STATE BANK OF PAKISTAN AND ITS SUBSIDIARIES
NOTES TO THE CONSOLIDATED ACCOUNTS
FOR THE YEAR ENDED JUNE 30, 2003

1. STATUS AND NATURE OF OPERATIONS

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.

The Bank has two subsidiaries as at June 30, 2003:

?? SBP Banking Services Corporation; and
?? National Institute of Banking and Finance (Guarantee) Limited which has become operative during the year and has accordingly been consolidated.

The Bank owns 100% of the share capital of SBP Banking Services Corporation and 59.4% of the share capital of National Institute of Banking and Finance (Guarantee) Limited.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation

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

The consolidated financial statements include the accounts of the State Bank of Pakistan and its subsidiaries. The financial statements of subsidiaries have been consolidated on a line-by-line basis.

All inter-group balances and transactions have been eliminated.

2.2 Accounting convention

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

2.3 Bank notes and rupee coins

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

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

2.4 Bad and doubtful balances

Balances considered bad and irrecoverable are written off from the books of account. Provision is made against debts considered doubtful based on the management's best estimate of the loss likely to arise on these balances.

2.5 Investments

- Investments in Government securities are stated at cost. The cost of securities is adjusted for any amortisation of discounts or premiums on a straight-line basis over the period to maturity.

- Investments in listed securities are stated at the lower of cost and market value determined on a portfolio basis.

- Investments in unlisted securities are stated at cost less provision for any diminution in value. This provision is made only if there is a permanent impairment in the value of these investments.

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

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

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

2.6 Gold reserves

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

2.7 Fixed assets and depreciation

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

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

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

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

2.8 Deferred income

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

2.9 Staff retirement benefits

The Bank and its subsidiaries operate:

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

Annual provisions are made 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.

2.10 Compensated absences

Annual provision is made in respect of liability for employees' compensated absences based on actuarial estimates.

2.11 Revenue recognition

?? Discount, interest/ mark-up and/ or return on loans and advances and investments is recorded on accrual basis. However, income on balances pertaining to transactions in former East Pakistan (now Bangladesh), doubtful loans and advances and overdue return on investments are recognized as income on receipt basis.

?? Dividend income is recognised when the Bank’s right to receive dividend is established.

?? All other revenues are recognised on accrual basis.

2.12 Finances under profit and loss sharing arrangements

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

2.13 Taxation

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

2.14 Foreign currency 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 (IMF), referred to in note 2.15, which are transferred to the Government of Pakistan.

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

2.15 Transactions and balances with the International Monetary Fund

Transactions and balances with the International Monetary Fund (IMF) are recorded on the basis of International Accounting Standards (IASs) 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 SDRs by the IMF is treated as capital receipt and is not revalued.

?? Income or charges pertaining to balances with the IMF are taken to the Government account except for the following which are taken to the profit and loss account:

?? charges on borrowings under credit schemes other than fund facilities;
?? charges on net cumulative allocation of Special Drawing Rights; and
?? return on holdings of Special Drawing Rights.

2.16 Cash and cash equivalents

Cash and cash equivalents include cash, balances in the current and deposit accounts and securities realisable in cash within three months.

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.