	(137,388)	142,023	2,570,888	333,616
Library books	725,751	-	380	726,131	100%	725,751	-	380	726,131	-
2005	**55,016,269**	**(4,219,311)**	**2,192,520**	**52,989,478**		**41,511,101**	**(2,959,341)**	**2,959,595**	**41,511,355**	**11,478,123**
2004	**53,351,022**	**-**	**1,665,247**	**55,016,269**		**38,315,180**	**-**	**3,195,921**	**41,511,101**	**13,505,168**

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.

	2005 Rupees	2004 Rupees

4. ADVANCES, DEPOSITS, PREPAYMENTS AND OTHER

These are unsecured but considered good:

	2005 Rupees	2004 Rupees
Advances to suppliers	2,998,000	-
Receivable against training programmes	8,996,141	5,007,542
Accrued profit on PLS accounts	220,600	233,663
Prepayments	179,505	114,699
Advances to staff against expenses	24,893	41,815
Security deposits	396,400	4,000
	12,815,539	5,401,719

5. CASH AND BANK BALANCES

	2005 Rupees	2004 Rupees
Cash in hand	-	-
Cash with banks on deposit accounts	53,875,753	53,420,346
	53,875,753	53,420,346

6. ADVANCE FOR ISSUE OF SHARES

	2005 Rupees	2004 Rupees
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

	2005 Rupees	2004 Rupees
Creditors	3,011,980	1,139,243
Traveling and training costs payable	450	316,040
Accrued charges	-	324,041
Salaries/stipends payable	162,764	243,211
Auditor's remuneration	-	70,000
Withholding tax payable	-	2,252
Other liabilities	60,040	174,170
	3,235,234	2,268,957

8. INCOME

	2005 Rupees	2004 Rupees
Hostel income	14,662,133	12,447,408
Education and training fee	7,576,061	3,066,060
Other income (Note 8.1)	526,672	1,192,118
	22,764,866	16,705,586

		2005 Rupees	2004 Rupees
8.1	**OTHER INCOME**		
	Profit on PLS accounts	442,344	475,909
	Miscellaneous income	84,328	716,209
		526,672	1,192,118
9.	**EXPENDITURE**		
	Reimbursable from State Bank of Pakistan:		
	Salaries, wages and other benefits	19,335,378	17,542,070
	Electricity, gas and water	7,999,495	8,105,191
	Training costs	3,912,611	3,706,864
	Repair and maintenance	6,686,872	3,910,189
	Boarding/lodging catering and allied expenses	3,945,199	3,146,103
	Printing and stationery	1,157,613	1,160,537
	Traveling and conveyance	1,796,089	1,308,478
	Medical expenses	626,096	936,204
	Telecommunication	844,926	896,917
	Vehicle running expenses	630,155	626,823
	Legal and professional charges	405,196	367,800
	Disinfectants and general consumables	167,218	160,577
	Security services/charges	447,061	229,219
	Newspapers and periodicals	66,322	116,320
	Insurance expense	90,760	88,883
	Auditors' remuneration-Audit fee	60,000	60,000
	Out of pocket expenses	31,684	27,060
	Postage and courier	150,813	103,063
	Entertainment	69,522	136,750
	Rent, rates and taxes	8,962	5,198
	Others	31,698	119,591
		48,463,670	42,753,837
	Allocated to the State Bank of Pakistan:		
	Depreciation (Note: 3)	2,959,595	3,195,921
		51,423,265	45,949,758

9.1 Number of employees of the Institute at the end of the year was 48 (2004: 65).

		2005 Rupees	2004 Rupees
10.	**TRANSACTIONS WITH HOLDING UNDERTAKING**		
	Expenses incurred on behalf of holding undertaking	106,644	6,530,749
	Amount disbursed by holding company on behalf of the company	48,463,670	42,753,837

Maximum aggregate amount due from holding undertaking at the end of any month during the year was Rs. NIL (2004: Rs. 3,199,083)

11. FINANCIAL INSTRUMENTS AND RELATED DISCLOSURES

11.1 Financial assets and liabilities of the Institute are as under:

	2005							2004
	Interest bearing			Non interest bearing			Total	
	Within one year	One year to five year	Sub Total	Within one year	One year to five year	Sub Total		
	Rupees	Rupees	Rupees	Rupees	Rupees	Rupees	Rupees	Rupees
Financial assets								
Advances and other receivables	-	-	-	9,613,141	-	9,613,141	9,613,141	862,095
Cash and bank balances	53,875,753	-	53,875,753	-	-	-	53,875,753	53,420,346
	53,875,753	-	53,875,753	9,613,141	-	9,613,141	63,488,894	54,282,441
Financial Liabilities								
Creditors accrued and other liabilities	-	-	-	3,175,234	-	3,175,234	3,175,234	2,266,705
Due to SBP	-	-	-	-	1,581,434	1,581,434	1,581,434	3,199,083
	-	-	-	3,175,234	1,581,434	4,756,668	4,756,668	5,465,788
Net financial assets (liabilities)	53,875,753	-	53,875,753	6,437,907	(1,581,434)	4,856,473	58,732,226	48,816,653

11.2 Effective Markup Rate

Effective markup rate for the current year for financial assets is 0.72% to 1.20% 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 mark up rate risk.

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.

12. EARNING PER SHARE -BASIC

There is no dilutive effect on the basic earning per share, which is as under:

		2005 Rupees	2004 Rupees
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 30 Aug 2005.

14. CORRESPONDING FIGURES

14.1 The corresponding figures have been re-arranged and re-classified for comparison, whereever necessary.

14.2 Figures have been rounded off to the nearest rupees.

MANAGING DIRECTOR **DIRECTOR**

Annexure

A Chronology of Policy Announcements

A.1 Exchange Policy

Date of Announcement	Circular #	Policy Decision
2004 01-July	FE-9	**Delivery of Shipping Documents.** In cases where advance payment in full has been realized from the consignee abroad against the export of goods from Pakistan, SBP allowed Authorized Dealers to release the export documents to concerned exporter for dispatch directly to foreign buyer.
2004 01-July	FE-10	**Issuance of ATM Cards To Non-Resident Rupee Account Holders**. With a view to facilitate individuals maintaining non-resident rupee accounts, SBP decided to allow banks to issue ATM Cards as well as Supplementary ATM Cards to the individual non-resident rupee account holders. However, withdrawals through ATM Cards were only allowed in Pakistan.
2004 03-July	FE-11	SBP made amendments in Foreign Exchange Manual to remove Money Changers from Authorized Dealers after their conversion into Exchange Companies.
2004 17-July	FE-12	**Liberalization of Foreign Exchange - Information Technology Services** To liberalize the Foreign Exchange regime, Authorized Dealers were granted general permission to release foreign exchange upto 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 certain Information Technology services, after satisfying themselves with the genuineness and bonafides of the requests through invoices, Government approvals/NOCs/licensing or certifications wherever so required as per the instructions in Foreign Exchange Manual, and after deducting all applicable taxes. List of eligible items is as follows: i) Satellite Transponder charges. ii) International Bandwidth charges. iii) International Internet service charges. iv) International Private Line charges. v) Software licence/maintenance & support fees for proprietary/ specialized software. vi) Subscriptions/payments for access to foreign electronic media & databases.
2004 17-September	FE-13 & 14	**Remittances by Hajj Group Organizers for Hajj-2005** SBP decided to grant general permission to the Authorised Dealers for release of foreign exchange to the Hajj Group Organizers enlisted with Ministry of Religious in accordance with the Government's Hajj Policy-2005. Further as a one time exception to facilitate Hajj pilgrims, SBP decided to allow remittances by Hajj Group Organizers through Exchange Companies strictly in adherence to the provisions of the Hajj Policy-2005.

Date of Announcement	Circular #	Policy Decision
2004 30-September	EPD-09 Circular Letter	**Permission for Establishment of Payment Booths/ Outlets.** In order to facilitate and further promote Home Remittances, all Exchange Companies were authorized to establish Payment Booths at the place of business with whom they have entered into an exclusive agreement, after obtaining prior approval from Exchange Policy Department (EPD), SBP, Karachi, specifically for the purposes of payments in Pak Rupees of Home Remittances to the beneficiaries in Pakistan against funds to be received by the Exchange Companies from abroad.
2004 11-October	EPD-11 Circular Letter	**Overnight Exposure** In order to facilitate Exchange Companies of 'B' Category, it has been decided to allow Exchange Companies of 'B' Category to carry a foreign currency exposure at the close of business each day at a level not higher than 25 percent of the capital base.
2004 20-October	FE-15	**Liberalization of Foreign Exchange Regime –Information Technology Services.** The scope of FE Circular No.12 of July 07, 2004 was enhanced to extend the remittance facility for payment on account of Information Technology services to those branches of foreign companies, which are operating in Pakistan with the permission of Board of Investment to undertake permissible business/commercial activities, pay local taxes and periodically repatriate their profit abroad under Para 13, Chapter XIV of Foreign Exchange Manual.
2004 01-November	EPD-12 Circular Letter	**Payments Against Imports of Petroleum Products** In order to provide adequate liquidity to the interbank market against rising prices of Petroleum (POL) products in the International Markets, SBP decided to make available funds to the market from its resources for payments in foreign currency in settlement of import of POL products.
2004 10-November	EPD-13 Circular Letter	**Advance Payments Against Imports** To accommodate the genuine needs of importers SBP allowed Authorized Dealers to consider applications for remittance up to the extent of 50 percent of the estimated Cost & Freight value of the capital goods to be imported only against irrevocable Letters of Credit, covering import of industrial capital goods; plant, machinery and equipment for manufacturing, excluding spare parts.
2004 23-November	EPD-15 Circular Letter	**Scheme for Freight Subsidy on Exports** SBP decided to continue Freight Subsidy Scheme for export of new products and export to new markets for FY05 under revised rules.
2005 19-January	FE-1	To facilitate passengers traveling abroad, SBP granted permission for In-Flight Duty Free Purchases in PKR
2005 11-February	EPD-1 Circular Letter	**Import of Raw and Refined Sugar** Economic Coordination Committee allowed import of raw and refined sugar.
2005 11-March	EPD-5 Circular Letter	To monitor the foreign Portfolio Investment in Pakistan closely, SBP decided to collect daily statement showing the Inflow /Outflow from Special Convertible Rupee Accounts (SCRAs) on Account of Portfolio Investment at Stock Exchanges

Date of Announcement	Circular #	Policy Decision
2005 31-March	FE-3	**Release of Private Travel Exchange Quota (PTEQ)** In order to facilitate the passengers traveling from Pakistan to India, SBP allowed Authorized Dealers to issue PTEQ to the passengers traveling to India as per procedure laid down in the Foreign Exchange Manual ie US$ 50/- per day subject to a maximum of US$2100/- per calendar year.
2005 01-April	EPD-6 Circular Letter	In order to further strengthen and streamline the procedure for export of Foreign Currency other than USDollars through Jinnah International Airport Karachi, a Joint Booth of SBP and Custom's was established at the International Lounge, JIAP, Karachi.
2005 25-April	FE-4	**Advance Payments Against Imports** In order to address the genuine needs of the manufacturing/industrial sector, SBP decided to allow advance payment upto the amount of US$10,000/- or equivalent thereof in other currencies per invoice, against intended imports of spare parts/consumables by manufacturing and industrial users for their own use without the requirement of a Letter of Credit or bank guarantee from the supplier.
2005 14- June	FE-5	**Export of Surplus Cash US Dollars by the Authorized Dealers** The scope of the procedure for disposal of surplus Cash Foreign Currencies by way of export was widened by SBP when it decided to allow the Authorized Dealers (ADs) to sell their surplus cash US Dollars to the Field Offices of SBP BSC.
2005 16- June	EPD-11 Circular Letter	SBP strictly advised all Exchange Companies to not make remittance on account of trade related activities on behalf of individual or corporate clients.
2005 18-June	FE-6	**6 percent Research and Development Support to Garments Industry** The Government decided to provide Research and Development Support to the Textile Garments Units manufacturing and exporting textile garments at the rate of 6 percent of the FOB value of the exports to EU and USA, subject to the terms and conditions mentioned in the Ministry of Commerce's SRO No. 437 (I)/2005 dated May 18, 2005, as amended vide Ministry of Commerce's SRO No. 611 (I)/2005 dated June 15, 2005. The said support is applicable to the shipments made on or after 12th April, 2005. The list of eligible items is as given under Chapter 61 and 62 of the Pakistan Customs Tariff.
2005 24- June	EPD-12 Circular Letter	SBP made it mandatory for all Exchange Companies of 'B' Category to submit basic information about sale and purchase of all foreign currency transactions and statement of exposure ie FCY balances held with them.

A.2 Banking Policy, Inspection and Supervision

Date of Announcement	Circular #	Policy Decision
2004 03-July	BPD-22	**Regulations for Financing to Brokers by Banks / DFIs** In order to facilitate the transition from Badla to Margin Financing in Stock Exchanges of Pakistan, encourage active participation of banks / DFIs in this area, unlock investments in equities, enable investors to leverage their stock holdings and to ensure that the relevant activities are undertaken by banks / DFIs in a prudent manner, State Bank of Pakistan (SBP) issued regulations for financing to brokers by banks / DFIs.
2004 06-July	BPD-23	**Release of Security/Margin held against Bank Guarantee** SBP advised that the banks, after the expiry period of the bank guarantee, should evaluate its effectiveness keeping in view its terms and conditions, validity period, legal position ie whether there is any claim or litigation pending against the said guarantee etc, as well as obtain the legal advice from their legal advisor/counsel. In case the issuing bank is fully satisfied that the guarantee has lost its effectiveness in all terms, it should release the security/margin retained by it against the guarantee after obtaining an indemnity bond from the customer and not insist upon the return of the original guarantee from the beneficiary. While releasing the security/margin to the customer they should simultaneously inform the beneficiary about the release of their liability towards that guarantee.
2004 08-July	BID-01	**Questionnaires for Self-Assessment-Institutional Risk Assessment Framework** SBP introduced the concept of Institutional Risk Assessment Framework (IRAF) for ensuring proactive monitoring of the risks the banks/DFIs are exposed to and to further strengthen the existing supervisory mechanism. The new framework envisages a collaborative and seamless supervisory focus amongst the various supervisory departments within SBP. The review of banks/DFIs under IRAF shall be based on inputs relating to four areas. These include compliance with standards, codes & guidelines; supervisory & regulatory information; financial performance & condition and market information & intelligence. In this regard, SBP prepared and circulated the Questionnaires for Self-Assessment of banks/DFIs. These questionnaires were prepared in light of PRs & guidelines issued from time to time for compliance by the banks/DFIs.
2004 13-July	BSD-10	**Revaluation Surplus / Deficit** SBP decided that banks/DFIs will classify their entire investment portfolio into ‘Held to Maturity’, ‘Available for Sale’ and ‘Held for Trading’ securities The banks/DFIs shall decide the category of the investment at the time of acquisition and the decision taken to that effect shall be recorded in writing on the investment proposals. However, banks/DFIs will be free to determine the extent of holding under the above categories taking into consideration various aspects such as trading strategies, intention of acquisition of securities, capital position, expertise available to manage investment portfolio, and the risk management capabilities, etc. The banks/DFIs will not resort to frequent shifting of securities from one category to another to take undue advantage of fluctuation in the market/ interest rates. Under exceptional circumstances, shifting from one category to another, except ‘ held to Maturity’ will be allowed subject to certain conditions.

Date of Announcement	Circular #	Policy Decision
2004 20-July	BPD-24	**Receipt and Processing of Applications for Subscription** SBP took serious note of the fact that during public issue of shares, bankers to the issue were not processing duly completed subscription applications of prospective investors who were not their account holders and advised the banks to immediately discontinue this practice and issue necessary instructions to their branches, under intimation to SBP.
2004 04-August	BSD-11	**Revaluation Surplus / Deficit** SBP clarified that i) BSD Circular No. 10 is effective from the date of its issuance ie July 13, 2004 ii) The banks shall classify their investments into three categories i.e. Held for Trading, Available for Sale and Held to Maturity. However, investments in subsidiaries and associates shall be reported separately in accordance with International Accounting Standards as applicable in Pakistan and shall not be subject to mark to market. iii) First time classification of securities into Held for Trading, Available for Sale or Held to Maturity will be as of the effective date of the above referred Circular, and any unrealized mark to market surplus/deficit existing in the books in respect of Held for Trading Securities only will be taken to Profit and Loss Account. iv) Banks can use investments held in any of the three categories as a collateral under Repo/Reverse repo transaction, however, in these transactions the securities are subject to a repurchase / resale commitment, and therefore the risk of loss due to change in price will remain with the owner. Consequently, a security which is the subject of a repurchase or security lending agreement will be treated as if it were still owned by the lender and will be marked to market by the lending bank (owner) and any surplus /deficit shall be treated according to its category of classification.
2004 04-August	BPD-27	SBP decided that all banks / DFIs shall observe minimum Security Standards for Enhancement of Security of Lockers.
2004 25-August	BSD-12	**Minimum Capital Requirements for Banks / DFIs** In order to align the regulatory capital requirement with the internationally accepted standards and institute a true risk based capital adequacy framework, SBP has decided to impose capital charge for market risk, in addition to presently applicable capital requirement on credit risk Furthermore, in order to strengthen the capital base of institutions, the minimum paid–up capital requirement (net of losses) of Rs1 billion is being increased to Rs2 billion. The capital position should be reported to SBP on consolidated as well as on standalone basis on the revised format as part C of the Quarterly Report of Condition Any bank/DFI that will fail to meet the minimum paid-up capital requirement (net of losses) of Rs1.5 billion by 31st December 2004 and Rs2 billion by 31st December, 2005, shall not be allowed to undertake a full range of financial services.
2004 04-September	BSD-13	**Guidelines on Business Continuity Planning** The need for making comprehensive arrangements for instituting physical security measures in order to ensure the operational sustainability of individual institutions and that of the industry necessitated SBP to issue Guidelines on Business

Date of Announcement	Circular #	Policy Decision
		Continuity Planning (BCP) meaning the level of readiness in the face of any actual or potential danger, damage, and disaster. BCP, being a risk-based framework, is a proactive process and deals with operational risk by developing policies, strategies, and specific responsibilities for the recovery of critical business functions. Most importantly, it should be commensurate with the institutions' nature, scale and complexity of business activities. It may be noted that the guidelines are issued with a view to help strengthen overall resilience of the financial system. Development of robust and practical contingency and security plans, involving participation from all concerned areas of organization, will ensure that banks / DFIs have the capacity to deal with an unexpected situation that might flow from sudden, internal as well as external events.
2004 24-September	BSD-14	**Revaluation Surplus / Deficit** On the request of Pakistan Banks Association, SBP decided to make the amendments in the instructions issued vide BSD Circular No. 10 and 11 dated July 13 and August 4, 2004: i) The "Held to Maturity" securities shall be carried at amortized cost and shall not be required to be revalued. This will, however, be subject to the condition that once a security is classified as "Held to Maturity" no subsequent reclassification/shifting to "Available for Sale" or "Held for Trading" categories will be permissible. ii) The term "permanent diminution" has been substituted with "impairment", which shall have the same meaning as defined in the International Accounting Standards. iii) Banks/DFIs shall complete the process of classification of their existing investment portfolio into "Held for Trading", "Available for Sale" and "Held to Maturity" categories by September 30, 2004.
2004 27-September	BSD-05 Circular Letter	SBP up-graded M/s Riaz Ahmad, Saqib, Gohar & Company, Chartered Accountants from 'C' to 'B' on the Panel of Auditors – Under Section 35(1) of the Banking Companies Ordinance, 1962
2004 29-September	BSD-15	**Guidelines on Information Technology Security** Today is the age of information technology (IT) and the banking institutions, in order to stay competitive, are taking maximum advantage of rapidly evolving innovations in IT. They are fast incorporating IT in their business processes to achieve efficiency, to serve their customers satisfactorily and to expand & modernize their product offerings. The use of information technology creates new risks, and the worst case would be the total disruption of service and its consequential financial implications. Keeping the above in view, SBP has prepared the guidelines for IT Security and expects all banks/DFIs to make adequate and reliable arrangements for IT Security. These guidelines will provide a starting point to set practices and procedures in place for enhancing IT Security. The guidelines emphasize on the commitment to IT Security and provides guidance on IT Security concept, Risk management, IT Security policy and plan development, IT Security areas, IT Security team, Awareness and training, Incident management, Contingency and disaster recovery planning, Information system audit and certification, and finally requires the banks/DFIs to have a well functioning and reliable IT Security system, which is working round the clock and is continuously being improved.
2004	BPD-31	**Banking in Un-banked Areas**

Date of Announcement	Circular #	Policy Decision
05-October		SBP decided that every bank (except for Microfinance Banks, Islamic Banks, Islamic Banking subsidiaries of existing commercial banks and stand alone Islamic Banking branches) should open at least 20% of the planned branches under its annual branch expansion plan, in unbanked areas. SBP further decided to charge fee for issuance of licences for commercial banking and branches in line with international practice.
2004 05-October	BPD-32	**Prudential Regulations for Consumer Finance** SBP amended Prudential Regulations for Consumer Finance to prohibit banks/DFIs from extending Housing Finance purely for the purchase of land/plots; rather, such financing would be extended for the purchase of land/plot and construction on it. To provide flexibility in the regulatory framework with respect to clean lending limit against Credit Cards and Personal Loans, SBP decided to allow assigning a clean limit higher than Rs500,000 to the prime customers of the banks/DFIs.
2004 12-October	BID-01 Circular Letter	**Questionnaires for Self-Assessment-IRAF** In order to further facilitate the local banks/DFIs/MFIs for the timely submission of the duly filled out questionnaires, SBP decided that the questionnaires may be filled-out by management, approved by the Board of Directors (BOD) and signed jointly by the President/CEO and the Secretary to BOD.
2004 26-October	IBD-03	**Fit and Proper Criteria for Shariah Advisors** To facilitate Islamic banking institutions, the Shariah Board of SBP revised the Fit and Proper Criteria for Appointment of Shariah Advisors.
2004 02-November	BPD-34	**Banking in Un-banked Areas** SBP clarified that the condition of opening 20% branches in un-banked areas shall not be applicable in case of bank having 100 or less branches.
2004 06-November	BSD-16	**Reporting to Credit Bureaus** After receiving complaints from the customers of banks/DFIs regarding misreporting of their names to the private credit bureau(s), SBP had been issued the following instructions: i) The reversals / write-offs made as a consequence of settlement in writing, through mutual consent of the bank/DFI and the borrower, should not be reported as “write-offs” to a private credit bureau(s). ii) The amounts in dispute with the customers, substantiated with the documentary evidence, should be reported as “amounts under dispute” and not as “defaults” to a private credit bureau(s). iii) The banks/DFIs shall send an intimation letter to the concerned borrower before reporting his name as “defaulter” to a private credit bureau(s) and allow a reasonable time period (at least 15 days) for reconciliation / settlement of overdue liability.
2004 26-November	BSD-17	**Financial Derivatives Business Regulations (FDBR)** At present banks are allowed to undertake the business of financial derivatives after getting specific transactional approval from SBP for entering into such transactions. In order to develop an Over the Counter (OTC) financial derivatives market in the country, it has been decided to allow Banks/DFIs to undertake

Date of Announcement	Circular #	Policy Decision
		derivatives business, provided they meet the eligibility criteria and obtain Authorized Derivatives Dealer (ADD) or Non Market Maker Financial Institution (NMI) status from SBP. Banks/DFIs obtaining the status of ADD or NMI should ensure that the derivative transactions undertaken do not contravene any other applicable laws, regulations, or restrictions, in force. In this context the Financial Derivatives Business Regulations (FDBR) have been issued, which interalia contain the regulatory framework for the OTC financial derivative transactions. FDBR comprises two parts, the main body of regulation and the product annexures. The first part i.e. the main body sets out the eligibility criteria and procedure for the institutions to become an ADD or NMI. It also sets the minimum operational, dealing and risk management standards, reporting and disclosure requirements. The second part contains the specifics related to Foreign Currency Options, Forward Rate Agreements, and Interest Rate Swaps, including permissible currency, tenor, and benchmarks.
2005 06-January	BSD-01 Circular Letter	SBP decided to discontinue the requirement of submission of the Special Audit Report by external Auditors.
2005 07-January	BSD-02 Circular Letter	**Risk Management Framework –Disclosure in Annual Accounts** In order to enhance disclosure and to meet information needs of the stakeholders, it has been decided that effective from the Accounting Year ended 31st December, 2004, all banks and DFIs will include a comprehensive paragraph under the heading “Risk Management Framework” in the Directors’ Report in their Annual Accounts. This paragraph will cover -the overall / broad plan to meet SBP’s guidelines on risk management; -the status and details of action / steps taken under the bank’s individual plan to implement SBP’s guidelines on Risk Management; and -the indicative timeframe to achieve completion of their plan i.e. full compliance of SBP’s guidelines.
2005 19-January	BSD-01	**Reporting Requirements on Frauds/Forgeries/Dacoities** Operational Risk is gaining importance in the banking industry in the wake of increasing complexity of operations and the risks involved therein. The incidents of internal and external frauds and forgeries are included in list of the operational risk events that have the potential to result in substantial losses. In view of the importance of frauds prevention/mitigation strategy in overall operational risk framework and to improve the mechanism for active supervisory response, SBP has formulated the revised reporting requirement for banks/DFIs on frauds/forgeries/dacoities cases. Submission of complete and timely information on revised formats will enable SBP to remain apprised of developments at banks/DFIs and monitor follow-up action taken by them for all medium and high severity frauds/forgeries including the emergency reported cases. The information so collected will also be used to develop a database of frauds, forgeries, and dacoities events, which will be used for measuring operational risk and determining capital requirements thereagainst. Furthermore, banks/DFIs will separately report all material incidents of frauds/forgeries/dacoities etc. of Rs1 million and above on urgent basis as under:- a) Preliminary report within 2 working days of the occurrence of such incident by mentioning the date of the incident and other information about the case as available at the time of such reporting; and

Date of Announcement	Circular #	Policy Decision
		b) Detailed report within 15 days of the occurrence of such incident
2005 26-January	BSD-03 Circular Letter	**Guidelines on Internal Controls** SBP has decided that banks/DFIs will include a Statement on Internal Controls, as envisaged in "Guidelines on Internal Controls" in their Annual Audited Financial Reports.
2005 28-January	BPD-01	**Establishment of Subsidiaries /Brokerage Companies by Banks / DFIs** SBP has issued a consolidated circular containing its earlier instructions with some modification for Banks/DFIs intending to undertake brokerage business and diversification of their activities through subsidiaries The following instructions in consolidated form will supersede the earlier instructions 1. The Banks/DFIs are required to establish separate subsidiaries if they wish to undertake asset management or conduct brokerage business. However they may at their own discretion, establish other subsidiaries as admissible under the law. 2. The Banks/DFIs desiring to establish any subsidiary shall obtain prior approval of State Bank of Pakistan. 3. The subsidiary can either be a public limited company or a private limited company. It should be ensured that the subsidiaries are established only for activities as are admissible under Section 23 of the Banking Companies Ordinance, 1962. It is clarified that the instructions contained in this circular are not applicable on the exchange companies established by the Banks.
2005 28-January	BPD-02	In order to discourage speculative activities on car purchases, which may be facilitated by the bank financing of premium, SBP decided that the banks/DFIs shall extend loans only for the ex-factory tax paid price fixed by the car manufacturers.
2005 15-February	BPD-04	**Branch Opening Policy for DFIs** Policy for opening/closing/shifting of branches of DFIs was revisited and modified by SBP to further streamline the policy.
2005 26-February	BPD-05	**Replacement of COT with Margin Financing** In order to safeguard the interest of all stakeholders and to ensure smooth transition from COT to Margin Financing, SBP decided that banks/DFIs shall cap their COT exposure, in each share, at the existing level as on February 25, 2005.
2005 08-March	BPD-08	**Prudential Regulations for Corporate /Commercial Banking and Small & Medium Enterprises Financing** Definition of "Equity of the Borrower" was modified to include preference shares of certain features only and de-classification of restructured/rescheduled accounts was made permissible in case the borrower had repaid or adjusted in cash at least 50 percent of the total restructured loan amount.
2005 15-March	BSD-04 Circular Letter	**Prudential Regulation G-1 Corporate Governance / Board of Directors and Management** SBP advised all banks and DFIs to change their external auditors every five years. Cases where two audit firms jointly audit their accounts and both of them complete 5 years period at the same time, one of the audit firms will be rotated in that year

Date of Announcement	Circular #	Policy Decision
		and the other one in the next year.
2005 19-March	BPD-09	**Prudential Regulations for Corporate And Commercial Banking** Placement of funds of FE-25 deposits with any one bank / financial institution, whether in Pakistan or abroad, shall be subject to; (a) Prudential Regulation R-1 for investing bank, which mentions different weightages according to credit ratings of financial institutions and (b) Not more that 25 percent of the total investable funds available under FE-25 shall be placed with a single institution.
2005 19-March	BPD-10	**Housing Finance: Relaxations in the Regulatory Framework** In order to facilitate origination of housing loans and securitization of mortgage/construction/developer finance, following relaxations in the present regulatory framework are allowed to Banks/DFIs: Keeping in view the active role of banks/DFIs for the provision of housing finance to a cross section of the society, the maximum per party limit of Rs10 million in respect of housing finance, as per Regulation R-15 of the Prudential Regulations for Consumer Financing, is being removed with immediate effect. Accordingly, banks/DFIs are allowed to determine the housing finance limit in accordance with their internal credit policy, credit worthiness and loan repayment capacity of the borrowers. In order to facilitate securitization of mortgage/construction/developer finance through Special Purpose Vehicle (SPV), banks/DFIs are allowed the following relaxations with respect to Listed and Unlisted Mortgage /Construction/Developer Finance Asset Backed Securities (ABS): **a. Listed ABS:** The minimum credit rating for banks/DFIs to make direct investment and for taking exposure (i.e. undertaking lending and reverse repo) against listed ABS for mortgage/construction/developer finance is reduced from "A" to "A- (or equivalent)". **b. Unlisted ABS:** Banks/DFIs are allowed to invest in non-listed mortgage/construction/developer finance ABS having a minimum credit rating of "A- (or equivalent)" as well as to take exposure (i.e. undertaking lending and reverse repo) against the security of such non-listed ABS.
2005 21-March	BPD-11 Circular Letter	**Opening of Pakistani Banks' Branches Abroad** State Bank of Pakistan has allowed opening of Pakistani Banks' branches abroad. The procedure for opening of branch(es) /office(s) abroad by locally incorporated banks has been notified to them.
2005 28-March	BSD-02	**Fit & Proper Criteria for Board Members and President/Chief Executive of Microfinance Banks** State Bank of Pakistan has formulated "Fit & Proper Criteria" for the Board Members and President/Chief Executive of Microfinance banks, which prescribe the minimum qualification, experience and integrity standards etc. for the MFBs' Board Members and President/Chief Executive. The criteria are being introduced as Prudential Regulations for Microfinance Banks, Fit & Proper Criteria for MFBs' Board Members and President/Chief Executive Officer.
2005 31-March	BSD-03	**Implementation Roadmap of Basel II in Pakistan announced** SBP decided to adopt the Basel II in Pakistan. For the smooth, realistic and undisrupted transition from present capital adequacy framework towards more risk sensitive new capital adequacy framework – the Basel II, all banks/DFIs are

Date of Announcement	Circular #	Policy Decision
		required to designate one senior officer from their institution who will supervise all activities relating to Basel II within the bank and will serve as a point of contact between SBP and that particular bank. For this purpose, banks may also put in place a support functionary to assist the person in charge as considered appropriate. SBP provided a broad roadmap and outline which is required to start work for the adoption of Basel II. The new framework consists of three mutually reinforcing pillars; the first pillar relates to Minimum Capital Requirement, second pillar describes Supervisory Review Process under the new framework and the third pillar describes the Market Discipline required to be adopted by the banks. Under pillar one, the framework offers three distinct options for assessment of capital requirements for credit risk and three options for operational risk. The approaches available for assessment of capital for credit risk are Standardized Approach, Foundation Internal Rating Based Approach and Advanced Internal Rating Based Approach. The approaches available for computing capital charge for operational risk are Basic Indicator Approach, Standardized Approach and Advance Measurement Approach. Whereas the capital requirement as to the Market Risks remains unchanged and banks will continue to assess the capital charge against the market risk based on the existing instructions under the Basel-I. The timeframe for adoption of different approaches under Basel II is as under: - i) Standardized Approach for credit risk and Basic indicator / Standardized Approach for operational risk from 1st January 2008. ii) IRB approach from 1st January 2010. Banks interested in adopting IRB Approach for capital requirement against credit risk before 1st January 2010 may approach SBP for the purpose. Their requests will be considered on case-to-case basis. Banks/DFIs will be required to adopt a parallel run of one and a half year for Standardized Approach and two years for IRB Approach starting from 1st July 2006 and 1st January 2008 respectively. The above timeframe has been finalized after consultation with and with the agreement of the Presidents / CEOs of all banks/DFIs. Each bank/DFI is required to formulate their internal plans specifying the approach they are willing to adopt and the plans for moving to the particular approach. The plans should envisage the risk management setup, various risk assessment methodologies being used for assessment of various risk categories and the policy and procedures for the capital allocation. It must highlight what are the gaps for moving to Basel II implementation and what steps are required to overcome those gaps. Banks/DFIs should give a time bound action plan narrating the activities to be done and the time when it will be accomplished within the overall implementation timeframe as mentioned above.
2005 36-March	BPD-11	**Replacement of COT with Margin Financing** The restriction on the maximum exposure against COT (generally known as Badla) was withdrawn.
2005 07-April	BPD-14	**Prudential Regulations for Corporate /Commercial Banking** SBP decided to replace Para 2 of Regulation R-4 pertaining to Limit on Exposure Against Unsecured Financing Facilities in Prudential Regulations for Corporate/Commercial Banking was amended to exclude/exempt certain facilities from the per party limit of Rs 500,000/- on the clean facilities.
2005	BPD-15	**Financing Facilities by SBP (Enhancement In Repo Rate)**

Date of Announcement	Circular #	Policy Decision
11-April		SBP has enhanced the minimum rate of return to be paid by recipients of financing facilities for meeting temporary liquidity shortage ie SBP 3-day Repo facility, against Government of Pakistan MTBs and PIBs from 7.5 percent to 9.0 percent.
2005 14-April	BPD-16	**Rates of Return on Deposits** SBP clarified that banks/DFIs may offer different rates of return to their depositors/investors in the same category. However, banks/DFIs should follow the principles of openness, fairness and avoid discrimination based on ethnicity, region, religion, sex, age, profession and marital status.
2005 16-April	BPD Notification	SME Bank Limited was declared a scheduled bank by SBP.
2005 27-April	BPD-17	**Procurement of Wheat by Private Sector** To encourage the participation of private sector in wheat procurement, SBP allowed banks to provide financing facilities to their eligible borrowers (licensed wheat traders and the Flour Mills) for procurement of wheat, subject to certain conditions.
2005 21-May	BPD-19	Amendments were made in Prudential Regulations for Corporate & Commercial Banking, and Prudential Regulations for SME Financing with respect to definition of Groups, Liquid Assets etc.
2005 31-July	SMED-01	**Establishment of Small and Medium Enterprises Department** For the promotion of development finance, SBP established Small and Medium Enterprises Department. The department is responsible for regulatory and supervisory matters relating to SMEs, Micro Finance, Export Refinance, Housing Finance and Infrastructure Project Financing.

A.3 Monetary and Credit Policy

Date of Announcement	Circular #	Policy Decision
2004 04-August	ACD-01 Circular Letter	**Revised Indicative Per Acre Credit Limit for Major Crops** To facilitate the farming community in availability of adequate and timely banking credit for meeting their genuine needs, Agricultural Credit Advisory Committee (ACAC) decided in its annual meeting held on July 17, 2004 to enhance the indicative per acre credit limits for four major agriculture crops (Sugar, Paddy, Wheat and Cotton).
2005 21-March	ACD-01 Circular Letter	**Agricultural Loan Scheme- List of Eligible Items for Agricultural Credit** To enhance the scope of Agricultural Loans Scheme and to ensure availability of adequate and timely credit to agriculture sector, the ACAC, in its mid-term meeting held on February 1, 2005 at SBP Karachi decided to include Poultry Feed Making Industry (credit requirement–75 percent of the cash requirement) in the list of items eligible for credit under SBP Supervised Agricultural Credit Scheme.

A.4 Money Market

Date of Announcement	Circular #	Policy Decision
2004 30-June	EDMD-08	**SBP selected the following institutions to act as Primary Dealers for the FY05:** 1. Citibank N.A. 2. United Bank Limited 3. National Bank of Pakistan 4. Habib Bank Limited 5. ABN Amro Bank N.V. 6. Jahangir Siddiqui & Company Limited 7. Pak Oman Investment Company Limited 8. American Express Bank Limited 9. Standard Chartered Bank 10. Union Bank Limited 11. Bank Alfalah Limited 12. Muslim Commercial Bank
2004 18-November	EDMD-13	**Money Market Computerized Reporting System** On successful completion of parallel run of Money Market Computerized Reporting System, SBP decided to make it fully operational and discontinued the following statements: i) Daily Statement showing the details of transactions in inter-bank Repo/Call Money Market. ii) Weekly Report on Secondary Market Trading of Treasury Bills/ Pakistan Investment Bonds/Federal Investment Bonds. iii) Statement of Sale of Pakistan Investment Bond to Investors during 'when issued period'.
2005 03-June	EDMD-07	**SBP announced the simultaneous auction of 3, 6 & 12 months Market Treasury Bills.**

A.5 Payment Systems

Date of Announcement	Circular #	Policy Decision
2005 27-August	Master Circular	**Master Circular of Payment Systems' Statements** To improve accuracy, avoid repeated errors, ensure timely submission and add new variables, a "Master Circular" was issued by consolidating all the previous instructions/circulars and incorporating new instructions. Accordingly the banks and switch operators were required to submit quarterly statements by 15th of the month following the quarter to which it pertained. List of circulars and circular letters that stood cancelled with the issuance of "Master Circular": 1) Circular No.1/2003 dated April 28, 2003 regarding "Payment Systems Perspective: Information / Data". 2) Circular No.2/2003 dated May 30, 2003 regarding "Monitoring of E-Banking Services". 3) Circular No.3/2003 dated October 04, 2003 regarding "Quarterly Electronic Banking Statistics (Online funds transfer)". 4) Circular No.4/2003 dated October 09, 2003 regarding "Payment Systems: Quarterly Statistics". 5) Circular Letter No.1/1038/2004 dated September 29, 2004 regarding "Electronic Submission of Data". 6) Circular Letter No.2/1058/2004 dated October 20, 2004 regarding "Transactions of Inter- Switch Connectivity of 1-Link and MNet". 7) Circular Letter No.3/1059/2004 dated October 20, 2004 regarding "Survey Report on Inter- Switch Connectivity of 1-Link and MNet". 8) Circular Letter No.4/1061/2004 dated October 22, 2004 regarding "ATM Oversight". 9) Circular Letter No.1/2005/006/91 dated January 06, 2005 regarding "Payment Systems: Quarterly Statistics".

B Governance Structure

The governance framework of SBP is specified in SBP Act of 1956. The Act provides for an independent Central Board of Directors to oversee the affairs of SBP. Under the provisions of SBP Act 1956, the general superintendence and direction of the affairs and business of SBP rests with the Central Board of Directors.

B.1 The Central Board of Directors

The Central Board of Directors 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 in the meeting, the Governor may exercise a casting vote, in the event of equality of votes.

B.1.1 Members of the Board as on June 30, 2005

Mr. Nawid Ahsan

Mr. Khair Mohamed Junejo

Mr. Abdul Razak Dawood

Mr. M. Yaqoob Vardag

Mr. Mohsin Aziz

Dr. Wasim Azhar

Mr. Kamran Y. Mirza

Mr. Alman A. Aslam

Mr. Kamran Y. Mirza and Mr. Alman A. Aslam joined the Central Board in FY05, their brief profile is:

Mr. Kamran Y. Mirza

Mr. Kamran Y. Mirza is a Chartered Accountant. He started his career, in Februiary 1969 as an Auditor in Winney Murray & Co, Chartered Accountants Tehran, Iran. Later on, he assumed positions of Auditor in A F Ferguson & Co in September 1969, and Director of Finance in Abbott Laboratories, Karachi in December 1970. Now he is the Chief Executive Chairman & Managing Director in the said institution. He has a distinguished career spanning over 36 years in Accounting. He also remained president of American Business Council, president of Overseas Investors Chambers of Commerce and Industry and chairman of Pharma Bureau (Group of 29 Multinational Pharmaceutical Companies). He was also Director on the Board of PSO and National Bank of Pakistan. He was appointed as member of the Central Board of SBP on February 10, 2005.

Mr. Alman A. Aslam

Mr. Alman A. Aslam is a seasoned banker with his banking career spaning over 28 years. Presently he is providing consultancy, advisory and investment banking services to corporations in Pakistan with several mandates under execution. He started his career from Citibank in 1975 as an account officer. Later on, he assumed positions of higher responsibility within Citibank and served the bank in its overseas operations. He has also served as Advisor to EMP Washington from August 2003 to April 2004. He was also appointed as became member of the Central Board of SBP on February 10, 2005.

B.1.2 Main Decisions of the Board

The Board met ten times during the FY05 at different centers to discuss and decide following important issues:

Accounts

a) Budget proposals for revenue and capital expenditure of SBP and its Subsidiaries for FY05.
b) Annual Accounts of the Bank for the year ended June 30, 2004.
c) Presentation on Business Plans of the Bank for FY04 and FY05.
d) Creation of State Bank of Pakistan Employees Welfare Trust.
e) Overdrafts of Government of Balochistan.
f) Profit and Loss Account for the period July to December, 2004 and the estimates of Profit and Loss Account for the period January to June, 2005.
g) Budget vis-à-vis Expenditure from July 2004 to March 2005.
h) Appointment of Auditors for audit of FY05 Accounts and fixation of their fee.
i) Actual Profit and Loss Account for the period July 2004 to March 2005 and the estimates of Profit and Loss Account for the period April 2005 to June 2005.

Agricultural Credit

a) Re-imbursement of Bonafide Losses under SBP supervised Agricultural Credit Scheme – Proposals for discontinuation/withdrawal of the said scheme with effect from July 1, 2005.

Banking Policy

a) Re-construction of Allied Bank of Pakistan Limited.
b) Setting up of Office of the Banking Ombudsman.
c) Old Scheme for Financing locally manufactured Machinery renegotiation of terms with IDBP.
d) Hiring of M/S Bankakdemie International, Germany under ADB's/ SME sector development project for developing SME Finance Capacity in Commercial Banks.
e) Introduction of Deposit Protection Scheme.

Banking Supervision

a) Establishment of the "Pakistan Institute of Corporate Governance".
b) Performance Review of the Banking System for the quarter ended June 30, 2004.
c) Presentation on Corporate Governance standards for banks and financial institutions.
d) Performance Review of the Banking system for the quarter ended September 2004.
e) Road Map for implementation of Basel-II in Pakistan.
g) Banking system Review for the year ended December 31, 2004

Corporate Services

a) Re-Appointment of Mr. Tawfiq A. Husain as Deputy Governor.
b) Re-constitution of Board Sub-Committees.
c) Appointment of Mr. Mansur-ur-Rehman Khan as Deputy Governor.
d) Conversion of SBP Library Building into an Art Gallery and Museum.
e) Governor's participation in the Board of Directors of National Academy of Performing Arts.
f) Nomination of Directors on the Central Board of SBP.
g) Nomination of Members on the Board of NIBAF.
h) Nomination of Directors of the Central Board as Administrator of the SBP's Employees Provident Fund.

Exchange and Debt Management

a) Foreign Exchange Reserves Management – Payment of fee to the Law Firm Allen & Overy.
b) Management of Third Currency collection and exports.
c) Presentation on Reserve Managements by M/s. Mercer.
d) Changes in the parameters/guidelines for investment fund managers.

Exchange Policy

a) Budget Estimates for 34th ACU Meeting.

Engineering

a) Construction of SBP New Office Building Complex at Sialkot – Award of work.
b) Sale of SBP Sub-Office Building (Press Building) at Shahrah-e-Kamal Ataturk, Karachi to Government of Sindh.
c) Disposal of Bank's Flats at North Nazimabad, Karachi.
d) Adoption of Public Procurement Rules 2004 by SBP.

Human Resources

a) Appointments in SBP.
b) Re-imbursement of Educational Expenses to the Children of deceased employees.
c) Merit and Provincial/Regional Quotas.
d) Revision of SBP Compensation and Benefits Structure.
e) Appointment of Head Investment Service.
f) Increase in Pension.
g) Implementation of Policies of Broad Banding and Professional Growth.
h) Annual Merit Increase in Salaries.
i) Regularization of Service of Head of Departments/Specialists hired on Contractual basis.
j) Medical facilities for dependent parents.
k) Appointments in SBP against Separate Salary Structure for Specialized Professionals.
l) Appointment of Data Warehouse Manager.
m) Financial Assistance for Dependent Children of Female Employees while on Study leave/Sabbatical.
n) Grant of Scholarship/Leave for Study.
o) Revision in SBP Staff Regulation 2001.

Information Systems

a) Procurement of Network Intrusion Detection and Prevention System for SBP Network as per proposal in its Business Plan for FY05.

Research and Economic Policy

a) Monetary and Credit Developments FY04 and credit plan FY05.
b) Pakistan Financial Sector Assessment 2003.
c) The State of Pakistan's Economy–1st Quarterly Report for July–September 2004.
d) Monetary Policy Statement (2004-05) Mid-Term Review.
e) The State of Pakistan's Economy–2nd Quarterly Report for October–December 2004.
f) The State of Pakistan's Economy–3rd Quarterly Report for January–March, 2005.

Strategic Planning

a) Strategic Plan 2005-10.
b) Annual Report FY04 on the State of the Economy and SBP Performance Review.

B.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 December 20, 2003 and again due to induction of two new members the Committees were reconstituted on May 15, 2005. The current setup of each sub-committee is discussed in more detail below.

Audit

The members of the Audit Sub-Committee are Mr. Kamran Y. Mirza, Mr. M. Yaqoob Vardag, Directors Central Board and Mr. Mujahid Eshai, Ex- President of Institute of Chartered Accountants of Pakistan. The Committee is chaired by Mr. Kamran Y. Mirza while the Director Audit acts 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 14 (Fourteen) times during the year and discussed the following issues:

a) Audit Report of Banking Policy, Agricultural Credit, Statistics and Information Systems Department.
b) Annual, half yearly and quarterly Accounts of SBP.
c) Profit and Loss projections for the period ended December 31, 2004.
d) Review of Management Letter issued by External Auditors.
e) Appointment of external Auditors.
f) Review of Budget Expenditure on annual, half yearly and quarterly basis.
g) Terms of Reference for external Auditors.
h) Accounting Policy for Investments.
i) Review of Accounting Policies relating to Investments and Budgeting.

Monetary and Credit Policies

The Monetary and Credit Policies Sub-Committee consists of Mr. Abdul Razak Dawood and Mr. Alman A. Aslam. Mr. Abdul Razak Dawood is the Chairman of the Sub-Committee while the Economic Advisor 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 and credit policies. The Sub-Committee met twice during the year and deliberated on the following issues:

a) Monetary Policy statement (July-December, 2004).
b) Credit Plan for FY05.
c) Monetary Policy Statement (January-June, 2005).

Budget and Expenditure

The members of the Budget and Expenditure Sub-Committee are Mr. Mohsin Aziz and Dr. Wasim Azhar. The Director Accounts Department acts as the Secretary of the Sub-Committee.

The Sub-Committee is responsible for reviewing the budget and expenditure of 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 three times during the year to discuss following issues:

a) The proposed SBP BSC Expenditure Regulations 2004.
b) Budget Proposals for Revenue and Capital Expenditures of SBP and its subsidiaries.
c) Review of SBP Budget *vis-à-vis* Expenditure of SBP and its subsidiaries.

Human Resources

This Sub-Committee comprises of Mr. Khair Mohamed Junejo and Mr. Kamran Y.Mirza. 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 FY05.

Automation

The members of the Automation Sub-Committee include Mr. Mohsin Aziz, Dr. Wasim Azhar; Deputy Governor (Management). 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. The committee met two times during FY05.

Building Projects

The Building Projects Sub-Committee comprises of Mr. M. Yaqoob Vardag (Chairman) and Mr. Khair Mohamed Junejo as Member while the Director Engineering Department acts as 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. Sixteen meetings of the Sub-Committee were held during FY05 for decisions and recommendations on the following:

a) Construction of SBP new office building complex at Sialkot – Award of civil work.
b) Purchase of Furniture for the Auditorium at SBP BSC, Multan – Award of work.
c) Purchase of land for construction of Bank's own office Building at Gujranwala.
d) Purchase of land for construction of Bank's own office Building at D. I. Khan.
e) Establishment of Ombudsman Office for Bank at IBP, Molvi Tamzuddin Khan Road, Karachi.

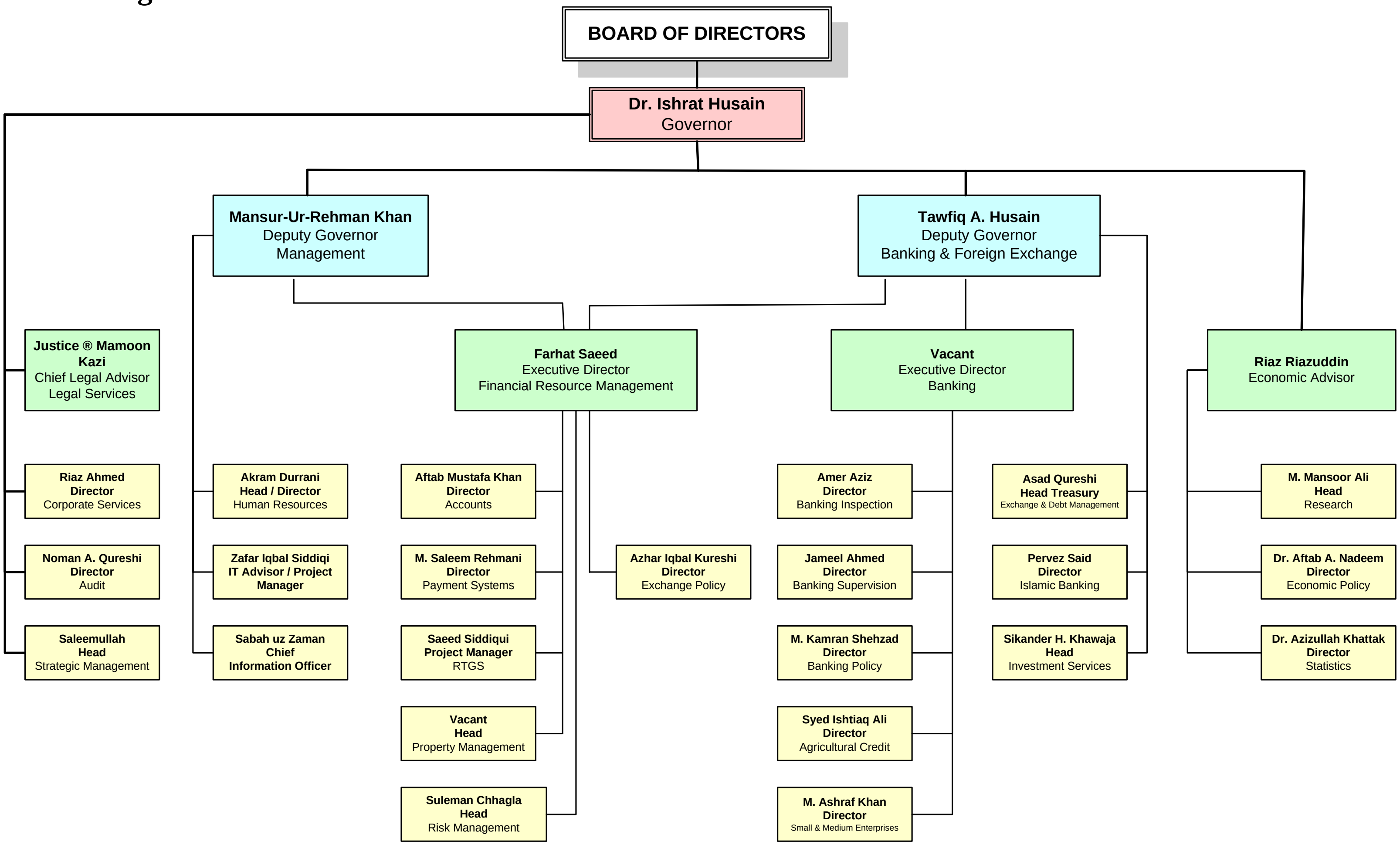
f) Replacement of Cooling Tower of Air Conditioning system installed at Lahore and Peshawar Office Building.
g) Renovation and Re-furnishing of Lift lobby/Staff entrance at SBP.
h) Disposal of Press Building.
i) Pre-qualification of Contractors for construction of additional floor at NIBAF, Islamabad.
j) Pre-qualification of consultants/consulting firms for SBPs various Civil, Interior Decorations, Electrical and Air-conditioning Projects.
k) Setting up Disaster Recovery site.
l) Supply and delivery of Generator Set at Karachi and Lahore.
m) Indus Valley proposal for Mural for the Learning Resource Center.
n) Purchase of land for construction of office building at Gawadar.
o) Pre-qualification of Contractors for Electrical and HAVC work for Sialkot and NIBAF Islamabad.
p) Outsourcing of Janitorial work for SBP.
q) Capital and Revenue Budget of Engineering Department and Field Offices in respect of engineering works.
r) Status Reports of the Projects/works approved and going on in FY05.

Investment

The Sub-Committee on Investment consists of Mr. Nawid Ahsan, Mr. Abdul Razak Dawood, Mr. Alman A. Aslam, Mr. Zafar M. Sheikh (as a Co-Opted Member) and Deputy Governor (Banking). 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 Mr. Garry Hawker of M/s. Mercer made a presentation on the quarterly performance of External Fund Manager and a broad review of overall investment process.

C Organizational Chart



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E List of Publications

Name of Publications	Frequency	Price List
1. Statistical Bulletin	Monthly	Rs160
2. Export Receipts	Monthly	Rs260
3. The State of Pakistan's Economy	Quarterly	Rs320
4. Quarterly Performance Review of the Banking System	Quarterly	Rs50
5. Statistics on Scheduled Banks in Pakistan	Half Yearly	Rs180
6. Index Numbers of Stock Exchange Securities	Annual	Rs150
7. Balance Sheet Analysis of Joint Stock Companies	Annual	Rs600
8. Banking Statistics of Pakistan	Annual	Rs435
9. Pakistan's Balance of Payments	Annual	Rs150
10. Export Receipts	Annual	Rs240
11. Equity Yields on Ordinary Shares	Annual	Rs140
12. Foreign Liabilities and Assets and Foreign Investment in Pakistan	Annual	Rs145
13. Pakistan Financial Sector Assessment	Annual	Rs395
14. Banking System Review	Annual	Rs230
15. SBP Annual Report (Vol-I) Review of the Economy	Annual	Rs450
16. SBP Annual Report (Vol-II) Performance Review	Annual	Rs375
17. Pakistan Financial Sector Assessment (1990-2000)	Occasional	Rs195
18. Foreign Exchange Manual, 2002 (Vol I&II)	Occasional	Rs950
19. History of the SBP Vol. I (1948-1960)	Occasional	Rs650
20. History of the SBP Vol. II (1961-1977)	Occasional	Rs550
21. History of the SBP Vol. III (1977-1988)	Occasional	Rs925
22. History of the SBP Vol. IV (1988-2003)	Occasional	Rs1200
23. Islamic Banking & Finance-Theory & Practice	Occasional	Rs480
24. Prudential Regulations for Consumer Financing	Occasional	Rs50
25. Prudential Regulations for Corporate / Commercial Banking	Occasional	Rs100
26. Prudential Regulations for Small and Medium Enterprise Financing	Occasional	Rs60
27. Minimum Capital Requirements for Banks/DFIs	Occasional	Rs100
28. An Overview of Performance since its inception (SBP BSC)	Occasional	Rs250
29. Leading Issues Facing Pakistan's Economy (Governor's speeches)	Occasional	Rs170
30. Current Issues in Pakistan's Economy (Governor's speeches)	Occasional	Rs170

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F List of Acronyms

A

ACAC	Agricultural Advisory Credit Committee
ADD	Authorized Derivatives Dealer
AMC	Authorized Money Changer
AML	Anti Money Laundering
ATM	Automated Teller Machine

B

BCO	Banking Companies Ordinance
BCP	Business Continuity Planning
BMA-PGBI	BMA Pakistan Government Bond Index
BPM5	Balance of Payments Manual–5th Edition
bps	basis points

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
CEO	Chief Executive Officer
CIB	Credit Information Bureau
CIRC	Corporate and Industrial Restructuring Corporation
CMT	Corporate Management Team
CRR	Cash Reserve Requirement
CRSIU	Revival of Sick Industrial Units

D

DFI	Development Finance Institution
DIS	Deposit Insurance Scheme
DMT	Departmental Management Team
DPCB	Domestic Private Commercial Bank
DSL	Digital Subscriber Line
DXX	Digital Cross Connect System

E

EC	Exchange Company
EDW	Enterprise Data Warehouse
ERP	Enterprise Resource Planning

F

FDBR	Financial Derivatives Business Regulations
FEOD	Foreign Exchange Operations Department
FMA-PGBI	Financial Market Association Pakistan Government Bond Index
FPCCI	Federation of Pakistan Chambers of Commerce and Industry
FSAP	Financial Sector Assessment Program

FY03	Fiscal Year 2002-03

G

GDP	Gross Domestic Product
GL	General Ledger
GMT	Group Management Team

H

HBFC	House Building Finance Corporation
HP	Hewlett Packard
HRD	Human Resources Department
HRMS	Oracle Human Resource Management System

I

IBI	Islamic Banking Institution
IIP	International Investment Position
IMF	International Monetary Fund
IRAF	Institutional Risk Assessment Framework
IRB	Internal Ratings Based
IT	Information Technology

J

JD	Joint Director
JS–PGBI	Jahangir Siddiqui Pakistan Government Bond Index

K

KIBOR	Karachi inter-bank offered rate

M

MCR	Minimum Capital Requirement
MERPC	Monetary and Exchange Rate Policy Committee
MFB	Microfinance Bank
MFI	Microfinance Institution
MPS	Monetary Policy Statement
MTB	Market Treasury Bill

N

NAB	National Accountability Bureau
NBFC	Non Bank Finance Company
NBP	National Bank of Pakistan
NCB	Nationalized Commercial Bank
NGO	Non-Governmental Organization
NIBAF	National Institute of Banking and Finance
NIFT	National Institutional Facilitation Technologies
NMI	Non Market Maker Financial Institution
NPL	Non Performing Loan
NWFP	North West Frontier Province

O

OG	Officer Grade
OMO	Open Market Operations
OTC	Over the Counter

P

PD	Primary Dealer
PIB	Pakistan Investment Bond
PKR	Pak-Rupee
PKRV	Reuters Pakistan Revaluation rates
PMN	Pakistan Microfinance Network
PMS	Performance Management System
POS	Points of Sale
PPAF	Pakistan Poverty Alleviation Fund
PRISM	Pakistan Real time Inter bank Settlement Mechanism

R

RCOA	Reporting Chart of Accounts
REIT	Real Estate Investment Trust
Rs	Pak-Rupee
RSP	Rural Support Program
RTGS	Real Time Gross Settlement

S

SBOTS	State Bank Officers Training Scheme
SBP BSC	SBP Banking Services Corporation
SBP	State Bank of Pakistan
SDP	Sector Development Program
SDR	Special Drawing Rights
SECP	Securities and Exchange Commission of Pakistan
SME	Small and Medium Enterprise
SMEDA	Small and Medium Enterprise Development Authority
SSHR	Self Service Human Resources
SSSSP	Separate Salary Structure for Specialized Professional

U

UBL	United Bank Limited
US$	US Dollar

V

VSAT	Very Small Aperture Terminal

W

WAN	Wide Area Network

Z

ZTBL	Zarai Taraqiati Bank Limited