

DIRECTOR'S REPORT TO THE SHAREHOLDERS

We are pleased to present the 8th annual report of SME Bank Limited with the audited accounts and auditors' report thereon for the year ended December 31, 2009.

The major restructuring of the Bank that started in 2004, under the SME Sector Development Program entered in the last phase during 2008 and continued through 2009. As part of the privatization process of the bank, due diligence exercise was completed by the bidders in 2008 and since then, no further progress has been made on the privatization of the bank. As the process of privatisation could not reach its logical conclusion thus the ownership of the Bank still rests with the Federal Government.

Board of directors of the bank was not functional from July 2008 to November 2009. In the meantime important decisions regarding rehabilitation of the bank were taken by the ministry and ratified by the shareholders in 7th EOGM dated October 7, 2009. On the proposal of the management, the shareholders unanimously agreed to reduce the establishment cost of the bank by offer of a Voluntary Separation Scheme to the regular employees of the bank and retirement of regular employees who

have completed 25 years of service and/or attained the age of 55 years as on 30.06.2009. Accordingly Voluntary Separation Scheme (VSS) was offered in October 2009 to all the regular employees of defunct SBFC & RDFC. In response to offer for VSS, 139 regular employees opted and has been relieved from the service of the bank w.e.f. November 14, 2009. On the instructions of Ministry of Finance (MOF), SBP has reimbursed the cost of VSS-2009 to the bank.

The shareholders further decided to recapitalize the bank by increasing its paid up capital. A letter in this context has been written to Ministry of Finance. However, State Bank of Pakistan has granted exemption to the Bank from meeting the minimum paid up capital requirement and allowed to operate with minimum paid up capital (free of losses) of Rs 2.00 billion till its privatization.

In line with SBP guidelines the Banks are required to raise paid up capital to Rs. 7 billion by December 31, 2010.

In view of restriction placed by State Bank of Pakistan there was no change in branch network during the year 2009 and the Bank continued to operate with 13 commercial banking branches and 14

recovery offices. However the fourteen recovery offices & booths as a consequence of outsourcing of the recovery operation of the old portfolio of the defunct SBFC and RDFC, have been closed from the close of business on December 31, 2009.

Interest Rate Scenario

Due to inflation prevailing in the economy in 2008 and early 2009, the State Bank Policy Rate went up to 15% in January 2009 and gradually reduce to 12.5% by end of 2009. This phenomenon has made cost of borrowing and cost of deposits exorbitantly high. Thus the average cost of funds rose from 9.67% in 2008 to 11.28% in 2009.

Credit Rating

The Bank was assigned a long term credit rating of BBB (Triple B) and short term rating of A-3 (A Three) by JCR-VIS credit rating agency for the year 2008. The credit rating for the year 2009 will be reviewed and assigned by the end of June 2010. Given the operational results of 2009, there are certain prospects of improvement in credit rating of the bank.

Operational Results & Highlights

In the backdrop of uncertainty with regard to the future corporate and operational status of the bank, the

operational performance of the staff affected adversely. Management has been struggling to meet day to day liquidity needs and maintaining of statutory liquidity requirements (SLR) set by the SBP. Under this enormous pressure of liquidity crunch, the bank however was able to achieve disbursements level of Rs 2.0 billion in 2009 as against Rs 2.17 billion in 2008. During the year under review, Income from SME lending operations rose by an amount of Rs 47 million and administrative expenses reduced by an amount of Rs 31 million. In spite of rising cost of funds and low recovery of old portfolio bank was able earn before tax profit of Rs 42 million during 2009.

The mark-up income of Rs 774 million (2008: Rs 775 million) comprises income from lending operation of Rs 474 million (2008: Rs 454) and income through treasury operations of Rs 300 million (2008: Rs 321 million).

The recoveries from SME lending operation rose from Rs 580 million in 2008 to Rs 656 million in 2009. The recoveries of old loan portfolio of defunct RDFC and SBFC contributed Rs 156 million in 2009 (2008: Rs 225 million). The reversal of provision amounted to Rs 22 million in 2009 compared to Rs 26 million in 2008. During the year State

Bank of Pakistan allowed benefit of 40% of forced sale value of pledged stock and mortgaged property for calculating the provisioning requirements. The bank has accordingly availed the benefit of 40% of FSV while calculating the provisioning requirement for the year 2009.

Loans & Advances on account of SME lending operation rose from 2.368 billion in 2008 to Rs 2.507 billion in 2009. Net advances of the bank stood at Rs 2.50 billion at end of year compared to Rs 2.53 billion as at December 31, 2008. The loan portfolio of defunct RDFC and SBFC is totally provided for and stands at zero book value.

Paid-up Capital

The Bank is operating with paid up capital of Rs 2.392 billion since 2007. The shareholders in their meeting dated October 7, 2009 decided to recapitalize the bank by increasing its paid up capital. A letter in this context has been written to Ministry of Finance. State Bank of Pakistan has granted exemption to meet the requirement of minimum paid up capital till Bank is privatized. The Minimum Capital Requirement set by the State Bank requires the banks to have Rs. 7.0 billion as paid up capital by the end of 2010.

Financial Statements

The financial statements have been prepared in accordance with guidelines issued by regulatory authorities. The disclosures in notes to financial statements correspond to the requirement of law and guidelines issued by regulatory authorities.

Deposits

SME Bank which is operating with 13 branches network has limited resources to attract large deposits. Bank is facing practical difficulties in the process of deposit mobilization i.e. interest rates and credit rating of the bank. At present SME Bank is not allowed to mobilize foreign currency deposits. Deposits which were at Rs 1.892 billion at the end of 2008 were Rs 2.203 billion by the end of current year.

Disbursements & Recovery

In spite of the liquidity problems bank was able to achieve disbursements level of Rs 2.00 billion compared to Rs 2.17 billion in 2008. The number of clients served during the year were 692 and total number of outstanding SME's stood at 1,830 by the end of current year. The recovery of the SME portfolio was Rs 656 million compared to Rs 580 million in preceding year. Recoveries from stuck-up portfolio of defunct SBFC and RDFC have been Rs 17 million (2008:

Rs 29 million) and Rs 34 million (2008: Rs 65 million) respectively.

Donations

During 2009 the bank has not donated any funds to any organization or made contribution to any charitable institution.

Leasing Business

SME Leasing Limited, a subsidiary of the bank, incorporated in 2002, has posted a loss before tax of Rs 70.560 million compared to profit of Rs 2.275 million last year. SME Leasing has been assigned a long term credit rating of "A" and short term rating of A-2 by JCR VIS Credit Rating Company. Previously, the company was assigned the BBB+ and A-2 rating by the same rating company. The Bank provides financing facility to SME Leasing on mark up basis as and when required. An amount of Rs 46 million was receivable from SME Leasing at close of the year 2009. The Bank also subscribed Rs. 100.0 million in Privately Placed Term Finance Certificates (PPTFs) and an amount of Rs 58.33 million is receivable at the close of the year 2009. The Bank would continue to support SME based leasing business through its subsidiary.

SME Leasing disbursed Rs 197 million (2008: Rs 562 million) to 41 clients (2008: 172). Total disbursement since

inception stands at Rs 4,125 billion with 1,735 clients served.

Training & HR Development

For enhancement of skill/knowledge base of human capital available with the specialised task, necessary training and skill development activities were carried out for the staff.

Information Technology

The management realises the importance of technology and its role in effectively managing an organisation. Since the inception of SME Bank, management has placed special emphasis on the development of IT Infrastructure. The Bank has not been able to undertake any development of IT infrastructure or software up gradation programme, as it involve major capital outlay which as per the Privatization Commission guidelines, the bank cannot undertake.

Basel II Implementation

State Bank of Pakistan has exempted SME Bank from implementing the Basel-II till its Privatization due to large investment in software, human resource and training etc.

Income Taxes

The income tax authorities have served a demand notice on October 27, 2009

for payment of Rs 612.706 million on account of reimbursement of VSS cost by the Government of Pakistan (GoP) in 2004. On the instructions of GoP, voluntary separation scheme was launched in 2003 and cost of VSS amounting to Rs 1.764 billion was reimbursed by the GoP. While assessing the income for the tax year 2005, the taxation authorities have added this amount of Rs. 1.764 billion towards the income of the bank and raised tax demand of Rs 612.706 million. The matter has been referred to Ministry of Finance since the bank does not have the liquidity and financial capability to meet the tax claim.

Concentration & Risks

The Bank believes that it is not exposed to major concentration of credit risk. It is ensured that bank's credit granting activities conform to the established strategy, prudential regulations and SBP instructions are strictly followed.

Privatization of Bank

The Bank is on active agenda of privatization by Privatization Commission (PC) since last quarter of 2006. The process of privatization initiated in the year 2007 and continued over the year 2008 could not proceed further during the year 2009. Under the circumstances of uncertainty about the

future corporate and operational status of the bank and restrictions on business expansion by the PC and SBP, management is struggling hard to undertake current business operations on self sustainable basis.

Board has already advised the management to take up the issue with MoF for raising the assets size of the bank through equity injection.

Board of Directors

The Board of Directors consists of a minimum of seven directors nominated by the Federal Government. The Board meets frequently and ensures to meet at least every quarter. During 2008 the tenure of the three directors expired on 11-07-2008 and these positions remained vacant till November 2009.

The Board held two meetings during 2009. The attendance at these meetings was as follows:

Directors	Meetings Attended
Mr. Shahid Rashid	2
Mr R.A. Chughtai	2
Mr Muhammad Sajid Khan (Resigned in November)	1
Mr Akbar Sharifzada	1
Mr. Muhammad Niaz Butt	2
Mr S.M. Naseer	1

Board Committees

After the formation of Board of Directors of the bank in November 2009, only one meeting of the Board held on November 25, 2009. Out of 7 members, 3 members were granted leave of absence. The Board constituted the Board Audit Committee and deferred the constitution of Risk Management Committee and Recruitment & Compensation Review Committee due to the absence of 03 members. Board Audit Committee consists of non executive members.

Audit Committee

This committee consists of three non-executive directors and has been formed to assist the Board in fulfilling its statutory and fiduciary responsibilities. This committee is advisory in nature and does not perform any management function. It assists the Board in discharging its responsibilities and in complying with good governance. During 2009, one meeting was held. Attendance in this meeting was as follows:

Directors	Meetings Attended
Mr. Shahid Rashid	1
Mr Akbar Sharifzada	1
Mr. Muhammad Niaz Butt	1

Recruitment and Compensation Review Committee

This Committee consists of three non-executive directors and is formed to assist the Board in matter related to staff benefits and compensation etc. The constitution of committee was deferred in 53rd BOD Meeting due to absence of 3 directors.

Risk Management Committee

This Committee consists of three non executive directors; it assists the Board in measurement and mitigating different risks. The constitution of committee was deferred in 53rd BOD Meeting due to absence of 3 directors.

Corporate Governance and Financial Reporting Framework

SME Bank is committed to observing good corporate governance and continues to improve its compliance with the currently applicable guidelines. The Directors have ensured that adequate arrangements are made to meet the financial recording and reporting parameters and are pleased to state that

- proper books of accounts as required by Companies Ordinance have been maintained
- applicable international accounting standards have been

followed in preparation of annual accounts

- the accounts have been prepared on going concern basis and the Bank has adopted prudent accounting policies and used sound accounting estimates;
- the financial statements prepared by the management of the Bank present fairly, state of affairs of the Bank as at 31 December, 2009, the results of its operations for the period then ended, cash flow and changes in equity;
- appropriate systems of internal control have been put in place for managing significant risks, with adequate arrangements for its effective implementation continuous review and monitoring;
- the Board of Directors is satisfied with Bank's ability to continue as a going concern;
- there are no outstanding statutory payments on account of taxes, duties and levies as on 31 December 2009 except as

disclosed in the financial statements;

- the value of investments held for staff funds is reflected in note 35 of notes to the accounts;
- the Bank has complied with the provisions of code of corporate Governance and there has been no material departure from the best practices of corporate Governance and there has been no material departure from the best practices of corporate governance.

Shareholding Pattern

The statement showing pattern of shareholding as at December 31, 2009, as required under Code of Corporate Governance is annexed.

Auditors

The predecessor auditors, M/s Anjum Asim Shahid Rahman & Co Chartered Accountants will retire at conclusion of 8th. Annual General Meeting. Board and its Audit Committee have recommended re-appointment of retiring auditors.

Appreciation

While the Board appreciates the efforts of the management and staff trying to steer the Bank out of current situation yet Board also highlights the need of much more efforts for improving the recovery drive for enhancing

disbursements. The Board would also like to thank the State Bank of Pakistan and other regulatory authorities for their continued support and guidance and the Shareholders for the trust and confidence reposed in us.

Chairman

FINANCIAL HIGHLIGHTS

	2009	2008	2007	2006	2005
<u>PROFITABILITY</u>					
Income					
Total Income	794.3	833.4	915.9	987.1	872.3
Interest Income	773.9	774.8	875.6	960.3	844.7
Expenses					
Total Expenses *	1,622.1	965.4	907.2	1,008.1	846.0
Interest Expenses	448.1	385.4	379.9	454.1	337.4
SBP Share in Profits	-	-	-	-	-
Spread (Net interest income / Gross interest Income)	42.10%	50.26%	56.60%	52.72%	60.05%
Profit before tax	42.4	(132.0)	152.1	231.7	369.1
Profit After Tax	35.9	(532.9)	110.4	153.2	206.2
<u>FINANCIAL POSITION</u>					
Share Holder's Funds					
Share Capital	2,392.5	2,392.5	2,392.5	2,000.0	1,500.0
Total Equity	2,392.2	2,356.3	2,808.6	2,287.9	2,162.3
Liabilities					
Total Liabilities	4,078.5	3,802.5	3,775.2	7,337.0	5,697.8
Loan form State Bank of Pakistan	-	-	-	2,430.0	2,500.0
Borrowings from financial institutions	1,371.8	1,518.1	1,400.0	2,600.0	1,530.0
Deposits	2,203.2	1,892.0	1,879.6	1,666.4	1,022.7
Assets					
Total Assets	6,299.2	5,757.0	6,583.7	9,624.9	7,860.1
Advances (net of Provisions)	2,500.9	2,526.3	2,118.3	1,731.3	1,184.8
Investment	2,939.1	2,545.1	3,058.1	5,584.6	4,807.7
<u>RATIOS</u>					
Return on Assets	0.59%	-2.16%	1.36%	1.75%	2.53%
Return on Equity	1.51%	-4.91%	4.33%	6.88%	10.42%
Capital Adequacy Ratio (Required 8%)	79.88%	84.24%	100.88%	58.90%	81.25%
Earning per share	0.15	(2.23)	0.48	0.77	1.66
<u>BUSINESS ACHIEVEMENTS</u>					
Recoveries of Old Portfolio	156.3	224.6	401.0	584.2	622.3
Recoveries of New Portfolio	655.8	579.9	619.5	684.9	707.6
Advances disbursed during the year	1,998.3	2,174.4	1,570.9	1,248.0	555.5
Number of SMEs Financed	692	798	838	1,117	753
<u>OTHER INFORMATION</u>					
Number of Employees	576	657	609	651	632
Number of Banking Branches	13	13	13	13	10
Total Branches	27	27	27	27	27

* Total expenses for 2009 includes VSS payment of Rs. 661 million.

Auditors' Report to the Members

We have audited the annexed balance sheet of SME Bank Limited (the "Bank") as at December 31, 2009 and the related profit and loss account, statement of changes in equity and cash flow statement, together with the notes forming part thereof (here-in-after referred to as the 'financial statements') for the year then ended, which include the unaudited certified returns from the branches and other offices except for six branches and one treasury office which have been audited by us 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 Board of Directors to establish and maintain a system of internal control, and prepare and present the financial statements in conformity with approved accounting standards and the requirements of the Banking Companies Ordinance, 1962 (LVII of 1962), and the Companies Ordinance, 1984 (XLVII of 1984). Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with the International Standards on Auditing 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, which in case of loans and advances covered more than sixty percent of the total loans and advances of the Bank, we report that:

- a)** in our opinion, proper books of account have been kept by the Bank as required by the Companies Ordinance, 1984 (XLVII of 1984) and the returns referred to above received from the branches have been found adequate for the purposes of our audit;

- b)** in our opinion:
 - (i)** the balance sheet and profit and loss account together with the notes thereon have been drawn up in conformity with the Banking Companies Ordinance, 1962 (LVII of 1962), and the Companies Ordinance, 1984 (XLVII of 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 Bank's business; and

- (iii) the business conducted, investments made and the expenditure incurred during the year were in accordance with the objects of the Bank and the transactions of the Bank which have come to our notice have been within the powers of the Bank;
- c) 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, statement of changes in equity and cash flow statement together with the notes forming part thereof conform with the approved accounting standards as applicable in Pakistan and give the information required by the Banking Companies Ordinance, 1962 (LVII of 1962) and the Companies Ordinance, 1984 (XLVII of 1984), in the manner so required and give a true and fair view of the state of the Bank's affairs as at December 31, 2009 and its true balance of the profit, its changes in equity and cash flows for the year then ended; and
- d) in our opinion Zakat deductible at source under the Zakat and Ushr Ordinance, 1980 (XVIII of 1980), was deducted by the Bank and deposited in the Central Zakat Fund established under section 7 of that Ordinance.

Without qualifying our opinion, we draw attention to contents of note 6 to the financial statements on financial restructuring of the Bank.

ANJUM ASIM SHAHID RAHMAN
Chartered Accountants
Islamabad
Audit Engagement Partner: Nadeem Tirmizi
Date:

SME Bank Limited
Balance Sheet
As at December 31, 2009

	Note	2009	2008
(Rupees in '000)			
ASSETS			
Cash and balances with treasury banks	7	213,778	200,112
Balances with other banks	8	57,296	49,751
Lending to financial institutions	9	33,445	100,000
Investments	10	2,939,132	2,545,053
Advances	11	2,500,916	2,526,322
Operating fixed assets	12	108,418	124,546
Deferred tax assets	13	-	2,597
Other assets	14	446,244	208,629
		6,299,229	5,757,010
LIABILITIES			
Bills payable	15	54,542	37,686
Borrowings	16	1,371,750	1,518,100
Deposits and other accounts	17	2,203,152	1,892,018
Sub-ordinated loans		-	-
Liability against assets subject to finance lease	18	12,087	19,442
Deferred tax liabilities		-	-
Other liabilities	19	436,957	335,275
		4,078,488	3,802,521
NET ASSETS		2,220,741	1,954,489
REPRESENTED BY			
Share capital	20	2,392,507	2,392,507
Reserves		206,526	199,356
Unappropriated loss		(206,848)	(235,530)
		2,392,185	2,356,333
Deficit on revaluation of assets	21	(171,444)	(401,844)
		2,220,741	1,954,489
CONTINGENCIES AND COMMITMENTS	22		

The annexed notes 1 to 45 and Annexure 1 form an integral part of these financial statements.

CFO & Company Secretary

President/Chief Executive

Director

Director

Director

SME Bank Limited
Profit and Loss Account
For the year ended December 31, 2009

		2009	2008
	Note	(Rupees in '000)	
Mark-up/return/interest earned	23	773,936	774,797
Mark-up/return/interest expensed	24	448,106	385,379
Net mark-up/interest income		325,830	389,418
Reversal of provision against non-performing advances-net		(21,766)	(26,214)
Provision for diminution/impairment in the value of investments & other assets		24,400	34,876
Bad debts written off directly	11.5.1	1,937	2,706
		4,571	11,368
Net mark-up/interest income after provisions		321,259	378,050
NON MARK-UP/INTEREST INCOME			
Fees, commission and brokerage income		11,094	5,667
Dividend income		3,813	42,177
Loss on sale of securities	25	-	(376)
Other income	26	5,491	11,179
Total non-markup/interest income		20,398	58,647
		341,657	436,697
NON MARK-UP/INTEREST EXPENSE			
Administrative expenses	27	1,189,203	570,101
Reversals of other provisions/write offs	14.3	(20,000)	(6,614)
Other charges	28	196	5,204
Total non-markup/interest expenses		1,169,399	568,691
		(827,742)	(131,994)
Gain on settlement related to retirement benefit plans	29	209,626	-
GOP Financing against VSS-2009	30	660,514	-
PROFIT/(LOSS) BEFORE TAXATION		42,398	(131,994)
Taxation - Current	31	3,949	-
- Deferred		2,597	400,954
		6,546	400,954
PROFIT/(LOSS) AFTER TAXATION		35,852	(532,948)
Unappropriated (loss)/profit brought forward		(235,530)	297,418
(Loss)/profit available for appropriation		(199,678)	(235,530)
	32	0.15	(2.23)

The annexed notes 1 to 45 and Annexure 1 form an integral part of these financial statements.

CFO & Company Secretary

President/Chief Executive

Director

Director

Director

SME Bank Limited
Cash Flow Statement
For the year ended December 31, 2009

	2009	2008
Note	(Rupees in '000')	
CASH FLOW FROM OPERATING ACTIVITIES		
Profit/(loss)before taxation	42,398	(131,994)
Less: Dividend income	(3,813)	(42,177)
	38,585	(174,171)
Adjustments for non-cash/ other items:		
Depreciation	20,485	27,484
Amortization	2,053	2,766
GoP Financing against VSS-2009	(660,514)	-
Reversal of Provision against non-performing advances	(21,766)	(26,214)
Provision for impairment in value of investments/other assets	24,400	34,876
Reversal of other provisions/write offs	(20,000)	(6,614)
Bad debts written off directly	1,937	2,706
Net (profit)/loss on sale of property and equipment	(712)	(453)
Finance charges on leased assets	753	1,180
	(653,364)	35,731
	(614,779)	(138,440)
(Increase)/ decrease in operating assets		
Lendings to financial institutions	(33,445)	258,944
Advances	45,235	(384,467)
Other assets (excluding advance taxation)	(226,950)	10,104
	(215,160)	(115,419)
Increase/ (decrease) in operating liabilities		
Bills payable	16,856	(2,755)
Borrowings from financial institutions	(146,350)	118,100
Deposits	311,134	12,431
Other liabilities (excluding current taxation)	100,306	35,135
	281,946	162,911
	(547,993)	(90,948)
Income tax paid	(2,573)	(129,612)
Net cash flow from/(used in) operating activities	(550,566)	(220,560)
CASH FLOW FROM INVESTING ACTIVITIES		
Net investments in available-for-sale securities	(149,412)	27,300
Net investments in held-to-maturity securities	(29,332)	174,067
Dividend income	3,813	42,177
Investments in operating fixed assets	(9,024)	(10,204)
Sale proceeds of property and equipment disposed-off	3,326	2,070
Net cash flow (used in)/from investing activities	(180,629)	235,410
CASH FLOW FROM FINANCING ACTIVITIES		
Payments of lease obligations	(8,108)	(4,672)
Government of Pakistan(GOP) financing	660,514	-
Net cash flow used in financing activities	652,406	(4,672)
Increase/(decrease) in cash and cash equivalents	(78,789)	10,178
Cash and cash equivalents at beginning of the year	33 349,863	339,685
Cash and cash equivalents at the end of year	33 271,074	349,863
Cash and cash equivalents at the end of year		

The annexed notes 1 to 45 and Annexure 1 form an integral part of these financial statements.

CFO & Company Secretary

President/Chief Executive

Director

Director

Director

SME Bank Limited
Statement of Changes in Equity
For the year ended December 31, 2009

	Reserves			Total
	Share Capital	Statutory reserve	Unappropriated profit / (loss)	
	('Rupees in '000)			
Balance as at January 1, 2008	2,392,507	199,356	297,418	2,889,281
Net loss for the year	-	-	(532,948)	(532,948)
Transfer to statutory reserve	-	-	-	-
Balance as at December 31, 2008	2,392,507	199,356	(235,530)	2,356,333
Net profit for the year	-	-	35,852	35,852
Transfer to statutory reserve	-	7,170	(7,170)	
Balance as at December 31, 2009	2,392,507	206,526	(206,848)	2,392,185

The annexed notes 1 to 45 and Annexure 1 form an integral part of these financial statements.

CFO & Company Secretary

President/Chief Executive

Director

Director

Director

SME Bank Limited
Notes to the Financial Statements
For the year ended December 31, 2009

1. GENERAL INFORMATION

1.1

SME Bank Limited (the Bank) is a public limited company incorporated in Pakistan on October 30, 2001 under the Companies Ordinance, 1984 having its registered office at 40-Jang Building, A.K. Fazal ul Haq road, Blue area, Islamabad. The Bank obtained its business commencement certificate on April 16, 2005 which became effective from the date of its issue. The Bank is now a Scheduled Commercial Bank engaged in the business of banking with the primary objective to support and develop Small and Medium Enterprise (SME) sector in Pakistan by providing necessary financial assistance and business support services on a sustainable basis. The Bank is operating through a network of 13 Commercial banking branches. Based on the latest credit rating report dated June 23, 2009 issued by JCR-VIS Credit Rating Company Limited, credit rating of the Bank was BBB (triple B) in the long term and A-3 (A three) in the short term.

1.2 Amalgamation of defunct RDFC and SBFC

The Federal Government promulgated the Regional Development Finance Corporation (RDFC) and Small Business Finance Corporation (SBFC) Amalgamation and Conversion Ordinance, 2001 (the Ordinance 2001) setting forth the mechanism of amalgamation of defunct RDFC and SBFC. Both these entities were Development Financial Institutions (DFIs). In pursuance of the Ordinance 2001, Finance Division, Ministry of Finance issued an Order (SRO (1) 2001) dated December 29, 2001 setting forth the scheme of amalgamation of RDFC and SBFC with the Bank effective January 1, 2002. Pursuant to this scheme entire assets and liabilities of defunct RDFC and SBFC as at December 31, 2001 were transferred to the Bank at fair value. These two institutions stand dissolved and ceased to exist effective January 1, 2002. The Bank allotted its shares to the share holders of defunct RDFC and SBFC in proportion to their shareholding therein based on the fair net assets value of defunct RDFC and SBFC on December 31, 2001.

Further, pursuant to clause 6 of the Ordinance 2001, notwithstanding anything contained in any other law for the time being in force, the Bank shall take and maintain existing deposits, continue lending and any other business which were being undertaken by defunct RDFC and SBFC, respectively, without prejudice to State Bank of Pakistan's permission for commencement of banking business.

2. BASIS OF PRESENTATION

These financial statements have been prepared in accordance with the requirements of BSD Circular No 4 dated February 17, 2006 issued by State Bank of Pakistan.

In accordance with the directives of the Federal Government regarding the shifting of the banking system to Islamic modes, the State Bank of Pakistan (SBP) has issued various circulars from time to time. Permissible forms of trade-related modes of financing include purchase of goods by banks from their customers and immediate resale to them at appropriate mark-up in price on deferred payment basis. The purchases and sales arising under these arrangements are not reflected in these financial statements as such but are restricted to the amount of facility actually utilized and the appropriate portion of mark-up thereon.

3. STATEMENT OF COMPLIANCE

3.1

These financial statements have been prepared in accordance with approved accounting standards as applicable in Pakistan and the requirements of the Companies Ordinance, 1984, the Banking Companies Ordinance, 1962 and the directives issued by Securities and Exchange Commission of Pakistan (SECP) and State Bank of Pakistan (SBP). Approved accounting standards comprise of such International Accounting Standards as notified under the provisions of the Companies Ordinance, 1984. Wherever the requirements of the Companies Ordinance, 1984, the Banking Companies Ordinance, 1962 or directives issued by SECP and SBP differ with the requirements of these standards, the requirements of the Companies Ordinance, 1984, the Banking Companies Ordinance, 1962 or the requirements of the said directives take precedence.

3.2 Standards not yet adopted by State Bank of Pakistan

In terms of BSD circular letter No. 10 dated August 26, 2002, the SBP has deferred the applicability of International Accounting Standard (IAS) 39, 'Financial Instruments: Recognition and Measurement', International Accounting Standard (IAS) 40, 'Investment Property' and International Financial Reporting Standard (IFRS) 7, 'Financial Instruments: Disclosures' for Banking Companies through BSD Circular Letter No. 11 dated September 11, 2002. Accordingly, the requirements of these standards have not been considered in the preparation of these financial statements. However, investments have been classified and valued in accordance with the requirements prescribed by the State Bank of Pakistan through various circulars.

3.3 Standards, interpretations and amendments to published approved accounting standards that are not yet effective:

The following amendments to an existing standard, IFRS and interpretations of approved accounting standards applicable to the Bank's financial statements have been published that are mandatory for the Bank's accounting periods beginning on or after the following dates:

- i) Amendments to IFRS 1 First time Adoption of International Financial Reporting Standards- Additional exemptions for first time adopters (effective for annual periods beginning on or after 01 January, 2010).
- ii) Amendment to IFRS 2 - Share based Payment - Group Cash settled Share based Payment Transactions (effective for annual periods beginning on or after 01 July 2009).
- iii) Revised IFRS 3- Business Combinations (applicable for annual periods beginning on or after 01 July 2009).
- iv) Amendments to IFRS 8 Operating segments (effective for annual periods beginning on or after 01 January, 2010).
- v) Amendments to IAS 1 Presentation of financial statements (effective for annual periods beginning on or after 01 January, 2010).
- vi) Amendments to IAS 7 Statement of Cash Flows (effective for annual periods beginning on or after 01 January, 2010).
- vii) Amendments to IAS 17 Leases (effective for annual periods beginning on or after 01 January, 2010).
- viii) Revised IAS 24 Related Party Disclosures (effective for annual periods beginning on or after 01 February, 2010).
- ix) Amended IAS 27 - Consolidated and Separate Financial Statements (effective for annual periods beginning on or after 01 July 2009).
- x) Amendments to IAS 36 Impairment of Assets (effective for annual periods beginning on or after 01 January, 2010).
- xi) Amendments to IAS 38 Intangible Assets (effective for annual periods beginning on or after 01 July 2009).

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- xii) Amendments to IFRIC 9 Reassessment of Embedded Derivatives (effective for annual periods beginning on or after 01 July 2009).
- xiii) Amendments to IFRIC 16 Hedges of a Net Investment in a Foreign Operation (effective for annual periods beginning on or after 01 July, 2009).
- xiv) IFRIC 17 - Distributions of Non-cash Assets to Owners (effective for annual periods beginning on or after 01 July 2009).
- xv) IFRIC 18 - Transfers of Assets from Customers (to be applied prospectively to transfers of assets from customers received on or after 01 July 2009).
- xvi) IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments (effective for annual periods beginning on or after 01 July, 2010).
- xvii) Amendments to IFRIC 14 and IAS 19 - The Limit on a Defined Benefits Assets, Minimum Funding Requirements and their Interaction (effective for annual periods beginning on or after 01 January, 2011).

Other standards and interpretations are either not relevant to the Bank's operations or are not expected to have significant impact on the Bank's financial statements other than certain increased disclosures in certain cases.

- 3.4** In terms of the provisions of the State Bank of Pakistan (SBP) BSD Circular No. 07 of 2009, the Bank was required to increase its paid-up capital (net of losses) as at December 31, 2009 upto Rs. 6 billion. The State Bank of Pakistan (SBP) has granted exemption from meeting the enhanced Minimum Capital Requirement and the Bank is allowed to operate with minimum paid-up capital (net of losses) of Rs. 2 billion till privatisation of the Bank.

4. BASIS OF MEASUREMENT

These financial statements have been prepared under the historical cost convention as modified for certain investments which are shown at revalued amounts.

The financial statements are presented in Pak Rupees, which is the Bank's functional and presentation currency. The amounts are rounded to nearest thousand.

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ESTIMATES

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

5.1 Cash and cash equivalents

Cash and cash equivalents comprise of cash and balances with treasury banks, balances with other banks and call money lendings.

5.2 Investments

In accordance with SBP's BSD circular No. 10 of 2004, investments have been classified into following categories:

Held for trading

These represent investments acquired by the Bank with the intention to trade by taking advantage of short-term market/interest rate movements. These are marked to market and surplus/(deficit) arising on revaluation is taken to profit and loss account in accordance with the requirement of SBP's BSD circular No. 10 dated July 13, 2004.

Held to maturity

These represent investments acquired by the Bank with the intention and ability to hold them upto maturity. These are carried at amortized cost in accordance with the requirement of BSD circular No. 14 dated September 24, 2004.

Available for sale

These represent investments which do not fall under held for trading or held to maturity securities.

In accordance with the requirement of SBP's BSD Circular No. 20 dated August 4, 2000 securities for which ready quotations are available on Reuters page (PKRV) or Stock Exchange are valued at quoted price and resulting surplus/deficit is kept in a separate account and is shown below the shareholders' equity in the balance sheet.

Unquoted equity securities are valued at lower of cost and break-up value. Break-up value of equity securities is calculated with reference to the net assets of the investee company as per the latest audited financial statements. Other unquoted investments are valued at cost.

Any premium paid or discount received on purchase of securities is amortised. Full year amortisation is charged in the year of purchase while no amortisation is charged in the year of disposal.

All purchases and sales of investment that require delivery within the timeframe established by regulation or market convention are recognized at the date which the bank commits to purchase or sell the investment.

Investment in subsidiary is carried at cost.

Gain/loss on sale of investments is recognized in the year of sale.

5.3 Agreements for sale and purchase of securities (repo and reverse repo)

Securities sold under repurchase agreement (repo) are retained in the financial statements as investments and a liability for consideration received is included in borrowings. The difference between sale and repurchase price is treated as mark-up expense and recognized over the period of contract.

Securities purchased under agreement to resell (reverse repo) are included in lending to financial institutions. The difference between purchase and resale price is treated as mark-up income and recognized over the period of the contract.

5.4 Advances

Advances are stated net of provision for non-performing advances. Provision for non-performing advances is determined in accordance with the requirements of Prudential Regulations issued by SBP from time to time.

State Bank of Pakistan vide BSD Circular No. 10 of 2009 allowed benefits of 40% of Forced Sale Value (FSV) of pledged stock and mortgaged residential, commercial & industrial properties held as collateral against NPL's for three years from date of classification for calculating provisioning requirement. The bank has accordingly availed the benefit of 40% of FSV while calculating the provisioning requirement against NPL's for the year 2009.

The provisions are charged to the profit and loss account. Advances are written off when there is no realistic prospect of recovery.

5.5 Capital work-in progress, Operating fixed assets and depreciation

Capital work-in-progress

Capital work-in-progress is stated at cost.

Operating fixed assets-Owned

Operating fixed assets are stated at cost/value on their acquisition less accumulated depreciation except for land which is stated at cost. Depreciation is charged on straight line method at the rates given in note 12.2, commencing from the month in which the asset is acquired. No depreciation is charged in the month of disposal of the asset. Gains or losses on disposal of property and equipment are taken to the profit and loss account.

Maintenance and normal repairs are charged to profit and loss account as and when incurred. Major renewals and improvements are capitalized.

Assets subject to finance lease

Assets subject to finance lease are stated at lower of present value of minimum lease payments under the lease agreements and the fair value of assets acquired on lease less accumulated depreciation at the rates similar to the bank's owned assets. The outstanding obligation under finance lease less financial charges allocated to future periods is shown as liability. Finance charges are calculated at interest rates implicit in the lease and are charged to profit and loss account in the period in which these are incurred.

Intangible assets

An intangible asset is recognized only if it is identifiable, the Bank has control over the asset, it is probable that economic benefits will flow to the enterprise and the cost of the asset can be measured reliably.

All intangible assets that meet the recognition criteria are initially measured at cost and are amortized on a straight line basis at the rate given in note 12.3 commencing from the month when these assets are available for use.

5.6 Impairment

The carrying amount of assets are reviewed at each balance sheet date for impairment, whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be recoverable. If such indication exists, and where the carrying value exceeds the estimated recoverable amount, assets are written down to their recoverable amount. The resulting impairment loss is taken to the profit and loss account except for impairment loss on revalued assets and available for sale investments, which has been taken to equity in terms of SBP BSD Circular No 4 dated February 13, 2009. An impairment loss is reversed only to the extent that the assets carrying amount does not exceed the carrying value that would have been determined net of depreciation/amortization, if no impairment loss had been recognized.

5.7 Taxation

Provision for current taxation represents expected tax payable on the taxable income for the year using applicable tax rates after taking into account tax credits and tax rebates, if any.

Deferred tax is accounted for using the balance sheet liability method in respect of all temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit at the rates that are expected to apply to the period when the differences reverse based on the tax rates that have been enacted. Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which the deductible temporary differences, unused tax losses and tax credits can be utilized. Deferred tax asset is reduced to the extent it is no longer probable that the related tax benefits will be realized.

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The Bank also recognises deferred tax asset/ liability on deficit/ surplus on revaluation of investments which is adjusted against the related deficit/ surplus in accordance with the requirements of International Accounting Standard on 'Income Taxes' (IAS 12).

5.8 Staff retirement and other benefits

The Bank operates following staff retirement and other benefit schemes for its employees:

Defined benefit plan-Pension and gratuity scheme

Fully funded defined benefit pension and gratuity scheme for permanent employees. Contributions are made in accordance with the actuarial valuation which is carried out periodically using 'Projected Unit Credit Method'. The actuarial gain/loss in excess of corridor (10% of higher of fair value of plan assets or present value of obligation) is recognized over the expected average remaining working lives of employees participating in the plan.

For its contractual employees the Bank operates a defined benefit unfunded gratuity scheme. The obligation under the defined benefit unfunded gratuity scheme is recognised on the basis of actuarial valuation using the 'Projected Unit Credit Method'. The amount recognised in the balance sheet represents the present value of defined benefit obligation.

Benevolent fund

Defined contributory scheme for permanent employees. Contributions to this fund were made equally by the Bank and employees till March 2002. Thereafter it is wholly contributed by the Bank at the rate of 2% of basic salary with a ceiling of Rs. 200 per month per employee.

Compensated absences

The Bank allows compensated absences, an unfunded scheme, per entitlement to all its permanent and contractual employees. Related provision is made in accordance with actuarial valuation. Provision for the year is charged to profit and loss account. The amount recognized in the balance sheet represents the present value of defined benefit obligation.

5.9 Revenue recognition

Markup/ interest on advances, except loans disbursed by defunct SBFC and penal mark-up on advances extended by SME Bank Limited, is accounted for on accrual basis on principal outstanding amounts and suspended, in compliance with requirements of prudential regulations of SBP. Interest on advances disbursed by defunct SBFC is suspended and recognised on cash basis owing to the nature and status of the portfolio. Likewise penal markup on advances is recognized on cash basis.

Return on investments is recognized on accrual basis.

Dividend income is recognized when the bank's right to receive dividend is established, while profit on other investments, bank deposits and staff loans is recognised on accrual basis. Income on non-funded facilities (fee, commission, documentation charges etc.) except commission on bank guarantees is recognised on receipt basis.

The Bank follows finance method in recognising income on lease contracts. Under this method, un-earned income i.e., the excess of aggregate lease rentals and the estimated residual value over the cost of the leased asset is taken to income over the lease term so as to produce a constant periodic rate of return on outstanding net investment in lease. Unrealized lease income is suspended, where required, in accordance with prudential regulations. Gain or loss on termination of lease contracts, documentation charges, front end fee and other lease income are recognised on receipt basis.

5.10 Off setting

Financial assets and liabilities are off set and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognized amounts and there is an intention either to settle on a net basis or realize the asset and settle the liability simultaneously.

5.11 Related party transactions

Transactions between the Bank and its related parties are carried out on arm's length basis determined in accordance with the generally accepted methods.

5.12 Borrowing costs

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset are capitalised. Other borrowing costs are recognised as an expense in the period in which it incurs.

5.13 Government grants

Government grants are recognized when the conditions attaching to the grant are complied with. Such grants are credited to income over the period necessary to match them with the related costs which they are intended to compensate.

5.14 Provisions

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

5.15 Segment reporting

A segment is the distinguishable component of the bank that is subject to risks and rewards that are different from those of other segments. A business segment is one that is engaged either in providing certain products or services, whereas a geographical segment is one engaged in providing products and services within a particular economic environment. Segment information is presented as per the Bank's functional structure and the guidance of the State Bank of Pakistan. The Bank's primary format of reporting is based on business segments:

5.15.1 Business Segments

Trading and Sales

This segment undertakes the Bank's treasury, money market and capital market activities.

Commercial banking

It includes loans, deposits and other transactions with individuals, small and medium enterprises and corporate customers.

5.15.2 Geographical Segments

The Bank operates only in Pakistan.

5.16 Use of critical accounting estimates and judgments

The preparation of financial statements in conformity with approved accounting standards as applicable in Pakistan requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Bank's accounting policies. The Bank uses estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The areas where assumptions and estimates are significant to the Bank's financial statements or where judgement was exercised in application of accounting policies are as follows:

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- i) Classification of investments (note 10)
- ii) Provision against investments (note 10.4) and advances (note 11.4)
- iii) Useful life of operating fixed assets (note 12)
- iv) Income taxes (note 31)
- v) Employee benefits (note 35)

6. FINANCIAL RESTRUCTURING

6.1 The Government of Pakistan (GoP) assisted by Asian Development Bank (ADB) is working on SME Sector Development Programme (SME SDP). Loan agreement for this programme between GoP and ADB and project agreement between ADB, SBP, Small and Medium Enterprise Development Authority (SMEDA) and the Bank have been signed on February 10, 2004. This programme, apart from other aspects on policy matrix relating to SME sector of Pakistan, also envisages restructuring of SME Bank Limited. Salient features of the restructuring of the Bank are given below:

- i) adjustment of accumulated balances due from SBP on account of its share in profits and losses of the Bank against credit lines provided by SBP;
- ii) payment of Rs 3 billion to SBP before January 1, 2004 against outstanding credit lines and conversion of balance of remaining credit lines into a loan repayable in full by June 30, 2006;
- iii) raising the paid-up capital to Rs 1,100 million by issuing additional shares to GoP;
- iv) the Ministry of Finance (MoF) shall ensure that SBP's shareholding in the Bank is terminated through the purchase of SBP held shares at nominal value by shareholders or otherwise;
- v) 100% provision to be made against non performing financial assistance extended by the defunct RDFC and SBFC prior to January 1, 2002 which provision to be adjusted against SBP credit lines. SBP will recover this amount from proceeds of ADB loan to GoP;
- vi) reduction in the number of recovery branches, staff rationalization through Voluntary Separation Scheme (VSS), human resource audit and hiring of new professional staff on merit;
- vii) reimbursement by GoP of costs related to VSS launched for all regular employees;
- viii) SBP to issue a banking license to the Bank on compliance with all conditions of restructuring and applicable SBP regulations. The commercial banking operations will be separate from the recovery operations of the defunct RDFC and SBFC portfolio and the two operations will be run as independent units within the Bank; and
- ix) privatization of the Bank by June 2006.

6.2 Current status of the above referred financial restructuring is given below:

- i) Accumulated balances of Rs 3,275.752 million due from SBP on account of its share in profits and losses of the Bank have been adjusted against credit lines provided by SBP;
- ii) Rs. 7,393 million has been paid to SBP since 2003, to fully adjust the loan liability.
- iii) Paid-up capital has been increased to Rs. 2,393 million by issue of 73,502,453 additional shares of Rs 10 each to GoP without right issue in 2004, issue of 40,000,000 additional shares of Rs 10 each to GoP without right issue in 2005, issue of 50,000,000 additional bonus shares of Rs 10 each to GoP without right issue in 2006 and issue of 39,250,700 additional shares of Rs. 10 each to GoP without right issue in 2007. Proceeds against issue of additional shares in 2004 were paid by GoP to SBP against the Bank's loan balance due to SBP;
- iv) Provision of Rs 1,283.196 million against non performing financial assistance extended by the defunct RDFC and SBFC was adjusted against credit lines of SBP in 2003;

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- v) VSS was approved by the Board of Directors of the Bank on November 7, 2003. Costs of VSS are reimbursable by GoP under the Small and Medium Enterprise Sector Development Programme loan agreement between GoP and Asian Development Bank. 712 employees opted for VSS. Aggregate estimated cost of VSS for 712 employees amounts to approximately Rs. 1,800 million. 707 employees were relieved under the scheme upto December 31, 2005 and the aggregate reported cost for 707 employees was Rs. 1,764.268 million, which has been received by the bank by March 31, 2007;
- vi) Human resource technical audit has been completed and report has been submitted to the Bank;
- vii) Banking license was issued by SBP on September 13, 2004 and the Bank has started banking operations after the issue of certificate for commencement of banking business by SBP on April 16, 2005; and
- viii) Privatization Commission (PC) has constituted a transaction committee which is represented by members from the Privatization Commission, State Bank of Pakistan, Ministry of Finance and the Bank. Privatization Commission has approved M/s BMA Capital as Financial Advisors for the bank and due diligence exercise for the privatization of the Bank has been carried out.
- ix) All the recovery offices and recovery booths have been closed with effect from December 31, 2009.
- x) 139 employees opted for VSS-2009 offered vide Circular No. HO/HR&SD/2009/5385 dated October 15, 2009. These employees have been relieved at a total cost of Rs.661 million with effect from November 14, 2009.
- xi) No further progress has been made on the privatisation of the bank.

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	Note	2009	2008
Rupees in '000			
7. CASH AND BALANCES WITH TREASURY BANKS			
In hand - local currency		61,803	61,078
In transit - local currency		439	327
National Prize Bonds		22	33
With State Bank of Pakistan (SBP) in :			
Local currency current accounts	7.1	102,822	120,472
With National Bank of Pakistan in :			
Local currency current account		48,650	18,202
Local currency deposit account		42	-
		213,778	200,112

7.1 Deposits with the State Bank of Pakistan are maintained to comply with the statutory requirements issued from time to time.

	Note	2009	2008
Rupees in '000			
8. BALANCES WITH OTHER BANKS			
In Pakistan:			
On current accounts		9,308	-
On deposit accounts	8.1	57,988	59,751
Provision for doubtful balance with a bank	8.2	(10,000)	(10,000)
		57,296	49,751

8.1 These carry interest rate ranging from 1% to 6.50% (2008: 1.50% to 6.50%) per annum.

8.2 Provision for doubtful balance is in respect of deposit of Rs. 10 million with Indus Bank Limited which is under liquidation.

	Note	2009	2008
Rupees in '000			
9. LENDINGS TO FINANCIAL INSTITUTIONS			
Call money lendings	9.2	-	100,000
Repurchase agreement lendings (reverse repo)	9.3	33,445	-
		33,445	100,000

9.1 PARTICULARS OF LENDING

In local currency	33,445	100,000
In foreign currencies	-	-
	33,445	100,000

9.2 This represents unsecured lendings with banks in the inter-bank money market at mark up rate ranging from 7.5% to 17% (2008: 6% to 21%) per annum for periods upto seven days.

9.3 This represents transactions with a bank for purchase of treasury bills under resale obligation (reverse repo) in the inter-bank money market at mark-up rate ranging from 4% to 14.90% (2008: 3% to 12.25%) per annum for periods upto thirty one days.

These lendings were secured against underlying treasury bills as detailed in note 9.4. The difference between purchase and resale price is treated as mark-up income and recognised over the period of reverse repo agreement.

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9.4 Securities held as collateral against lending to financial institutions	Note	2009			2008		
		Held by the bank	Further given as collateral	Total	Held by the bank	Further given as collateral	Total
Rupees in '000							
Market Treasury Bills		33,445	-	33,445	-	-	-
		33,445	-	33,445	-	-	-
		2009			2008		
		Held by the bank	Given as collateral	Total	Held by the bank	Given as collateral	Total
		(Rupees in '000)			(Rupees in '000)		
10. INVESTMENTS							
10.1 INVESTMENTS BY TYPES:							
Available-for-sale securities							
Market Treasury Bills		335,000	-	335,000	100,000	-	100,000
Pakistan Investment Bonds (PIBs)		721,696	1,539,905	2,261,601	490,217	1,821,132	2,311,349
Fully paid ordinary shares/mutual fund		208,715	-	208,715	208,715	-	208,715
Term Finance Certificates (TFCs)		89,551	-	89,551	125,391	-	125,391
		1,354,962	1,539,905	2,894,867	924,323	1,821,132	2,745,455
Held-to-maturity securities							
Certificates of Investments (COI's)		2,122	-	2,122	2,122	-	2,122
Term Deposit Receipts (TDR's)		52,000	-	52,000	22,668	-	22,668
		54,122	-	54,122	24,790	-	24,790
Investment in subsidiary							
SME Leasing Limited	10.9	215,457	-	215,457	215,457	-	215,457
Investments at cost		1,624,541	1,539,905	3,164,446	1,164,570	1,821,132	2,985,702
Provision for diminution/impairment in value of investments	10.4	(53,870)	-	(53,870)	(38,805)	-	(38,805)
Investments net of provisions		1,570,671	1,539,905	3,110,576	1,125,765	1,821,132	2,946,897
Surplus/(Deficit) on revaluation of Available-for-sale-securities	21	2,720	(174,164)	(171,444)	(70,853)	(330,991)	(401,844)
Total Investments at market value		1,573,391	1,365,741	2,939,132	1,054,912	1,490,141	2,545,053

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	Note	2009	2008
		Rupees in '000	
10.2 INVESTMENTS BY SEGMENTS :			
Federal Government Securities:	10.3		
- Market Treasury Bills		335,000	100,000
- Pakistan Investment Bonds		2,261,601	2,311,349
		2,596,601	2,411,349
Fully paid up ordinary shares:			
- Listed companies/mutual funds	10.6	187,712	187,712
- Unlisted companies/mutual funds	10.7	21,003	21,003
		208,715	208,715
Term Finance Certificates, Debentures, Bonds and Participation Term Certificates:			
-Listed TFCs	10.8	31,218	33,724
-Unlisted TFCs	10.8	58,333	91,667
		89,551	125,391
Subsidiary company:			
SME Leasing Limited	10.9	215,457	215,457
Other investments			
- Certificates of Investment (CoIs)		2,122	2,122
- Term Deposit Receipts (TDRs)		52,000	22,668
		54,122	24,790
Total investments at cost		3,164,446	2,985,702
Provision for diminution/impairment in value of investments	10.4	(53,870)	(38,805)
Investment (net of provision)		3,110,576	2,946,897
Less: Deficit on revaluation of available for sale securities - net	21	(171,444)	(401,844)
Total investments at market value		2,939,132	2,545,053

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10.3 Principal terms of investments in Federal Government securities

Name of investment	Maturity	Principal payment	Rate	Coupon payment
Market Treasury Bills	February 2010 to June 2010	On maturity	11.25% to 12.15%	-
Pakistan Investment Bonds	February 2011 to June 2013	On maturity	9% to 14%	semi-annually

Market Treasury Bills and Pakistan Investment Bonds are securities eligible for re-discounting with the State Bank of Pakistan.

10.4 Particulars of provision for diminution in value of investments

	2009	2008
	Rupees in '000	
Opening balance	38,805	23,929
Charge for the year	15,065	34,876
Reversal for the year	-	(20,000)
Closing balance	53,870	38,805

10.4.1 Particulars of provision in respect of type and segment

Available-for-sale securities				
-Fully paid up ordinary shares				
- Quoted Companies		19,290		19,290
- Quoted Mutual Fund		11,455		11,455
- Unlisted Mutual Fund/Shares		20,000		4,935
- Delisted Companies		1,003		1,003
Held-to-maturity securities				
- Other investments				
- Certificates of Investment		2,122		2,122
		53,870		38,805

10.5 Quality of Available-for-sale securities

	Note	2009		2008	
		Market value Rupees '000	Rating	Market value Rupees '000	Rating
Market Treasury Bill	10.5.1	322,668	unrated	100,000	unrated
Pakistan Investment Bonds	10.5.1	2,088,570	unrated	1,913,365	unrated
Fully paid up ordinary shares					
National Refinery Limited	10.5.2	2,652	AAA (L)	1,427	AAA (L)
PICIC Investment Fund Limited		801	3-Star	279	AA- (L)
Hub Power Company Limited		3,326	AA+	1,508	unrated
Pakistan PTA Limited		625	unrated	127	unrated
Dewan Salman Fibre Limited		27	unrated	26	unrated
Pakistan Telecommunication Company Limited		152	unrated	145	unrated
D.G. Khan Cement Company Limited		185	unrated	121	unrated
Faisal Spinning Mills Limited		99	unrated	176	unrated
Treet Corporation Pakistan Limited		142	unrated	130	unrated
Askari Income Fund		107,388	5-Star	95,065	5-Star
NAFA Cash Fund		54,100	A(f)	51,029	A(f)
Nishat Mills Limited		7	A+ (L)	3	A+ (L)
Crescent Textile Mills Limited		1	unrated	1	unrated
Services Industries Limited		19	unrated	4	unrated
Invest Capital Investment Bank Ltd		1,565	A-	1,666	A-
AKD-Venture Fund		-	unrated	15,065	unrated
		171,089		166,772	
Term Finance Certificates					
Financial Receivables Securitisation Company Limited		10,989	AA-(L)	13,744	AA-(L)
SME Leasing Ltd		58,333	unrated	91,667	unrated
Pakistan Mobile Communications Limited		20,026	AA- (L)	21,379	AA- (L)
		89,348		126,790	

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2,671,675 2,306,927

10.5.1 These are Government of Pakistan guaranteed securities.

10.5.2 Rating of these equity securities represent 'Entity/Funds Rating'.

10.5.3 Securities have either been rated by 'The Pakistan Credit Rating Agency Limited' (PACRA) or 'JCR-VIS Credit Rating Company Limited' (JCR-VIS). These ratings reflect independent credit risk assessment by respective credit rating entities.

10.6 Investments in listed companies/mutual funds

No. of ordinary shares/units		Paid-up value per share/ average price per unit (Rs)	Name of company/mutual fund	Note	2009	2008
2009	2008				Rupees in '000	
15,000	15,000	354.17	National Refinery Limited		5,312	5,312
137,668	137,668	18.12	PICIC Investment Fund Limited		2,494	2,494
107,000	107,000	18.95	Hub Power Company Limited		2,028	2,028
79,775	79,775	10.15	Pakistan PTA Limited		810	810
18,449	18,449	18.24	Dewan Salman Fibre Limited		337	337
8,600	8,600	68.20	Pakistan Telecommunication Company Limited		586	586
5,672	5,672	49.38	D.G. Khan Cement Company Limited		280	280
4,000	4,000	40.41	Faisal Spinning Mills Limited		162	162
500	500	295.00	Treet Corporation Pakistan Limited		147	147
319	319	93.52	Nishat Mills Limited		30	30
18	18	34.84	Crescent Textile Mills Limited		1	1
72	72	25.30	Services Industries Limited		2	2
1,117,876	1,117,876	11.84	Invest Capital Investment Bank Ltd		13,236	13,236
Mutual Funds						
1,011,004	1,011,004	105.36	Askari Income Fund		106,519	106,519
5,321,308	5,321,308	10.48	NAFA Cash Fund		55,768	55,768
					187,712	187,712
Impairment in Available for Sale listed shares/units					(30,745)	(30,745)
Investment in listed shares/units (net of impairment)					156,967	156,967
Surplus/(Deficit) on revaluation of listed shares/units - (net)					14,122	(5,260)
Market value as on December 31,					171,089	151,707

10.7 Particulars of investments held in unlisted mutual funds and delisted companies				Note	2009	2008
					Rupees in '000	
AKD Venture Fund (formerly TMT-PKIC Incubation Fund Limited)				10.7.1	20,000	20,000
Companies delisted from stock exchange				10.7.2	1,003	1,003
					21,003	21,003

	Percentage	Number of units held	Cost/Paid-up value per unit held (Rupees)	Total paid up value (Rupees in '000)	Break up value	Name of Chief executive
10.7.1						
AKD Venture Fund (formerly TMT-PKIC Incubation Fund Limited)	8%	2,000,000	10.00	20,000	-	Kashif Shamim
10.7.1.1	Management has provided fully this investment as irrecoverable and impaired.					

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10.7.2 Particulars of investments in shares of companies delisted from stock exchange and are currently under liquidation.

	Number of shares held	Cost/Paid- up value per share (Rupees)	Total paid up value (Rupees in '000)
Mohib Exports Company Limited	4,600	23.81	109
Sunflo Citrus Limited	100,000	4.22	422
Tawakal Garments Company Limited	4,000	38.38	154
Tristar Shipping Lines Limited	5,000	23.56	118
Zahoor Textile Mills Limited	15,200	13.16	200
			<u>1,003</u>

10.8 Investment in Term Finance Certificates/Bonds

Investment in Listed Term Finance Certificates/Bonds

No. of certificates			Nominal value per certificate Rupees	2009	2008
2009	2008	Company's name		Rupees in '000	
4,000	4,000	Pakistan Mobile Communications Limited	4,993	19,972	19,980
3,000	3,000	Financial Receivables Securitisation Company Limited	3,749	11,246	13,744
				<u>31,218</u>	<u>33,724</u>

Investment in unlisted Term Finance Certificates/Bonds

No. of certificates			Nominal value per certificate Rupees	2009	2008
2009	2008	Company's name		Rupees in '000	
20,000	20,000	SME Leasing Limited	2,917	58,333	91,667
		(Deficit)/Surplus on revaluation of TFCs/ Bonds		(203)	1,399
		Market value as on December 31,		<u>89,348</u>	<u>126,790</u>

These carry rate of return ranging from 13.22% to 18.97% (2008: 10.90% to 18.50%) per annum and having maturity periods of upto 7 years (2008: 7 years).

10.9 Subsidiary company

SME Leasing Limited (SMEL) was incorporated on July 12, 2002 as a public limited company under the Companies Ordinance, 1984. Upto the year 2005, SMEL was a wholly owned subsidiary of the Bank, however, a public offering of 10 million ordinary shares was made during the year 2006 at an offer price of Rs. 11 per share. The Bank subscribed for 1,405,205 shares in SMEL and holds 73.14% shares in SMEL as at December 31, 2009. SMEL is listed on Lahore Stock Exchange. Value of investment in SMEL based on market value as at December 31, 2009 was Rs. 245,754 thousand. This investment is designated as a 'Strategic Investment' in terms of BPD Circular Letter No. 16 dated August 1, 2006.

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	Note	2009	2008
		(Rupees in '000)	
11. ADVANCES			
Loans, cash credits, running finances, etc. in Pakistan			
Extended by:			
Defunct SBFC		4,420,980	4,605,596
Defunct RDFC		560,315	593,786
SME Bank Limited		2,507,438	2,367,636
Due from ex-employees		22,867	23,937
Due from employees		209,116	350,721
		<u>7,720,716</u>	<u>7,941,676</u>
Net investment in finance lease - In Pakistan	11.2	1,253	1,253
Advances - Gross	11.1	<u>7,721,969</u>	<u>7,942,929</u>
Provision for non-performing advances	11.4	5,221,053	5,416,607
Advances - Net of provision		<u>2,500,916</u>	<u>2,526,322</u>
11.1 Particulars of Advances (Gross)			
11.1.1 In local currencies		7,721,969	7,942,929
In foreign currencies		-	-
		<u>7,721,969</u>	<u>7,942,929</u>
11.1.2 Short Term (upto one year)		1,724,221	1,698,134
Long term (over one year)		5,997,748	6,244,795
		<u>7,721,969</u>	<u>7,942,929</u>

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11.2 NET INVESTMENT IN FINANCE LEASE	2009				2008			
	Not later than one year	Later than one and less than five years	Over five years	Total	Not later than one year	Later than one and less than five years	Over five years	Total
	Rupees in '000							
Lease rentals receivable	973	-	-	973	973	-	-	973
Residual value	280	-	-	280	280	-	-	280
Minimum lease payments	1,253	-	-	1,253	1,253	-	-	1,253
Financial charges for future periods	-	-	-	-	-	-	-	-
Present value of minimum lease payments	1,253	-	-	1,253	1,253	-	-	1,253

11.3 Advances include Rs. 5,543,241 thousands (2008: 5,496,498) which have been placed under non-performing status as detailed below:

Category of Classification	2009				
	Domestic	Overseas	Total	Provision Required	Provision Held
	Rupees in '000				
Substandard	132,813	-	132,813	18,954	18,954
Doubtful	147,618	-	147,618	36,081	36,081
Loss	5,262,810	-	5,262,810	5,166,018	5,166,018
	5,543,241	-	5,543,241	5,221,053	5,221,053

11.4 Particulars of provision against non-performing advances

	2009			2008		
	Specific	General	Total	Specific	General	Total
	Rupees in '000					
Opening balance	5,416,607	-	5,416,607	5,643,871	-	5,643,871
Charge for the year	23,154	-	23,154	57,740	-	57,740
Amounts written off	11.5 (173,788)	-	(173,788)	(201,050)	-	(201,050)
Reversals	(44,920)	-	(44,920)	(83,954)	-	(83,954)
Closing balance	5,221,053	-	5,221,053	5,416,607	-	5,416,607

11.4.1 The state bank of Pakistan has amended the Prudential Regulation vide BSD Circular No. 10 of 2009 in relation to provision for loans and advances, thereby allowing benefit of 40% of Forced Sale Value (FSV) of pledged stocks, mortgaged commercial and residential properties held as collateral against non performing advances. This change has resulted in reduced charged for specific provision for the year by Rs.148.769 million. Had the basis for determining the specific provision was not changed, profit before tax and profit after tax would have been lower by Rs.148.769 million.

11.4.2 Particulars of provisions against non-performing advances	2009			2008		
	Specific	General	Total	Specific	General	Total
	Rupees in '000					
In local currency	5,221,053	-	5,221,053	5,416,607	-	5,416,607
In foreign currencies	-	-	-	-	-	-
	5,221,053	-	5,221,053	5,416,607	-	5,416,607

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	Note	2009	2008
11.5 PARTICULARS OF WRITE OFFS:		Rupees in '000	
11.5.1 Against provisions	11.4	173,788	201,050
Directly charged to Profit & Loss account		1,937	2,706
		175,725	203,756
11.5.2 Write Offs of Rs. 500,000 and above	11.6	7,776	27,302
Write Offs of Below Rs. 500,000		167,949	176,454
		175,725	203,756

11.6 DETAILS OF LOAN WRITE OFF OF Rs. 500,000 AND ABOVE

In terms of sub-section (3) of Section 33A of the Banking Companies Ordinance, 1962 the Statement in respect of written-off loans or any other financial relief of five hundred thousand rupees or above allowed to a person(s) during the year ended December 31, 2009 is given at Annexure-1.

11.7 PARTICULARS OF LOANS AND ADVANCES TO DIRECTORS, ASSOCIATED COMPANIES, ETC.	Note	2009	2008
		Rupees in '000	
Debts due by executives or officers of the bank or any of them either severally or jointly with any other persons:			
Balance at the beginning of the year		51,304	44,298
Loans granted during the year		21,426	17,787
Repayments		(21,553)	(10,781)
Balance at the end of the year		51,177	51,304
Debts due by subsidiary company:			
Balance at the beginning of the year		5,847	52,655
Loans granted during the year		60,000	-
Repayments		(22,286)	(46,808)
Balance at the end of the year		43,561	5,847
		94,738	57,151

12. OPERATING FIXED ASSETS

Capital work-in-progress	12.1	1,408	2,636
Property and equipment	12.2	103,955	120,568
Intangible assets	12.3	3,055	1,342
		108,418	124,546
12.1 Capital Work-in-progress			
Advances to suppliers and contractors for:			
- assets subject to finance lease		-	-
- other assets		1,408	2,636
		1,408	2,636

SME Bank Limited
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12.2 PROPERTY PLANT AND EQUIPMENT

(Rupees '000)

	Note	C O S T			DEPRECIATION			As at December 31, 2009	Net book value as at December 31, 2009	Depreciation rate per annum %
		As at January 01, 2009	Transfer from leased assets	Additions/ (Disposals)	As at December 31, 2009	As at January 01, 2009	Transfer from leased assets			
Owned										
Land	12.6	64,087	-	-	64,087	-	-	-	64,087	-
Buildings		15,794	-	-	15,794	2,455	790	3,245	12,549	5
Leasehold improvements		16,829	-	37	16,866	14,215	2,593	16,807	59	33 1/3
Office furniture and fixtures		13,202	-	(1)	13,172	11,165	(1)	12,093	1,079	20
Library		19	-	128	19	19	(150)	19	-	20
Office equipment		19,981	-	(157)	23,774	11,242	1,078	13,394	10,380	15
Computer equipment		74,309	-	(759)	73,304	64,544	(481)	67,757	5,547	33 1/3
Vehicles		44,488	5,190	(2,733)	45,002	40,881	(2,733)	43,484	1,518	20
				40			(4,106)			
		248,709	5,190	(8,365)	252,018	144,521	15,829	156,799	95,219	
							(7,471)			
Leased										
Vehicles		26,573	(5,190)	-	17,005	10,193	4,656	8,269	8,736	20
				(4,379)			(2,661)			
2009		275,282	-	6,485	269,023	154,714	20,485	165,068	103,955	
				(12,745)	-	-	(10,132)	-	-	
2008		268,760	-	11,787	275,282	130,896	27,484	154,714	120,568	
				(5,265)			(3,666)			

12.3 INTANGIBLE ASSETS

(Rupees '000)

		C O S T			AMORTISATION			As at December 31, 2009	Net book value as at December 31, 2009	Amortization rate per annum %
		As at January 01, 2009	Transfer from leased assets	Additions/ Disposals	As at December 31, 2009	As at January 01, 2009	Transfer from leased assets			
Computer software		19,960	-	3,767	23,727	18,618	2,053	20,672	3,055	33 1/3
2009		19,960	-	3,767	23,727	18,618	2,053	20,672	3,055	
2008		19,036	-	924	19,960	15,852	2,766	18,618	1,342	

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12.4 Details of disposal of fixed assets :

Particulars of assets	Cost	Accumulated depreciation	Book value	Sale proceed	Mode of disposal	Particulars of buyers
Vehicles						
Santro Executive	639	394	245	192	As per Bank policy	Jafer Ali - Executive
Mitsubishi Lancer	1,043	832	211	313	-do-	Mehfooz Ellahi - Executive
Honda City	846	395	451	465	-do-	M. Khalid - Executive
Honda Atlas	902	662	240	361	-do-	Ali Akbar - Executive
Toyota Corolla	947	378	569	521	-do-	Raheel Anjum - Executive
Honda City	801	721	80	160	-do-	M.A. Ghazali Marghoob
Suzuki Baleno	629	629	-	370	Through Auction	Nusrat Iqbal
Suzuki Cultus	569	559	10	114	As per Bank policy	Tariq Mehmood - Executive
Santro Club	541	469	72	108	-do-	Abdul Waheed - Executive
Honda City	836	668	168	167	-do-	Muhammad Azam - Executive
Santro Executive	639	511	128	128	-do-	Ms. Asia Zainab Kazmi - Executive
Santro Executive	639	511	128	128	-do-	Muhammad Ayub - Executive
Honda CD (Motorcycle)	64	38	26	27	-do-	M Mustafa - Employee
	<u>9,095</u>	<u>6,767</u>	<u>2,328</u>	<u>3,054</u>		
Other assets having book value of more than Rs.250,000 or cost of Rs.1,000,000 which ever is less						
	-	-	-	-		
2009	<u>9,095</u>	<u>6,767</u>	<u>2,328</u>	<u>3,054</u>		
2008	<u>5,051</u>	<u>3,455</u>	<u>1,596</u>	<u>2,026</u>		

12.5 Gross carrying amount of fully depreciated assets that are still in use was Rs. 143,449 thousands (2008: Rs. 113,060 thousands)

12.6 This represent cost of land measuring 500 square yards in sector G-7 and 4666.66 square yards situated in sector G-5/2 originally allotted to SBFC and RDFC respectively. CDA required payment of Rs. 3.367 million for transferring the plot in the name of the Bank. However on receiving draft of the required amount CDA returned the same requiring payment of market value in view of proposed privatization of SME Bank. The payment has been accounted for as addition in 2007 as the matter is being pursued by the SME Bank with CDA.

13. DEFERRED TAX ASSETS	2009	2008
	Rupees in '000	
Deductible temporary differences on:		
Accelerated tax depreciation	<u>1,172</u>	3,669
	<u>1,172</u>	3,669
Taxable temporary differences on:		
Excess of accounting book value of leased assets over corresponding liabilities	<u>(1,172)</u>	(1,072)
	<u>(1,172)</u>	(1,072)
	<u>-</u>	2,597
13.1 Temporary differences for which no deferred tax is recognized:		
Provision for impairment in investments/doubtful receivables	<u>129,863</u>	1,613,783

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	Note	2009	2008
		Rupees in '000	
14. OTHER ASSETS			
Income/mark-up accrued in local currency	14.1	128,589	139,206
Advances, deposits, advance rent and other prepayments		30,389	28,406
Refund due from defined benefit pension and gratuity fund		182,064	12,382
VSS Cost reimbursable from GoP		59,808	-
Receivable from subsidiary company		1,442	252
Receivable from Ravi Securities (Pvt) Limited and Taas Securities (Pvt) Limited		11,699	31,447
Stock exchange membership	14.2	38,000	18,000
Receivable from Speedway Fondmetall Pakistan Limited		19,640	19,640
Receivable from Equity Participation Fund		4,339	3,936
Receivable against factorized portfolio		8,248	8,248
Others		36,105	32,252
		<u>520,323</u>	<u>293,769</u>
Less: Provision held against other assets	14.3	74,079	85,140
Other assets (net of provision)		<u>446,244</u>	<u>208,629</u>
14.1	This balance has been arrived at after adjusting interest in suspense of Rs 4,003,869 thousand (2008: Rs 4,098,611 thousand)		
14.2	This includes membership of Lahore stock exchange of Rs.20 million as settlement with Ravi Securities (Pvt) Limited and Taas Securities Limited. The cost reflected here is based on best management estimate of the fair value of membership of Lahore stock exchange at settlement date.		
	Note	2009	2008
14.3 Provision against other assets		Rupees in '000	
Opening balance		85,140	94,499
Transfer from provision for impairment in value of investments		-	-
Charge for the year		9,335	25
Reversals		(20,000)	(6,614)
Amount written off		(396)	(2,770)
Closing balance		<u>74,079</u>	<u>85,140</u>
Provision balance is in respect of:			
Income/mark-up accrued in local currency			
Prudential Investment Bank Limited		506	506
Universal Leasing Limited		22	22
Receivable from Ravi Securities (Pvt) Limited and Taas Securities (Pvt) Limited		11,699	31,447
Receivable from Speedway Fondmetall Pakistan Limited		19,640	19,640
Receivable against factorized portfolio		8,248	8,248
Other receivables- SME Portfolio		8,140	-
Legal charges recoverable from borrowers-SBFC & RDFC		22,137	21,470
Others		3,687	3,807
		<u>74,079</u>	<u>85,140</u>

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	Note	2009	2008
		Rupees in '000	
15. BILLS PAYABLE			
In Pakistan		54,542	37,686
Outside Pakistan		-	-
		<u>54,542</u>	<u>37,686</u>
16. BORROWINGS			
In Pakistan		1,371,750	1,518,100
Outside Pakistan		-	-
		<u>1,371,750</u>	<u>1,518,100</u>
16.1 Particulars of borrowings with respect to currencies			
In local currency		1,371,750	1,518,100
In foreign currencies		-	-
		<u>1,371,750</u>	<u>1,518,100</u>
16.2 Details of borrowings Secured/unsecured			
Repurchase agreement borrowings - secured	16.2.1	1,371,750	1,518,100
		<u>1,371,750</u>	<u>1,518,100</u>
16.2.1 These represent transactions with financial institutions for sale of Government Securities under re-purchase agreement (REPO) in the inter bank money market at mark-up rates ranging from 6.00% to 14.90% (2008: 4.00% to 14.50%) per annum for periods upto three month (2008: upto one month). REPO transactions are secured against investment of the Bank in Government securities.			
17. DEPOSITS AND OTHER ACCOUNTS	Note	2009	2008
		Rupees in '000	
Customers			
Fixed deposits		910,599	843,448
Savings deposits	17.2	595,785	474,803
Current accounts - non-remunerative		304,665	243,339
Margin accounts		25,161	10,527
		<u>1,836,210</u>	1,572,117
Financial Institutions			
Remunerative deposits		366,942	319,901
		<u>2,203,152</u>	<u>1,892,018</u>
17.1 Particulars of deposits			
In local currency		2,203,152	1,892,018
In foreign currencies		-	-
		<u>2,203,152</u>	<u>1,892,018</u>
17.2 Saving deposits include Rs. 266.879 million (2008: Rs. 239.765 million) related to Equity Participation Fund.			

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18. LIABILITIES AGAINST ASSETS SUBJECT TO FINANCE LEASE

	2009			2008		
	Minimum lease payments	Financial charges for future periods	Principal outstanding	Minimum lease payments	Financial charges for future periods	Principal outstanding
	Rupees in '000					
Not later than one year	4,226	351	3,875	6,879	763	6,116
Later than one year and not later than five years	8,294	82	8,212	13,803	477	13,326
Over five years	-	-	-	-	-	-
	12,520	433	12,087	20,682	1,240	19,442

This represents liability against vehicle lease agreements with leasing companies. Monthly lease rentals are payable including financial charges at rates ranging between 12.00% and 16.00% (2008: 8.50% and 16.00%) per annum, which have been used as discounting factor to determine present value of minimum lease payments. The purchase option is available with the Bank at the time of payment of the last installment or surrender of deposit money under the lease agreements.

	Note	2009	2008
		Rupees in '000	
19. OTHER LIABILITIES			
Mark-up/ return/ interest payable in local currency		44,813	63,057
Unearned commission on guarantees		1,319	1,203
Accrued expenses		67,680	6,922
Income tax payable		64,553	63,177
Accounts payable		1,708	3,998
Sundry creditors		107,659	17,398
Branch adjustment account		2,014	1,303
Industrial Credit for Rural Women - Promotional Fund	19.1	30,851	30,820
Payable against employees benefit plans			
Defined benefit unfunded gratuity scheme	35.2.1	24,475	20,675
Unfunded compensated absences	35.3.4	54,793	91,670
Benevolent fund	35.4	-	-
Security deposits against lease		280	284
Employees' VSS payments withheld	19.2	17,422	17,301
Payable to Cash Management Scheme		85	100
Income tax withheld payable		17,714	17,346
Others		1,591	21
		436,957	335,275

19.1 Industrial Credit for Rural Women - Promotional Fund

Funds received including accumulated profit	30,851	30,820
Loan and mark up receivable outstanding - net of provision	-	-
	30,851	30,820

The Fund is in respect of Rs 21.5 million received by the defunct RDFC in 1995 from GoP, National Development Finance Corporation (now amalgamated with National Bank of Pakistan), IDBP and Pakistan Banking Council (now taken over by SBP) for providing industrial credit to rural women. An amount of Rs. 3.491 million advance is outstanding which is fully provided in the books of accounts.

19.2 Employees VSS payments of Rs.17.422 has been withheld due to legal cases pending in the courts against employees filed by SME bank and customers.

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20. SHARE CAPITAL

20.1 Authorized Capital

2009	2008		2009	2008
			Rupees in '000	
1,000,000,000	1,000,000,000	Ordinary shares of Rs 10 each	10,000,000	10,000,000

20.2 Issued, subscribed and paid up capital

2009	2008		2009	2008
		Ordinary shares of Rs 10 each		
152,853,153	152,853,153	Fully paid in cash	1,528,532	1,528,532
50,000,000	50,000,000	Issued as bonus shares	500,000	500,000
36,397,547	36,397,547	Issued for consideration other than cash	363,975	363,975
239,250,700	239,250,700		2,392,507	2,392,507

20.3 Break-up of share capital is as follows:	Number of		2009	2008
	shares	%		
Federal Government	224,615,978	93.89	2,246,160	2,246,160
National Bank of Pakistan Limited	6,121,095	2.56	61,211	61,211
United Bank Limited	3,975,003	1.66	39,750	39,750
Habib Bank Limited	1,987,501	0.83	19,875	19,875
MCB Bank Limited	1,490,619	0.62	14,906	14,906
Allied Bank Limited	774,351	0.32	7,744	7,744
Industrial Development Bank of Pakistan	286,146	0.12	2,861	2,861
Directors	7	-	-	-
	239,250,700	100	2,392,507	2,392,507

21. (DEFICIT)/ SURPLUS ON REVALUATION OF ASSETS

Deficit on revaluation of Available-for-sale securities

Federal Government securities

- Market Treasury Bill	(12,332)	(21)
- Pakistan Investment Bonds	(173,031)	(397,961)
	(185,363)	(397,982)

Fully paid up ordinary shares/units

- Listed companies/mutual funds	14,122	(5,260)
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Term Finance Certificates, Debentures, Bonds and Participation Term Certificates

- Listed TFCs	(203)	1,399
- WAPDA Bonds	-	-
	(203)	1,399
	(171,444)	(401,844)

Deferred tax thereon

13.1	-	-
	(171,444)	(401,844)

SME Bank Limited
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	2009	2008
	(Rupees in '000)	
22. CONTINGENCIES AND COMMITMENTS		
22.1 Transaction-related contingent liabilities		
Guarantees in favour of:		
Government	71,156	3,250
Others	90,411	103,220
22.2 Other Contingencies		
a) Claims not acknowledged as debt from various borrowers for loss sustained due to non-disbursement.	24,972	24,972
b) Damages claim by a borrower for delay in recording repayments received from a borrower , not acknowledged as debt.	49,800	40,000
c) Damages claim by Ravi Securities (Private) Limited and Taas Securities (Private) Limited, not acknowledged as debt.	23,800	23,800
d) Tax demands raised by the income tax authorities related to Vss staff cost (Rs.1,746.03 million)re-imbursed by GOP to SME Bank through issuing show cause notice to amend the assessment of tax year 2005 u/s 122 (3) .Appeal has been filed against the decision.Management based on tax advisor assessment is expecting a favourable outcome.	612,707	171,512
e) Tax audit of tax year 2007 is in progress and decision is pending at balance sheet date.	-	-
f) Adjustment of loan guarantee amount against borrowing from IDBP repaid in prior years, disputed by IDBP	9,939	9,939
g) Back benefits and claims of staff/employees under litigation	90,800	83,845
	<u>973,585</u>	<u>460,538</u>
22.3 Commitments in respect of forward lending		
Commitments to extend credit	243,700	226,650
22.4 Commitments for the acquisition of operating fixed assets	680	1,947
22.5 Commitments against Repo/Reverse Repo transactions		
Purchase and resale agreements	33,445	-
Sale and repurchase agreements	1,371,750	1,518,100
	<u>1,405,195</u>	<u>1,518,100</u>
22.6 Other commitments		
Undrawn facilities	201,747	234,970
22.7 Bills for collection		
Payable in Pakistan	2,076	2,191

SME Bank Limited
Notes to the Financial Statements
For the year ended December 31, 2009

		2009	2008
	Note	Rupees in '000	
23. MARK-UP/ RETURN/ INTEREST EARNED			
On loans and advances to			
Customers			
Extended by:			
Defunct RDFC		3,752	7,479
Defunct SBFC		100,764	124,234
SME Bank Limited		353,204	306,168
		<u>457,720</u>	<u>437,881</u>
Employees		10,368	13,609
Financial Institution - SME Leasing Limited		6,167	2,498
		<u>474,255</u>	<u>453,988</u>
On investments in			
Available for sale securities		286,375	274,631
Held to maturity securities		4,503	16,415
		<u>290,878</u>	<u>291,046</u>
On deposits with financial institutions		3,456	2,443
On securities purchased under resale agreements		3,587	17,116
On call money lending		1,760	10,204
		<u>773,936</u>	<u>774,797</u>
24. MARK-UP/ RETURN/ INTEREST EXPENSED			
Deposits		214,768	153,897
Securities sold under repurchase agreements		182,387	180,037
Amortisation of premium/ discount on investments		49,748	49,924
Brokerage and commission		555	800
Bank charges		648	721
		<u>448,106</u>	<u>385,379</u>
25. (LOSS)/GAIN ON SALE OF SECURITIES			
Mutual Funds		-	(376)
26. OTHER INCOME			
Net profit on sale of property and equipment		712	453
Profit on off-balance sheet item	26.1	272	1,152
Others		4,507	9,574
		<u>5,491</u>	<u>11,179</u>
26.1 Profit on off-balance sheet item			
Equity Participation Funds		272	1,152
		<u>272</u>	<u>1,152</u>

SME Bank Limited
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		2009	2008
		Rupees in '000	
27. ADMINISTRATIVE EXPENSES	Note		
Salaries, allowances, etc.		312,626	352,479
Charge for defined benefit plans			
- pension fund		33,729	22,563
- unfunded gratuity scheme		8,909	9,043
Contribution to defined contribution plan - benevolent fund		726	794
Non-executive directors' fees, allowances and other expenses		107	208
Rent, taxes, insurance, electricity, etc.		70,073	62,480
Legal and professional charges		11,980	11,903
Communications		7,214	7,243
Repairs and maintenance		11,913	10,540
Finance charges on leased assets		753	1,180
Stationery and printing		4,002	4,177
Advertisement and publicity		457	467
Depreciation	12.2	20,485	27,484
Amortization	12.3	2,053	2,766
Auditors' remuneration	27.1	2,218	2,130
Staff separation costs	27.2	661,883	1,335
Staff recovery costs		5,403	7,853
Recovery expenses - outsourced portfolio		1,177	5,298
Recruitment expenses		373	343
Travel and transport		5,218	6,385
Vehicle running and maintenance expenses		9,641	11,252
Entertainment		1,969	1,769
Training		344	674
Books, subscription and newspapers		3,007	3,747
Other expenses		12,943	15,988
		1,189,203	570,101
27.1 Auditors' remuneration			
Audit fee		1,100	1,100
Special certifications, half yearly review and audit of consolidated financial statements		567	475
Out-of-pocket expenses		551	555
		2,218	2,130
27.2	139 employees opted for VSS-2009 offered vide Circular No. HO/HR&SD/2009/5385 dated October 15, 2009. These employees have been relieved at a total cost of Rs.661 million with effect from November 14, 2009.		
		2009	2008
		Rupees in '000	
28.	Penalties imposed by the State Bank of Pakistan	196	5,204
29. GAIN ON SETTLEMENT RELATED TO RETIREMENT BENEFIT PLANS		2009	2008
		Rupees in '000	
Defined benefit pension and gratuity fund		185,469	-
Leave encashment & unfunded gratuity		24,157	-
		209,626	-
30. GOP FINANCING AGAINST VSS-2009		660,514	-
	This represents amount granted by Govt. of Pakistan through SBP for payment of benefits of those employees who opted VSS during the year ended December 2009.		

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	2009	2008
31. TAXATION	Rupees in '000	
For the year		
Current	3,949	-
Deferred	2,597	400,954
	6,546	400,954
31.1 Provision for current year expenses is charged on minimum tax rate 0.5% of the turnover due to accumulated tax losses of the Bank.		
32. BASIC/ DILUTED EARNINGS PER SHARE	Rupees in '000	
Profit/(Loss) for the year	35,852	(532,948)
	Number of shares	
Weighted average number of ordinary shares	239,250,700	239,250,700
	Rupees	
Basic/Diluted earnings per share	0.15	(2.23)
33. CASH AND CASH EQUIVALENTS	Rupees in '000	
Cash and balances with treasury banks	213,778	200,112
Balance with other banks	57,296	49,751
Call money lending	-	100,000
	271,074	349,863
34. STAFF STRENGTH	Number	
Permanent	176	316
Temporary/ on contractual basis	302	294
Daily Wagers	9	10
Others (Recovery Tehsildars & Police constables)	6	22
Bank's own staff strength at the end of the year	493	642
Outsourced	73	15
Total staff strength	566	657

SME Bank Limited
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35. EMPLOYEE BENEFIT PLANS

35.1 Defined benefit pension and gratuity plan

35.1.1 General description

Bank operates an approved defined benefit pension and gratuity fund for all its permanent and regular employees. Contributions are made in accordance with the actuarial recommendations.

The scheme entitles the members to:

- Gratuity payable to members who have completed a minimum of 5 years of service and total service on retirement or cessation of service or death is less than 10 years.
- Pension payable to members who have completed a minimum of 10 years of service with the Bank on retirement at age of sixty years or on completion of 25 years of service with the Bank or on permanent disability or on death during service.

	2009	2008
	Rupees '000	
35.1.2 The amounts recognised in the balance sheet are as follows:		
Present value of defined benefit obligation	245,555	342,592
Fair value of plan assets	(409,184)	(345,070)
(Surplus)/ deficit	(163,629)	(2,478)
Unrecognized actuarial loss	(12,996)	(3,377)
Unrecognized past service cost	(5,439)	(6,527)
Net asset	(182,064)	(12,382)

35.1.3 Movement in net asset recognised in the balance sheet

Opening balance of net asset	(12,382)	(12,177)
Expense for the year	33,729	22,563
Gain on settlement related to retirement benefit plans	(185,469)	-
Contribution to the fund	(17,942)	(22,768)
Closing balance of net asset	(182,064)	(12,382)

35.1.4 The amounts recognised in the profit and loss account are as follows:

Current service cost	17,906	20,796
Interest cost	51,389	29,310
Expected return on plan assets	(51,761)	(28,631)
Past service cost - over the vesting period	1,088	1,088
Actuarial (Gain)/Loss recognized - Due to curtailment	15,107	-
Expense for the year	33,729	22,563
VSS Gain	(185,469)	-
Gain on settlement related to retirement benefit plans	(185,469)	-

The expense has been recognized in administrative expenses in profit and loss account.

	2009	2008
	Rupees '000	
35.1.5 Actual return on plan assets	54,383	38,311

The expected return on plan assets is based on the market expectations and depend upon the asset portfolio of the Fund, at the beginning of the year. Expected yield on fixed interest investments is based on gross redemption yields as at the balance sheet date.

SME Bank Limited
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	2009	2008
	Rupees '000	
35.1.6 Changes in present value of defined benefit obligation		
Present value of obligation at the beginning of the year	342,592	293,103
Current service cost	17,906	20,796
Interest cost	51,389	29,310
Benefits paid (existing pensioners)	(8,211)	(2,319)
VSS Gain	(185,469)	-
Actuarial loss	27,348	1,702
Present value of obligation at the end of the year	245,555	342,592
35.1.7 Changes in fair value of plan assets		
Fair value of opening plan assets	345,070	286,310
Expected return on plan assets	51,761	28,631
Contributions	17,942	22,768
Benefits paid	(8,211)	(2,319)
Actuarial gain/(loss)	2,622	9,680
Fair value of closing plan assets	409,184	345,070

There is no expected Pension expense for the year 2010

	2009		2008	
	Rupees '000	% age	Rupees '000	% age
T-bills	330,819	81%	-	-
Defence savings certificates	-	0%	54,689	16%
Term deposits receipts	73,527	18%	285,695	83%
Bank deposit accounts	4,838	1%	4,686	1%
	409,184	100%	345,070	100%

35.1.9 Principal actuarial assumptions

Actuarial valuation is carried out annually. Latest actuarial valuation was carried out as at December 31, 2009 using Projected Unit Credit Method. Significant actuarial assumptions used are as follows:

	2009	2008
Valuation discount rate - per annum	14%	15%
Expected return on plan assets - per annum	14%	15%
Salaries increase rate - per annum	13%	14%
Pension indexation rate	10%	10%
Mortality rate	61-66	61-66
Average expected remaining working lives in years	7	9

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35.1.10 Disclosure for current and previous four annual years

	2009	2008	2007	2006	2005
	Rupees '000				
Present value of obligation	245,555	342,592	293,103	245,335	215,652
Fair value of plan assets	(409,184)	(345,070)	(286,310)	(245,919)	(205,580)
Deficit /(Surplus)	<u>(163,629)</u>	<u>(2,478)</u>	<u>6,793</u>	<u>(584)</u>	<u>10,072</u>
Experience adjustments on plan liabilities-Loss/(Gain)	<u>27,348</u>	<u>1,702</u>	<u>(5,953)</u>	<u>9,231</u>	<u>(47,448)</u>
Experience adjustments on plan assets-Gain/(Loss)	<u>2,622</u>	<u>9,680</u>	<u>(2,655)</u>	<u>255</u>	<u>(9,789)</u>

	2009	2008
	Rupees '000	
35.2 Defined benefit unfunded gratuity scheme	<u>24,475</u>	<u>20,675</u>

35.2.1 The amounts recognised in the balance sheet are as follows:

Present value of defined benefit obligation	27,562	24,284
Unrecognized actuarial loss	(3,087)	(3,609)
Net liability	<u>24,475</u>	<u>20,675</u>

35.2.2 Movement in net liability recognised in the balance sheet

Opening balance of net liability	20,675	16,338
Expense for the year	8,909	9,043
Benefits paid during the year	(5,109)	(4,706)
Closing balance of net liability	<u>24,475</u>	<u>20,675</u>

35.2.3 The amount recognised in the profit and loss account are as follows:

Current service cost	5,175	7,346
Interest cost	3,643	1,697
Actuarial Losses/(Gains) recognised	91	-
	<u>8,909</u>	<u>9,043</u>

The expense has been recognized in administrative expenses in profit and loss account.

	2009	2008
	Rupees '000	
35.2.4 Movement in payable to defined benefit unfunded gratuity scheme		
Present value of obligation at the beginning of the year	24,284	16,972
Current service cost	5,175	7,346
Interest cost	3,643	1,697
Benefits paid	(5,109)	(4,706)
Actuarial loss	(431)	2,975
Present value of obligation at the end of the year	<u>27,562</u>	<u>24,284</u>

35.2.5 Significant actuarial assumptions are as follows:

Discount factor - per annum	14%	15%
Salary increase rate - per annum	14%	15%
Average expected remaining working lives in years	12	14
Mortality rate	EFU 61-66	EFU 61-66

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35.2.6 Disclosure for current and previous four annual periods

	2009	2008	2007	2006	2005
	Rupees '000				
Present value of obligation	27,562	24,284	16,972	14,417	-
Unrecognized actuarial loss	(3,087)	(3,609)	(634)	(561)	-
	<u>24,475</u>	<u>20,675</u>	<u>16,338</u>	<u>13,856</u>	<u>-</u>

35.3 Unfunded compensated absences

35.3.1 General description

Bank allows compensated absences, an unfunded scheme, per entitlement to all its permanent and contractual employees. Related provision is made in accordance with the actuarial valuation.

35.3.2 Principal actuarial assumptions

Actuarial valuation was carried out as at December 31, 2009 using Projected Unit Credit Method. Significant actuarial assumptions used were as follows:

	2009	2008
Discount factor - per annum	14%	15%
Salaries increase rate - per annum	13%	14%
Average expected remaining working lives in years	7	8
Mortality rate	EFU 61-66	EFU 61-66

35.3.3 The amounts recognised in the balance sheet are as follows:

	2009	2008
	(Rupees '000)	
Present value of defined benefit obligation	54,793	91,670
Unrecognized actuarial (gain)/loss	-	-
Net liability	<u>54,793</u>	<u>91,670</u>

35.3.4 Movement in liability recognized in the balance sheet

	2009	2008
	(Rupees '000)	
Balance at beginning of the year	91,670	83,673
Expense for the year	530	19,179
VSS Gain	(24,157)	
Benefits paid during the year	(13,250)	(11,182)
Balance at end of the year	<u>54,793</u>	<u>91,670</u>

35.3.5 The amounts recognised in the profit and loss account are as follows:

	2009	2008
	(Rupees '000)	
Current service cost	3,544	3,238
Interest cost	13,751	8,367
Actuarial gain recognised	(16,765)	7,574
Expense for the year	<u>530</u>	<u>19,179</u>
VSS Gain	(24,157)	-
Gain on settlement related to retirement benefit plans	<u>(24,157)</u>	<u>-</u>

The expense has been recognized in administrative expenses in profit and loss account.

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	2009	2008
35.3.6 Movement in payable to defined benefit unfunded Compensated absences	(Rupees '000)	
Present value of obligation at the beginning of the year	91,670	83,673
Current service cost	3,544	3,238
Interest cost	13,751	8,367
Benefits paid	(13,250)	(11,182)
VSS Gain	(24,157)	-
Actuarial (Gain)/Loss	(16,765)	7,574
Present value of obligation at the end of the year	54,793	91,670

35.3.7 Disclosure for current and previous four annual periods

	2009	2008	2007	2006	2005
	Rupees '000				
Present value of obligation	54,793	91,670	83,764	75,925	67,102
Unrecognized actuarial (gain)/loss	-	-	-	-	-
	54,793	91,670	83,764	75,925	67,102

	Staff Benevolent Fund	Officers Benevolent Fund	Total
35.4 Benevolent fund	(Rupees '000)		
Total liability	18,356	36,506	54,862
Investment against funds			
Defence Savings Certificates (including accrued income)	16,109	31,624	47,733
Term Deposit Receipts (including accrued income)	1,821	4,253	6,074
Bank deposit account	426	629	1,055
	18,356	36,506	54,862
Net liability/(asset) - December 31, 2009	-	-	-
Net liability/(asset) - December 31, 2008	-	-	-

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36. COMPENSATION OF DIRECTORS AND EXECUTIVES

	President/Chief Executive		Directors		Executives	
	2009	2008	2009	2008	2009	2008
	Rupees in '000					
Fees	-	-	50	120	-	-
Managerial remuneration	3,600	3,600	-	-	53,093	47,655
Charge for defined benefit plan	740	740	-	-	7,688	5,853
Rent and house maintenance	840	-	-	-	9,311	7,511
Utilities	95	840	-	-	5,246	4,766
Medical	-	-	-	-	4,779	4,444
Conveyance	-	-	-	-	605	248
Leave fare assistance	-	-	-	-	4,056	3,991
Bonus/ex-gratia	-	310	-	-	-	4,651
Others	962	998	57	88	52,049	16,673
	6,237	6,488	107	208	136,827	95,792
Number of persons	1	1	5	7	62	52

Executives mean employees, other than the chief executive and directors, whose basic salary exceeds five hundred thousand rupees in a financial year.

37. FAIR VALUE OF FINANCIAL INSTRUMENTS

	2009		2008	
	Book value	Fair value	Book value	Fair value
37.1 On-balance sheet financial instruments	Rupees in '000			
Assets				
Cash balances with treasury banks	213,778	213,778	200,112	200,112
Balances with other banks	57,296	57,296	49,751	49,751
Lending to financial institutions	33,445	33,445	100,000	100,000
Investments	2,939,132	2,939,132	2,545,053	2,545,053
Advances	2,500,916	2,500,916	2,526,322	2,526,322
Other assets	145,373	145,373	151,100	151,100
	5,889,940	5,889,940	5,572,338	5,572,338
Liabilities				
Bills payable	54,542	54,542	37,686	37,686
Borrowings	1,371,750	1,371,750	1,518,100	1,518,100
Deposits and other accounts	2,203,152	2,203,152	1,892,018	1,892,018
Liabilities against assets subject to finance lease	12,087	12,087	19,442	19,442
Other liabilities	290,899	290,899	156,963	156,963
	3,932,430	3,932,430	3,624,209	3,624,209
37.2 Off-balance sheet financial instruments				
Commitments to extend credit	243,700	243,700	226,650	226,650

37.3 The fair value of investments is based on quoted market prices and rates quoted at Reuters Pages (PKRV) with the exception of unlisted securities, investment in subsidiary and held to maturity investments.

Fair value of the remaining financial assets and liabilities except fixed term loans, staff loans, non-performing advances and fixed term deposits is not significantly different from the carrying amounts since such assets and liabilities are short term in nature.

Fair value of fixed term loans, staff loans, non-performing advances and fixed term deposits cannot be calculated with sufficient reliability due to absence of current and active market for such assets and reliable data regarding market rates for similar instruments.

The provision for non-performing advances has been calculated in accordance with the Bank's accounting policy as stated in note 5.4. The maturity profile and effective rates are stated in note 41.2.3.

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38. SEGMENT DETAILS WITH RESPECT TO BUSINESS ACTIVITIES

The segment analysis with respect to business activity is as follows:-

	Trading & Sales	Commercial Banking
	Rupees in '000	
2009		
Total income	275,638	1,384,265
Total expenses	239,722	1,377,783
Net income	<u>35,916</u>	<u>6,482</u>
Segment Assets (Gross)	3,373,193	8,396,674
Segment Non Performing Loans	-	5,543,241
Segment Provision Required	256,653	5,273,793
Segment Liabilities	1,446,839	2,631,649
Segment Return on net Assets (ROA) (%)	1.15%	0.21%
Segment Cost of funds (%)	13.30%	9.75%
2008		
Total income	325,291	496,785
Total expenses	239,315	714,755
Net income	<u>85,976</u>	<u>(217,970)</u>
Segment Assets (Gross)	3,251,917	8,457,489
Segment Non Performing Loans	-	5,496,498
Segment Provision Required	491,736	5,460,660
Segment Liabilities	1,652,527	2,149,994
Segment Return on net Assets (ROA) (%)	3.11%	-7.27%
Segment Cost of funds (%)	11.86%	8.13%

Assumptions used:

- Unallocatable administrative expenses have been allocated to segments based on their respective incomes except for the depreciation expense which has been allocated on the annual basis of net book value of segment operating fixed assets.
- Unallocatable assets representing 2.22% (2008: 0.73%) of the total assets have been allocated to segments based on their respective incomes.
- Unallocatable liabilities representing 9.61% (2008: 7.16%) of the total liabilities have been allocated to segments based on their respective incomes.

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39. RELATED PARTY TRANSACTIONS

The Bank has a related party relationship with its subsidiary - SME Leasing Limited (SMEL), its directors, executive officers and employees' funds.

Details of balances outstanding at year end and transactions with related parties are as follows:

	2009	2008			
	(Rupees in '000)				
Balances outstanding					
SME Leasing Limited :					
Investment in subsidiary	215,457	215,457			
Loan to SMEL	43,561	5,847			
Receivable from SMEL	1,442	252			
Liability against assets subject to finance lease	12,087	19,442			
Investment in TFC's issued by SMEL	58,333	91,667			
Executive officers					
Loan to executives	51,177	51,304			
Transactions during the year					
SME Leasing Limited					
Interest income on loan to SMEL	6,167	2,498			
Loan disbursed	60,000	-			
Repayment of loan	22,286	46,808			
Repayment of interest on loan	4,764	3,492			
Payment received against TFC's	33,334	8,333			
Investment in TFC's issued by SMEL		100,000			
Principal terms of loan to SMEL					
Year	Amount	Term	Interest rate	Repayment	Number of installments
	(Rupees '000)				
2009	30,000	6 Months	3 months Kibor + 1.5% per quarter (Floor of 15%)	Quarterly	2
2009	15,000	4 years	3 months Kibor + 2 % per quarter	Quarterly	16
2009	15,000	1 Month	15% for one month	Monthly	1
Markup on liability against assets subject to finance lease				753	1,240
Payment for liability against assets subject to finance lease				2,746	2,847
Down payment for acquisition of vehicles under finance lease				-	802
Loan to executives:					
Loans disbursed during the year				3,622	1,878
Repayments during the year				14,437	8,230
Mark up earned				1,651	1,520
Payment/contribution to employee's funds				37,027	39,450
Charge for the year relating to employee's funds				43,894	51,579
Remuneration of chief executive officer and executives and fee paid to directors is disclosed in note 36 to the financial statements.					

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40. CAPITAL ADEQUACY

The risk weighted assets to capital ratio, calculated in accordance with the State Bank's guidelines on capital adequacy was as follows:

	2009		2008	
	Rupees in '000			
Regulatory capital base				
<i>Tier I capital</i>				
Shareholders capital/assigned capital	2,392,507		2,392,507	
Reserves	206,526		199,356	
Unappropriated/unremitted profits (net of losses)	(206,848)		(235,530)	
	2,392,185		2,356,333	
Less: Adjustments				
Investment in equity of subsidiary	(215,457)		(215,457)	
Deficit on revaluation of available for sale investments	(195,837)		(403,243)	
	(411,294)		(618,700)	
<i>Total tier I capital</i>	1,980,891		1,737,633	
<i>Tier II capital</i>	1,818		-	
<i>Eligible tier III capital</i>	-		-	
Total regulatory capital (a)	1,982,709		1,737,633	
Risk-weighted exposures	2009		2008	
	Book Value	Risk Adjusted Value	Book Value	Risk Adjusted Value
	Rupees '000			
<i>Credit risk</i>				
Balance sheet items:-				
Cash and other liquid assets	271,074	11,547	249,863	13,656
Money at call	-	-	100,000	20,000
Investments	2,972,577	312,438	2,545,053	316,229
Loans and advances	2,500,916	1,369,123	2,526,322	1,326,353
Fixed assets	108,418	108,418	124,546	124,546
Deferred tax assets	-	-	2,597	2,597
Other assets	446,244	330,677	208,629	152,870
	6,299,229	2,132,203	5,757,010	1,956,251
Off balance sheet items				
Loan repayment guarantees	90,411	90,411	106,470	106,470
	90,411	90,411	106,470	106,470
Credit risk-weighted exposures	6,389,640	2,222,614	5,863,480	2,062,721
Market risk				
Market risk-weighted exposures	-	-	-	-
Total risk-weighted exposures (b)	2,222,614		2,062,721	
<i>Capital adequacy ratio</i> [(a) / (b) x 100]	89.21%		84.24%	

The Commercial Banks are required to disclose State Bank of Pakistan's (SBP) forms for annual financial statements' Note 44.1 (Capital-Assessment and Adequacy Basel II Specific) in place of Note 44 (Capital Adequacy) from December 31, 2008. However, State Bank of Pakistan (SBP) has granted exemption to the Bank from applying Note 44.1(Capital-Assessment and Adequacy Basel II Specific).

SME Bank Limited
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41. RISK MANAGEMENT

41.1 Credit risk

Credit risk represents the accounting loss that would be recognised at the reporting date if counter parties failed completely to perform as contracted. The Bank is not exposed to major concentration of credit risk. Written procedures for credit and risk management functions have been developed and implemented. Credit evaluation system comprise of well designed loan approval and review responsibilities and it is ensured that Bank's credit-granting activities conform to the established strategy, prudential regulations and SBP instructions are strictly followed. To ensure that credit granting activities are adequately diversified, besides fixing limits on individual credit, it is ascertained that there is no concentration in a particular industry or economic sector, geographical region and specific product. Special attention is placed on such non-performing loans and a special Recovery Division follows up and recovers all such loans. Recovery against certain specific non-performing loans has been outsourced to independent Recovery Service Providers.

41.1.1 Segment by class of business

	2009					
	Advances (Gross)		Deposits		Contingencies and Commitments	
	Rupees in '000	Percent	Rupees in '000	Percent	Rupees in '000	Percent
Chemical and pharmaceuticals	104,138	1.35%	530	0.02%	1,853	0.07%
Agriculture, forestry, hunting and fishing	257,297	3.33%	60		48	0.00%
Textile	406,920	5.27%	69,624	3.16%	7,219	0.26%
Cement	21,284	0.28%	10,822		-	0.00%
Sugar	-	0.00%	-	-	-	0.00%
Footwear and leather garments	8,094	0.10%	264,822	12.02%	-	0.00%
Automobile and transportation equipment	175,316	2.27%	6,320	0.29%	3,657	0.13%
Financial	43,561	0.56%	366,942	16.66%	1,415,134	50.06%
Insurance	-	-	219	0.01%	-	-
Electronics and electrical appliances	96,969	1.26%	16,306	0.74%	90	0.00%
Power (electricity), gas, water and sanitary	5,326	-	1,513	0.07%	-	0.00%
Wholesale and trade	-	-		0.00%	-	0.00%
Communication	-	-		0.00%	-	0.00%
Individuals	2,201,207	28.51%	873,108	39.63%	523,380	18.51%
Services	17,574	-		-	23,800	0.84%
Government	-	-		-	683,863	24.19%
Others	4,384,283	56.78%	592,886	26.91%	167,939	5.94%
	<u>7,721,969</u>	<u>100%</u>	<u>2,203,152</u>	<u>100%</u>	<u>2,826,983</u>	<u>100%</u>

41.1.2 Segment by sector

	-	-	-	-	-	-
Public/Government	-	-	809,353	37%	683,863	24.2%
Private	<u>7,721,969</u>	<u>100%</u>	<u>1,393,799</u>	<u>63%</u>	<u>2,143,120</u>	<u>75.8%</u>
	<u>7,721,969</u>	<u>100%</u>	<u>2,203,152</u>	<u>100%</u>	<u>2,826,983</u>	<u>100%</u>

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41.1.3 Details of non-performing advances and specific provisions by class of business segment

	2009		2008	
	Rupees in '000			
	Classified Advances	Specific Provisions Held	Classified Advances	Specific Provisions Held
Chemical and pharmaceuticals	79,079	72,142	89,460	88,961
Agriculture, forestry, hunting and fishing	236,345	236,346	247,774	247,774
Textile	281,629	260,172	277,732	275,545
Cement	21,284	21,284	21,804	21,804
Sugar	-	-	-	-
Footwear and leather garments	8,094	8,094	83,911	83,306
Automobile and transportation equipment	135,394	133,026	125,521	125,329
Financial	-	-	1,600	1,600
Electronics and electrical appliances	72,574	68,280	76,622	72,420
Individuals	1,726,322	1,650,925	1,597,813	1,536,913
Others	2,982,520	2,770,784	2,974,261	2,962,955
	5,543,241	5,221,053	5,496,498	5,416,607

41.1.4 Details of non-performing advances and specific provisions by sector

Public/ Government	-	-	-	-
Private	5,543,241	5,221,053	5,496,498	5,416,607
	5,543,241	5,221,053	5,496,498	5,416,607

41.1.5 GEOGRAPHICAL SEGMENT ANALYSIS

	2009			
	Profit before taxation	Total assets employed	Net assets employed	Contingencies and commitments
	Rupees in '000			
Pakistan	42,398	6,299,229	2,220,741	2,826,983
Asia Pacific (including South Asia)	-	-	-	-
Europe	-	-	-	-
United States of America and Canada	-	-	-	-
Middle East	-	-	-	-
Others	-	-	-	-
	42,398	6,299,229	2,220,741	2,826,983

41.1.5.1 Total assets employed includes intra group items of Rs. 318.794 million.

SME Bank Limited
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41.2 Market risk

Market risk is the risk that the value of on and off-balance sheet positions of the Bank will be adversely affected by movements in interest rates, foreign exchange rates and equity prices resulting in a loss to earnings and capital. The Bank's interest rates exposure comprises those originating from investing and lending activities. The Asset and Liability Committee of the Bank monitors and manages the interest rate risk with the objective of limiting the potential adverse effect on the profitability of the Bank.

41.2.1 Foreign exchange risk

Presently the Bank does not deal in foreign exchange.

	2009			
	Assets	Liabilities	Off-balance sheet items	Net foreign currency exposure
	Rupees in '000			
Pakistan rupee	6,299,229	4,078,488	-	-
United States dollar	-	-	-	-
Great Britain pound	-	-	-	-
Deutsche mark	-	-	-	-
Japanese yen	-	-	-	-
Euro	-	-	-	-
Other currencies	-	-	-	-
	6,299,229	4,078,488	-	-

41.2.2 Equity position risk

The Bank's exposure in equity market is classified in available for sale category with the intent to earn profit based on fundamentals.

SME Bank Limited
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41.2.3 Mismatch of interest rate sensitive assets and liabilities

	Effective Yield/Interest rate	Total	2009 Exposed to Yield/Interest risk								Non-interest bearing financial instruments	
			Upto 1 month	Over 1 to 3 months	Over 3 to 6 months	Over 6 months to 1 year	Over 1 to 2 years	Over 2 to 3 years	Over 3 to 5 years	Over 5 to 10 years		Above 10 years
On-balance sheet financial instruments												
Assets												
Cash and balances with treasury banks		213,778	42	-	-	-	-	-	-	-	-	213,736
Balances with other banks	3.67%	57,296	47,988	-	-	-	-	-	-	-	-	9,308
Lending to financial institutions	12.10%	33,445	33,445	-	-	-	-	-	-	-	-	-
Investments	12.00%	2,939,132	179,422	439,173	159,286	16,667	684,986	1,066,600	392,998	-	-	-
Advances	13.52%	2,500,916	718,699	511,137	439,080	269,324	204,167	143,196	109,031	78,167	28,115	-
Other assets		145,373	-	-	-	-	-	-	-	-	-	145,373
		5,889,940	979,596	950,310	598,366	285,991	889,153	1,209,796	502,029	78,167	28,115	368,417
Liabilities												
Bills payable		54,542	-	-	-	-	-	-	-	-	-	54,542
Borrowings	12.79%	1,371,750	492,099	879,651	-	-	-	-	-	-	-	-
Large time deposits (over 5 million rupees)	10.63%	2,203,152	137,700	272,505	316,275	125,407	15,300	-	-	-	-	329,826
Deposits and other accounts		-	907,655	26,197	17,181	32,793	19,505	2,808	-	-	-	-
Sub-ordinated loans		-	-	-	-	-	-	-	-	-	-	-
Loan from the State Bank of Pakistan		-	-	-	-	-	-	-	-	-	-	-
Liabilities against assets subject to finance lease	15.00%	12,087	180	366	566	2,763	7,366	846	-	-	-	-
Other liabilities		290,899	-	-	-	-	-	-	-	-	-	290,899
		3,932,430	1,537,634	1,178,719	334,022	160,963	42,171	3,654	-	-	-	675,267
On-balance sheet gap		1,957,510	(558,038)	(228,409)	264,344	125,028	846,982	1,206,142	502,029	78,167	28,115	(306,850)
Off-balance sheet financial instruments												
Commitments to extend credit		243,700	243,700	-	-	-	-	-	-	-	-	-
Off-balance sheet gap		243,700	243,700	-	-	-	-	-	-	-	-	-
Total Yield/Interest Risk Sensitivity Gap			(801,738)	(228,409)	264,344	125,028	846,982	1,206,142	502,029	78,167	28,115	(306,850)
Cumulative Yield/Interest Risk Sensitivity Gap			(801,738)	(1,030,147)	(765,803)	(640,775)	206,207	1,412,349	1,914,378	1,992,545	2,020,660	1,713,810

41.2.3.1 Reconciliation of Assets and Liabilities exposed to Yield/Interest Rate Risk with Total Assets and Liabilities

	Rupees '000		Rupees '000
Total financial assets as per note 41.2.3	5,889,940	Total financial liabilities as per note 41.2.3	3,932,430
Add non-financial assets:		Add non-financial liabilities:	
Operating Fixed Assets	108,418	Other Liabilities	146,058
Deferred Tax Assets	-		
Other Assets	300,871		
Balance as per Balance Sheet	6,299,229	Balance as per Balance Sheet	4,078,488

41.2.3.2 Yield risk is the risk of decline in earnings due to adverse movement of the yield curve.

41.2.3.3 Interest rate risk

Interest rate risk is the risk that the value of financial instrument will fluctuate due to changes in the market interest rates. Out of total financial assets of Rs. 5,889.940 million (2008: Rs 5,572.338 million), the financial assets which were subject to interest rate risk amounted to Rs. 5,521.523 million (2008: Rs 5,220.832 million)." Investments and other assets amounting to **Rs 2,411.238 million** (2008: Rs 2,013.367 million) respectively are guaranteed by the Government of Pakistan. An Assets Liability Committee of the Bank meets periodically and ensures that the investments are made in an appropriate manner to mitigate any interest rate and liquidity risk.

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41.3 Liquidity Risk

Liquidity risk reflects an enterprise's inability in raising funds to meet commitments. In order to avoid liquidity risk, the Bank has a policy to maintain sufficient liquidity. To closely watch liquidity position, the Assets Liability Committee meets periodically to ensure that adequate liquidity is maintained to meet any future financial obligation.

41.3.1 Maturities of Assets and Liabilities

	2009									
	Total	Upto 1 Month	Over 1 to 3 Months	Over 3 to 6 Months	Over 6 Months to 1 Year	Over 1 to 2 Years	Over 2 to 3 Years	Over 3 to 5 Years	Over 5 to 10 Years	Above 10 Years
Rupees in '000										
Assets										
Cash and balances with treasury banks	213,778	213,778	-	-	-	-	-	-	-	-
Balances with other banks	57,296	57,296	-	-	-	-	-	-	-	-
Lending to financial institutions	33,445	33,445	-	-	-	-	-	-	-	-
Investments	2,939,132	179,422	439,173	159,286	16,667	684,986	1,066,600	392,998	-	-
Advances	2,500,916	718,699	511,137	439,080	269,324	204,167	143,196	109,031	78,167	28,115
Operating fixed assets	108,418	1	173	186	1,282	6,973	11,402	6,214	5,552	76,635
Deferred tax assets	-	-	-	-	-	-	-	-	-	-
Other assets	446,244	137,599	102,572	2,808	5,541	8,588	801	6,271	-	182,064
	6,299,229	1,340,240	1,053,055	601,360	292,814	904,714	1,221,999	514,514	83,719	286,814
Liabilities										
Bills payable	54,542	54,542	-	-	-	-	-	-	-	-
Borrowings	1,371,750	492,099	879,651	-	-	-	-	-	-	-
Large time deposits (over 5 million rupees)	867,187	137,700	272,505	316,275	125,407	15,300	-	-	-	-
Deposits and other accounts	1,335,965	1,237,481	26,197	17,181	32,793	19,505	2,808	-	-	-
Sub-ordinated loans	-	-	-	-	-	-	-	-	-	-
Liabilities against assets subject to finance lease	12,087	180	366	566	2,763	7,366	846	-	-	-
Deferred tax liabilities	-	-	-	-	-	-	-	-	-	-
Other liabilities	436,957	293,136	-	64,553	-	-	-	-	-	79,268
	4,078,488	2,215,138	1,178,719	398,575	160,963	42,171	3,654	-	-	79,268
Net assets	2,220,741	(874,898)	(125,664)	202,785	131,851	862,543	1,218,345	514,514	83,719	207,546
Share capital	2,392,507									
Reserves	206,526									
Unappropriated profit	(206,848)									
Deficit on revaluation of assets	(171,444)									
	2,220,741									

41.4 Operational Risk

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and system or from external events.

Operational risks are managed through Bank-wide or line of business specific policies and procedures, controls and monitoring tools. Examples of these include personnel management practices, data reconciliation processes, fraud management units, transaction processing monitoring and analysis and business continuity planning.

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42. OFF BALANCE SHEET ITEMS

42.1 Equity participation funds

GoP provided funds aggregating Rs 173.621 million to defunct RDFC in prior years for investing in the shares of private limited companies in public sector of NWFP, Baluchistan and Azad Jammu and Kashmir. This off balance sheet activity is dealt through three equity participation funds for investment in NWFP, Baluchistan and Azad Jammu and Kashmir respectively. Profit earned on these funds upto December 31, 2009 was Rs. 111.00 million (2008: Rs 96.563 million). Aggregate amount of Rs. 13.553 million (2008: Rs. 15.974 million) has been invested in shares of private limited companies and Rs. 266.879 million (2008: Rs. 239.765 million) has been retained by the Bank as deposits on which return is paid to the funds. Other net assets of the funds at December 31, 2009 amounts to Rs. 5.764 million (2008: Rs. 14.445 million). Balances and transactions of these funds are not part of the financial statements of the Bank. Ministry of Finance, Government of Pakistan has requested for repayment of the balance amount.

42.2 Cash management scheme

Cash Management Scheme (CMS) was the activity of defunct Regional Development Finance Corporation (RDFC). As a result of amalgamation of defunct RDFC, SME Bank Limited assumed the responsibilities of maintaining the books of accounts of CMS and also to phase it out over the period. Balances and transactions of the fund are not part of the financial statements of the Bank. The outstanding balance due to the customers under this scheme as on December 31, 2009 was Rs 99.99 thousand (2008: Rs 99.99 thousand).

43. CORRESPONDING FIGURES

Corresponding information has been re-arranged or additionally incorporated in these financial statements, wherever necessary to facilitate comparison and to conform with changes in presentation in the current year.

44. DATE OF AUTHORIZATION

These financial statements were authorized for issue by the Board of Directors of the Bank on _____, 2010.

45. Figures have been rounded to the nearest thousand rupees unless otherwise stated.

CFO & Company Secretary

President/ Chief Executive

Director

Director

Director

		Bashir Ahmed 212-47-097089	Ghulam Muhammad								
12	Muhammad Rafique Ayub Road,Salamat Pura Lahore	Muhammad Rafique 270-62-188216	Muhammad Sharif	500,000	106,506	-	606,506	500,000	106,506	-	606,506
13	Mohd Azhar Hussain Ghori Shamnagar Chuburji Park Lahore	Muhammad Azhar Hussain 272-62-130999	Muhammad Nazir Hussain	500,000	128,827	-	628,827	500,000	106,647	-	606,647
14	Mohd Jahangir Fateh Sher Road New Mozang,Lahore	Mohd Jahangir 274-91-037217	Haji Muhammad Bashir	483,555	261,752	-	745,307	483,555	123,052	-	606,607
15	Karamat Ali Guldast Town,Harbanspura,Barki Road Lahore	Karamat Ali 268-93-032997 Mohd Younas 353-88-260303 Shaukat Ali 277-89-310794 Abdur Rauf 277-91-049775	Muhammad Tufail Mohd Ali Mohd Anwar Muhammad Sadiq	600,000	291,409	-	891,409	543,709	-	-	543,709
16	M. Fayyaz Ashraf H#2,St-8,Ghaznawi Street Salamat Pura,Lahore	M. Fayyaz Ashraf 272-93-428146	Muhammad Ashraf	500,000	234,200	-	734,200	500,000	47,585	-	547,585
17	Saleemuddin (Oscar Garments) House 55, Sector-H, 100 Quarter, Korangi, Karachi	Saleemuddin 521-90-109044	Islamuddin	954,606	270,214	5,000	1,229,820	737,410	-	-	737,410
18	M.Saleem House No. 136, Block No. 2, Chichawatni	M. Saleem 335-88-103446	Faqir Muhammad	1,059,093	-	-	1,059,093	1,070,061	-	-	1,070,061
19	Amir Nawab Palai Malakand Agency	Amir Nawab 117-40-124545	Kabalai	780,580	287,839	-	1,068,419	752,198	-	-	752,198
20	Shabbir Ahmad H#O-27, Kohati Bazar, Rawalpindi	Shabbir Ahmad 211-87-226149	Muhammad Ilyas	525,000	207,353	-	732,353	525,000	43,353	-	568,353
				51,964,463	127,181,360	277,313	179,423,136	7,776,144	122,092,902	272,313	130,141,359