

A.F.FERGUSON & CO.

CHARTERED ACCOUNTANTS
KARACHI-LAHORE-ISLAMABAD

AUDITORS' REPORT TO THE MEMBERS

We have audited the annexed balance sheet of SME Bank Limited (the Bank) as at December 31, 2006 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, in which are incorporated the unaudited certified returns from the branches and other offices except for 11 branches and 1 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 amounts and disclosures in the financial statements. An audit also includes assessing 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 the case of loans and advances covered more than sixty per cent 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 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, 2006 and its true balance of the profit, changes in equity and its 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.

We draw attention to contents of note 6 to the financial statements on financial restructuring of the Bank and our opinion is not qualified in this respect.

Chartered Accountants

Islamabad

SME BANK LIMITED
BALANCE SHEET AS AT DECEMBER 31, 2006

	Note	2006	2005
Rupees in '000			
ASSETS			
Cash and balances with treasury banks	7	311,954	188,460
Balances with other banks	8	125,704	112,047
Lendings to financial institutions	9	292,454	-
Investments	10	5,584,582	4,807,743
Advances	11	1,731,271	1,184,844
Operating fixed assets	12	156,384	160,438
Deferred tax assets	13	447,794	439,338
Other assets	14	974,735	967,207
		<u>9,624,878</u>	<u>7,860,077</u>
LIABILITIES			
Bills payable	15	18,090	6,271
Borrowings	16	2,600,000	1,530,000
Deposits and other accounts	17	1,666,360	1,022,702
Sub-ordinated loans		-	-
Loan from the State Bank of Pakistan	18	2,430,000	2,500,000
Liabilities against assets subject to finance lease	19	19,697	21,684
Deferred tax liabilities		-	-
Other liabilities	20	602,819	617,097
		<u>7,336,966</u>	<u>5,697,754</u>
NET ASSETS		<u><u>2,287,912</u></u>	<u><u>2,162,323</u></u>
REPRESENTED BY			
Share capital	21	2,000,000	1,500,000
Reserves		177,275	146,638
Unappropriated profit		209,096	586,546
		<u>2,386,371</u>	<u>2,233,184</u>
Deficit on revaluation of assets - net of tax	22	<u>(98,459)</u>	<u>(70,861)</u>
		<u><u>2,287,912</u></u>	<u><u>2,162,323</u></u>
CONTINGENCIES AND COMMITMENTS	23		

The annexed notes 1 to 42 form an integral part of these financial statements.

President/ Chief Executive

Director

Director

Director

SME BANK LIMITED
PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED DECEMBER 31, 2006

	Note	2006	2005
		Rupees in '000	
Mark-up / return / interest earned	24	960,293	844,666
Mark-up / return / interest expensed	25	<u>454,062</u>	<u>337,437</u>
Net mark-up/ interest income		506,231	507,229
Reversal of provision against non-performing loans and (Reversal)/ provision for impairment in the value of investments	11.4	<u>(217,499)</u>	<u>(311,863)</u>
Bad debts written off directly	10.4	(16,415)	5,690
	11.5	<u>1,245</u>	<u>-</u>
		<u>(232,669)</u>	<u>(306,173)</u>
Net mark-up / interest income after provisions		738,900	813,402
NON MARK-UP/ INTEREST INCOME			
Fee, commission and brokerage income		2,591	690
Dividend income		1,173	341
Income from dealing in foreign currencies		-	-
Gain on sale of securities		-	40
Unrealized gain/ (loss) on revaluation of investments classified as held for trading		-	-
Other income	26	<u>23,046</u>	<u>26,518</u>
Total non-markup/ interest income		<u>26,810</u>	<u>27,589</u>
		765,710	840,991
NON MARK-UP/ INTEREST EXPENSES			
Administrative expenses	27	<u>553,867</u>	<u>507,715</u>
Other provisions/ write offs	14.2	<u>(20,000)</u>	<u>(36,645)</u>
Other charges	28	<u>158</u>	<u>809</u>
Total non-markup/ interest expenses		<u>534,025</u>	<u>471,879</u>
		231,685	369,112
Extra ordinary/ unusual items		-	-
PROFIT BEFORE TAXATION		231,685	369,112
Taxation - current	29	<u>72,034</u>	<u>144,817</u>
- prior years	29	-	23,886
- deferred	29	<u>6,464</u>	<u>(5,800)</u>
		<u>78,498</u>	<u>162,903</u>
PROFIT AFTER TAXATION		153,187	206,209
Unappropriated profit brought forward		586,546	421,579
Profit available for appropriation		<u>739,733</u>	<u>627,788</u>
Basic/ diluted earnings per share - Rupees	30	<u>0.77</u>	<u>1.18</u>

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President/ Chief Executive

Director

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SME BANK LIMITED
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2006

	Share capital	Statutory reserve	Unappropriated profit	Total
	Rupees in '000			
Balance as at January 1, 2005	1,100,000	105,396	421,579	1,626,975
Net profit for the year	-	-	206,209	206,209
Transfer to statutory reserve	-	41,242	(41,242)	-
Issue of share capital	400,000	-	-	400,000
Balance as at December 31, 2005	<u>1,500,000</u>	<u>146,638</u>	<u>586,546</u>	<u>2,233,184</u>
Net profit for the year	-	-	153,187	153,187
Transfer to statutory reserve	-	30,637	(30,637)	-
Issue of share capital	500,000	-	(500,000)	-
Balance as at December 31, 2006	<u><u>2,000,000</u></u>	<u><u>177,275</u></u>	<u><u>209,096</u></u>	<u><u>2,386,371</u></u>

The annexed notes 1 to 42 form an integral part of these financial statements.

President/ Chief Executive

Director

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SME BANK LIMITED
CASH FLOW STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2006

	Note	2006	2005
		Rupees in '000	
CASH FLOW FROM OPERATING ACTIVITIES			
Profit before taxation		231,685	369,112
Less: Dividend income		(1,173)	(341)
		<u>230,512</u>	<u>368,771</u>
Adjustments:			
Depreciation		30,153	25,208
Amortization		3,034	2,261
Provision against non-performing advances		(217,499)	(311,863)
Provision for impairment in the value of investments/ other assets		(36,415)	(30,955)
Net profit on sale of property and equipment		(11,956)	(4,169)
Finance charges on leased assets		743	833
Bad debts written off directly		1,245	-
		<u>(230,695)</u>	<u>(318,685)</u>
		(183)	50,086
(Increase)/ decrease in operating assets			
Lendings to financial institutions		(92,454)	-
Advances		(330,173)	263,409
Others assets		14,896	992,552
		<u>(407,731)</u>	<u>1,255,961</u>
Increase/ (decrease) in operating liabilities			
Bills payable		11,819	6,271
Borrowings from financial institutions		1,070,000	(150,000)
Deposits		643,658	818,926
Other liabilities (excluding current taxation)		31,058	51,648
		<u>1,756,535</u>	<u>726,845</u>
		1,348,621	2,032,892
Income tax paid		<u>(117,370)</u>	<u>(313,641)</u>
Net cash flow from operating activities		<u>1,231,251</u>	<u>1,719,251</u>
CASH FLOW FROM INVESTING ACTIVITIES			
Net investments in available-for-sale securities		(75,306)	(122,431)
Net investments in held-to-maturity securities		(712,179)	(558,323)
Investment in subsidiary		(15,457)	-
Dividend income		1,173	341
Investments in operating fixed assets		(29,533)	(51,410)
Sale proceeds of property and equipment disposed-off		18,007	7,490
Net cash flow from investing activities		<u>(813,295)</u>	<u>(724,333)</u>
CASH FLOW FROM FINANCING ACTIVITIES			
Payment of loan from the State Bank of Pakistan		(70,000)	(1,500,000)
Payments of lease obligations		(10,805)	(21,142)
Issue of share capital		-	400,000
Net cash flow from financing activities		<u>(80,805)</u>	<u>(1,121,142)</u>
Increase/ (decrease) in cash and cash equivalents		337,151	(126,224)
Cash and cash equivalents at beginning of the year	31	<u>300,507</u>	<u>426,731</u>
Cash and cash equivalents at end of the year	31	<u><u>637,658</u></u>	<u><u>300,507</u></u>

The annexed notes 1 to 42 form an integral part of these financial statements.

President/ Chief Executive

Director

Director

Director

SME BANK LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

1. STATUS AND NATURE OF BUSINESS

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 in Islamabad.

The Bank obtained its business commencement certificate on April 16, 2005 which became effective from the date of its issue. The Bank is engaged in the business of banking with the primary objective to support and develop 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 27 branches including 13 Commercial banking branches. Based on the latest credit rating report dated March 10, 2005 issued by JCR-VIS Credit Rating Company Limited, credit rating of the Bank was BBB (triple B) in the long term and A - 2 (A two) in the short term.

1.2 In terms of the provisions of the State Bank of Pakistan BSD Circular No. 6 of 2005, the Bank was required to increase its paid-up capital (net of losses) as at December 31, 2006 from Rs 2 billion to Rs 3 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.

1.3 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 value of net assets 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 SBP 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 SBP.

In accordance with the directives of the Federal Government regarding shifting of the banking system to Islamic modes, SBP has issued a number of circulars. One permissible form of trade related mode of financing comprises of purchase of goods by the Bank from its customers and resale to them at appropriate mark-up price on a 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 facilities actually utilised and the appropriate portion of mark-up thereon.

3. STATEMENT OF COMPLIANCE

3.1 These financial statements are 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 the Securities and Exchange Commission of Pakistan (SECP) and SBP. Approved accounting standards comprise of such International Accounting Standards and International Financial Reporting 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 In terms of provisions of BSD Circular Letter No 10 dated August 26, 2002, SBP has deferred applicability of International Accounting Standards on Financial Instruments: Recognition and Measurement (IAS 39) and Investment Property (IAS 40) for Banking Companies in Pakistan till further instructions. Accordingly, requirements of these standards have not been considered in the preparation of these financial statements. However, investments have been presented in accordance with the requirements of the format prescribed by SBP's BSD Circular No. 4 dated February 17, 2006 and have been classified in accordance with the requirements prescribed by SBP through various circulars.

3.3 Amendments to published standards and new standards

Amendments effective in 2006

IAS 19 (Amendment) - 'Employee Benefits', is mandatory for the Bank and is effective from accounting period beginning January 1, 2006. It introduces the options of an alternative recognition approach for actuarial gains and losses. It also adds new disclosure requirements. The Bank does not intend to adopt the alternative approach for recognition of actuarial gains and losses. Adoption of this amendment only impacts the format and extent of disclosures as presented in note 33.1 to the financial statements.

Amendment not yet effective

The published amendment to existing International Accounting Standard on Presentation of Financial Statements (IAS 1) related to Capital Disclosures are not yet effective and are mandatory for the Bank's accounting periods beginning on or after January 1, 2007 or later periods. However, effect of adoption of the above amendments on future financial statements is not likely to be material.

Standards not yet effective and irrelevant

Certain new standards and interpretations have been published that are effective on or after January 1, 2007, but are considered not to be relevant since those are not approved accounting standards/ interpretations.

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.

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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 amortised cost in accordance with the requirement of SBP's 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 categories.

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.

Investment in subsidiary is carried at cost.

Gain/ loss on sale of investments is included in income currently.

5.3 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. In addition to this all advances outstanding for more than one year are fully provided for in accordance with the requirements of the loan agreement for SME Sector Development Programme between GOP and Asian Development Bank.

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

5.4 Operating fixed assets and depreciation

Capital work-in-progress is stated at cost.

Property and equipment

Property and equipment 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 the asset is disposed off. Gains or losses on disposal of property and equipment are taken to the profit and loss account.

Maintenance and normal repairs are charged to income as and when incurred. Major renewals and improvements are capitalised.

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 and basis applicable 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.

5.5 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, which is adjusted against the related revaluation surplus to the extent that the impairment loss does not exceed the surplus on revaluation of those assets.

5.6 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.

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).

5.7 Staff retirement and other benefits

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

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) are 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. During the year, the Bank changed the method of recognition of liability for gratuity scheme and the obligation under the defined benefit unfunded gratuity scheme is now 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. Previously, annual provision for liabilities towards gratuity scheme was made on the basis of last drawn basic salary.

Provident fund

Non-contributory scheme for permanent employees. Monthly contributions are made by employees only, at the rate of 8% of basic salary.

Benevolent fund

Defined benefit 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.

5.8 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.

5.9 Revenue recognition

Income on non interest based loans, except loans disbursed by defunct SBFC, is accounted for on accrual basis on principal outstanding amounts giving consideration to total mark-up price, and suspended, in compliance with requirements of prudential regulations of SBP. Income on loans disbursed by defunct SBFC is suspended when accrued and recognised as income on cash basis owing to the nature and status of the portfolio.

Income on interest based loans, except loans disbursed by defunct SBFC, is accounted for on accrual basis on principal outstanding amounts and suspended, in compliance with requirements of prudential regulations of SBP. Income on loans disbursed by defunct SBFC is suspended and recognised on cash basis owing to the nature and status of the portfolio.

Dividend income on investment is accounted for on declaration of dividend 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.) 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 Use of critical accounting estimates and judgments

The preparation of financial statements in conformity with approved accounting standards 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:

- 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 29)
- v) staff retirement benefits (note 33)

5.11 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.

5.12 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.

5.13 Borrowing costs

All borrowing costs are recognized as expense in the period in which these are incurred.

5.14 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 and are netted off from the related expense.

5.15 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.

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 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 4,963 million has been paid to SBP upto December 31, 2006 against outstanding credit lines. Subsequent to the year end, GOP and the Bank have respectively paid Rs 1,128.654 million and Rs 600 million to SBP against the Bank's loan balance due to
- iii) paid-up capital has been increased to Rs. 2,000 million by issue of 73,502,453 and 40,000,000 additional shares of Rs 10 each to GOP without right issue in 2004 and 2005 respectively and issue of 50,000,000 bonus shares of Rs 10 each in 2006. 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;
- v) number of recovery branches was reduced to 14 by December 31, 2006;
- vi) 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. Aggregate related cost for 707 employees relieved under the scheme upto December 31, 2006 was Rs 1,764.268 million. Upto December 31, 2006, Rs 1,028.121 million has been received from GOP, while balance of Rs 736.147 million reflected in the financial statements as reimbursable by GOP under other assets was received subsequent to the year end in February 2007;
- vii) human resource technical audit was completed and report was submitted to the Bank in 2004;
- viii) banking license was issued by SBP on September 13, 2004 and the Bank started banking operations after the issue of certificate for commencement of banking business by SBP on April 16, 2005; and
- ix) Privatisation Commission (PC) has constituted a transaction committee which is represented by members from the PC, SBP, MOF and the Bank. Necessary formalities have been initiated by the PC on February 12, 2007, with respect to appointment of a financial advisor for the privatisation of the Bank.

7. CASH AND BALANCES WITH TREASURY BANKS

		2006	2005
		Rupees in '000	
In hand - local currency		59,108	28,830
In transit - local currency		4,159	7,276
National prize bonds		7	301
With the State Bank of Pakistan in			
Local currency current accounts	7.1	248,451	151,869
With National Bank of Pakistan in			
Local currency deposit account		229	184
		<u>311,954</u>	<u>188,460</u>

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

		2006	2005
		Rupees in '000	
8. BALANCES WITH OTHER BANKS			
In Pakistan			
On deposit accounts	8.1	135,704	122,047
Provision for doubtful balance with a bank	8.2	(10,000)	(10,000)
		<u>125,704</u>	<u>112,047</u>

8.1 These carry interest rate ranging from 1.50% to 5.00% (2005: 1.00% to 5.50%) 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.

		2006	2005
		Rupees in '000	
9. LENDINGS TO FINANCIAL INSTITUTIONS			
Call money lendings	9.3	200,000	-
Repurchase agreement lendings (reverse repo)	9.4	92,454	-
		<u>292,454</u>	<u>-</u>

9.1 Particulars of lendings

In local currency		292,454	-
In foreign currencies		-	-
		<u>292,454</u>	<u>-</u>

9.2 Securities held as collateral against lendings to financial institutions

	2006			2005		
	Held by the Bank	Further given as collateral	Total	Held by the Bank	Further given as collateral	Total
	Rupees in '000					
Market Treasury Bill	92,454	-	92,454	-	-	-
	<u>92,454</u>	<u>-</u>	<u>92,454</u>	<u>-</u>	<u>-</u>	<u>-</u>

9.3 This represents unsecured lending with a bank in the inter-bank money market at mark-up rate of 11.75% (2005: nil) per annum for six days.

9.4 This represents transaction with a bank for purchase of treasury bill under resale obligation (reverse repo) in the inter-bank money market at mark-up rate of 8.35% (2005: nil) per annum for thirty three days (2005: nil). This lending is secured against underlying treasury bill. The difference between purchase and resale price is treated as mark-up income and recognised over the period of reverse repo agreement.

10. INVESTMENTS	2006			2005		
	Held by the Bank	Given as collateral	Total	Held by the Bank	Given as collateral	Total
	Rupees in '000					
10.1 INVESTMENTS BY TYPES:						
Available-for-sale securities						
Market Treasury Bill	191,225	-	191,225	96,198	-	96,198
Pakistan Investment Bonds	666,069	2,852,792	3,518,861	1,912,689	1,737,297	3,649,986
WAPDA Bonds	35,000	-	35,000	35,000	-	35,000
Fully paid up ordinary shares/ units	178,192	-	178,192	33,754	-	33,754
Term Finance Certificates (TFCs)	193,502	-	193,502	226,536	-	226,536
Stock exchange membership	18,000	-	18,000	18,000	-	18,000
	<u>1,281,988</u>	<u>2,852,792</u>	<u>4,134,780</u>	<u>2,322,177</u>	<u>1,737,297</u>	<u>4,059,474</u>
Held-to-maturity securities						
Letter of placements	500,410	-	500,410	45,012	-	45,012
Certificates of investment	308,282	-	308,282	284,481	-	284,481
Term deposit receipts	600,652	-	600,652	367,672	-	367,672
	<u>1,409,344</u>	<u>-</u>	<u>1,409,344</u>	<u>697,165</u>	<u>-</u>	<u>697,165</u>
Investment in subsidiary						
SME Leasing Limited	215,457	-	215,457	200,000	-	200,000
	<u>2,906,789</u>	<u>2,852,792</u>	<u>5,759,581</u>	<u>3,219,342</u>	<u>1,737,297</u>	<u>4,956,639</u>
Investments at cost						
Provision for impairment in value of investments	10.4 (23,125)	-	(23,125)	(39,540)	-	(39,540)
	<u>2,883,664</u>	<u>2,852,792</u>	<u>5,736,456</u>	<u>3,179,802</u>	<u>1,737,297</u>	<u>4,917,099</u>
Investments (net of provisions)						
Surplus/ (deficit) on revaluation of Available-for-sale securities	22 3,033	(154,907)	(151,874)	45,220	(154,576)	(109,356)
	<u>2,886,697</u>	<u>2,697,885</u>	<u>5,584,582</u>	<u>3,225,022</u>	<u>1,582,721</u>	<u>4,807,743</u>
Total investments at market value						

10.2 INVESTMENTS BY SEGMENTS:	Note	2006 Rupees in '000	2005
Federal Government Securities:	10.3		
- Market Treasury Bill		191,225	96,198
- Pakistan Investment Bonds		<u>3,518,861</u>	<u>3,649,986</u>
		3,710,086	3,746,184
Fully paid up ordinary shares:			
- Listed companies/mutual funds	10.6	<u>157,189</u>	<u>12,751</u>
- Unlisted companies/mutual funds	10.7	<u>21,003</u>	<u>21,003</u>
		178,192	33,754
Term Finance Certificates, Debentures, Bonds and Participation Term Certificates:	10.8		
- Listed TFCs		<u>193,502</u>	<u>226,536</u>
- WAPDA Bonds		<u>35,000</u>	<u>35,000</u>
		228,502	261,536
Subsidiary company			
SME Leasing Limited	10.9	215,457	200,000
Other investments			
- Letter of placements		<u>500,410</u>	<u>45,012</u>
- Certificates of investment		<u>308,282</u>	<u>284,481</u>
- Term deposit receipts		<u>600,652</u>	<u>367,672</u>
- Islamabad Stock Exchange membership		<u>18,000</u>	<u>18,000</u>
		1,427,344	715,165
Total investment at cost		<u>5,759,581</u>	<u>4,956,639</u>
Less: Provision for impairment in value of investments	10.4	(23,125)	(39,540)
Investment (net of provision)		<u>5,736,456</u>	<u>4,917,099</u>
Less: Deficit on revaluation of Available-for-sale securities - net		(151,874)	(109,356)
Total investment at market value		<u><u>5,584,582</u></u>	<u><u>4,807,743</u></u>

10.3 Principal terms of investments in Federal Government securities

Name of investment	Maturity	Principal payment	Rate	Coupon payment
Market Treasury Bill	July 2007	On maturity	8.77%	at maturity
Pakistan Investment Bonds	January 2007 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.

	2006	2005
	Rupees in '000	
10.4 Particulars of provision for impairment in value of investments		
Opening balance	39,540	141,758
Charge for the year	-	5,775
Reversal for the year	(16,415)	(85)
Transfer to provision against other assets	-	(107,908)
Closing balance	<u>23,125</u>	<u>39,540</u>
10.4.1 Particulars of provision in respect of type and segment		
Available-for-sale securities		
- Fully paid up ordinary shares		
- unlisted companies	1,003	6,778
Held-to-maturity securities		
- Other investments		
- Certificates of investment	22,122	32,762
	<u>23,125</u>	<u>39,540</u>

	2006		2005	
	Market value Rupees '000	Rating	Market value Rupees '000	Rating
10.5 Quality of Available-for-sale securities				
Market Treasury Bill - note 10.5.1	190,764	unrated	96,232	unrated
Pakistan Investment Bonds - note 10.5.1	3,366,008	unrated	3,539,266	unrated
WAPDA Bonds	35,700	unrated	35,700	unrated
Fully paid up ordinary shares - note 10.5.2				
National Refinery Limited	3,238	AAA (L)	4,522	AAA (L)
PICIC Investment Fund Limited	1,996	3 - Star	2,505	unrated
Hub Power Company Limited	2,889	unrated	2,568	unrated
Pakistan PTA Limited	391	unrated	642	unrated
Dewan Salman Fibre Limited	141	unrated	695	unrated
Pakistan Telecommunication Company Limited	381	unrated	562	unrated
D.G. Khan Cement Company Limited	325	unrated	440	unrated
Faisal Spinning Mills Limited	156	unrated	320	unrated
Treet Corporation Pakistan Limited	98	unrated	132	unrated
Askari Income Fund	96,797	unrated	-	
NAFA Cash Fund	50,690	A (f)	-	
Nishat Mills Limited	11	A+ (L)	24	A+ (L)
Crescent Textile Mills Limited	1	unrated	17	unrated
Services Industries Limited	2	unrated	2	unrated
Adamjee Insurance Company Limited	-		93	AA (M2L)
Kashmir Polytex Limited	-		28	unrated
Pioneer Cement Limited	-		12	unrated
Gandhara Nissan Limited	-		9	unrated
Maple Leaf Cement Factory Limited	-		4	unrated
First Allied Bank Modaraba Limited	-		3	unrated
PICIC Commercial Bank Limited	-		2	A+ (M2L)
Cherat Papersack Limited	-		1	unrated
First Capital Securities Corporation Limited	-		1	unrated
Pakistan Oilfields Limited	-		1	unrated
ABAMCO Stock Market Fund Limited	-		1	A+ (L)
TMT-PKIC Incubation Fund	20,000	unrated	14,225	unrated
	177,116		26,809	
Term Finance Certificates				
Jahangir Siddiqui and Company Limited	33,710	AA+ (L)	44,955	AA+ (L)
First Dawood Investment Bank Ltd (formerly Dawood Leasing Company Ltd)	38,480	AA- (L)	38,480	AA- (L)
Bank Alfalah Limited	36,122	AA- (L)	36,136	AA- (L)
Trust Leasing and Investment Bank Limited	17,787	AA (L)	22,375	AA (L)
Crescent Leasing Corporation Limited	20,300	A- (M2L)	20,300	AA- (M2L)
Chanda Oil and Gas Securitisation Company Limited	8,550	A (L)	9,417	A (L)
World Call Communication Limited	4,370	AA- (L)	8,739	AA- (L)
Pakistan Mobile Communications Limited	19,996	AA- (L)	-	
Financial Receivables Securitisation Company Limited	15,000	AA- (L)	-	
Orix Leasing Pakistan Limited	-		41,000	AA+
First Oil & Gas Securitisation Company Limited	-		3,421	A (M2L)
Securetel SPV Limited (Paktel SPV)	-		2,510	A
	194,315		227,333	
Stock Exchange membership	18,000	unrated	18,000	unrated
	<u>3,981,903</u>		<u>3,943,340</u>	

10.5.1 These are Government of Pakistan guaranteed securities.

10.5.2 Rating of these equity securities represent 'Entity 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

2006	2005	Paid-up value per share / average price per unit Rs	Name of companies/ mutual funds	2006 Rupees in '000	2005
12,500	12,500	425.00	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	43,449	18.24	Dewan Salman Fibre Limited	337	792
8,600	8,600	68.20	Pakistan Telecommunication Company Limited	586	586
5,157	4,126	54.31	D.G. Khan Cement Company Limited	280	244
4,000	4,000	40.41	Faisal Spinning Mills Limited	162	162
500	500	295.00	Treet Corporation Pakistan Limited	147	147
910,946	-	104.29	Askari Income Fund	95,000	-
4,816,909	-	10.38	NAFA Cash Fund	50,000	-
290	290	102.87	Nishat Mills Limited	30	30
17	516	36.88	Crescent Textile Mills Limited	1	20
72	72	25.30	Services Industries Limited	2	2
-	683	115.00	Adamjee Insurance Company Limited	-	79
-	9,500	1.85	Kashmir Polytex Limited	-	18
-	225	37.29	Pioneer Cement Limited	-	8
-	252	32.75	Gandhara Nissan Limited	-	8
-	100	34.18	Maple Leaf Cement Factory Limited	-	3
-	166	13.90	First Allied Bank Modaraba Limited	-	2
-	56	40.46	PICIC Commercial Bank Limited	-	2
-	20	62.05	Cherat Papersack Limited	-	1
-	3	15.55	First Capital Securities Corporation Limited	-	1
-	1	415.00	Pakistan Oilfields Limited	-	1
-	24	11.15	ABAMCO Stock Market Fund Limited	-	1
				157,189	12,751
				(73)	(166)
				157,116	12,585

Deficit on revaluation of shares / units - (net)

Market value as on December 31

		2006	2005
		Rupees in '000	
10.7	Particulars of investments held in unlisted companies and mutual funds		
	TMT-PKIC Incubation Fund Limited	20,000	20,000
	Companies delisted from stock exchange	1,003	1,003
		<u>21,003</u>	<u>21,003</u>

	Percentage of holding	Number of units held	Cost / Paid-up value per unit held (Rupees)	Total Paid-up Value (Rupees in '000)	Break up Value	Based on accounts audited as at	Name of Chief Executive	
10.7.1	TMT-PKIC Incubation Fund Limited	8%	2,000,000	10.00	20,000	20,262	June 30, 2006	Kashif Shamim

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

	Number of shares held	Cost / Paid-up value per share held (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 Listed Term Finance Certificates/ Bonds

No. of certificates		Company's name	Nominal value per certificate Rupees	2006	2005
2006	2005			Rupees in '000	
9,000	9,000	Jahangir Siddiqui & Company Limited	3,750	33,747	45,054
7,400	7,400	Dawood Investment Bank Ltd (formerly Dawood Leasing Company Ltd)	5,000	37,000	37,636
7,200	7,200	Bank Alfalah Limited	5,136	36,979	37,253
5,000	5,000	Trust Leasing and Investment Bank Limited	3,563	17,816	22,445
4,000	4,000	Crescent Leasing Corporation Limited	5,000	20,000	20,000
2,000	2,000	Chanda Oil & Gas Securitisation Company Limited	4,340	8,680	9,560
3,000	3,000	World Call Communication Limited	1,428	4,284	8,688
4,000	-	Pakistan Mobile Communications Limited	4,999	19,996	-
5,000	-	Financial Receivables Securitisation Company Limited	3,000	15,000	-
-	8,000	Orix Leasing Pakistan Limited	-	-	40,000
-	2,000	First Oil & Gas Securitisation Company Limited	-	-	3,424
-	5,953	Securetel SPV Limited (Paktel SPV)	-	-	2,476
				193,502	226,536
7,000	7,000	WAPDA Bonds	5,000	35,000	35,000
Surplus on revaluation of TFCs/ Bonds				1,513	1,497
Market value as on December 31				230,015	263,033

10.8.1 These carry rate of return ranging from 9.25% to 13.22% (2005: 7.5% to 16%) per annum and having maturity periods of upto 7 years (2005: 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 previous year, SMEL was a wholly owned subsidiary of the Bank, however, a public offering of 10 million ordinary shares was made during the year at an offer price of Rs 11 per share. The Bank subscribed for 1,405,205 shares in SMEL and holds 73% shares in SMEL as at December 31, 2006. SMEL is listed on Lahore Stock Exchange. Value of investment in SMEL based on market value as at December 31, 2006 was Rs 252,776 thousand. This investment is designated as a 'Strategic Investment' in terms of BPD Circular Letter No. 16 dated August 1, 2006.

11. ADVANCES		2006
		Rupees i
Loans, cash credits, running finances, etc. - In Pakistan		
Extended by:		
Defunct SBFC		5,143,763
Defunct RDFC		792,928
SME Bank Limited		1,537,499
Due from ex-employees		25,013
Due from employees		308,513
		<u>7,807,716</u>
Net investment in finance lease - In Pakistan	11.2	1,253
Advances - gross		<u>7,808,969</u>
Provision for non-performing advances	11.4	<u>6,077,698</u>
Advances - net of provision		<u><u>1,731,271</u></u>
11.1 Particulars of advances		
11.1.1 In local currency		
In foreign currencies		
		7,808,969
		-
		<u>7,808,969</u>
11.1.2 Short term (for upto one year)		
Long term (for over one year)		
		782,593
		<u>7,026,376</u>
		<u><u>7,808,969</u></u>

11.2 Net investment in finance lease

	2006			Total	2005		
	Not later than one year	Later than one and less than five years	Over five years		Not later than one year	Later than one and less than five years	Over five years
	Rupees in '000						
Lease rentals receivable	973	-	-	973	1,751	-	-
Residual value	280	-	-	280	510	-	-
Minimum lease payments	1,253	-	-	1,253	2,261	-	-
Financial charges for future periods	-	-	-	-	(1)	-	-
Present value of minimum lease payments	1,253	-	-	1,253	2,260	-	-

11.3 Advances include Rs. 6,119,396 thousand (2005: Rs 6,798,211 thousand) which have been placed under non-performing status as detailed below:

Category of Classification	2006							
	Classified Advances			Provision Required			Provision Held	
	Domestic	Overseas	Total	Domestic	Overseas	Total	Domestic	Overseas
Substandard	32,877	-	32,877	8,219	-	8,219	8,219	-
Doubtful	34,081	-	34,081	17,041	-	17,041	17,041	-
Loss	6,052,438	-	6,052,438	6,052,438	-	6,052,438	6,052,438	-
	6,119,396	-	6,119,396	6,077,698	-	6,077,698	6,077,698	-

11.4 Particulars of provisions against non-performing advances

	2006			2005	
	Specific	General	Total	Specific	General
	Rupees in '000				
Opening balance	6,767,586	-	6,767,586	7,584,337	8,459
Charge for the year	32,089	-	32,089	10,868	-
Amounts written off	(472,389)	-	(472,389)	(513,347)	-
Reversals	(249,588)	-	(249,588)	(314,272)	(8,459)
Closing balance	6,077,698	-	6,077,698	6,767,586	-

11.4.1 Particulars of provisions against non-performing advances

	2006			2005	
	Specific	General	Total	Specific	General
	Rupees in '000				
In local currency	6,077,698	-	6,077,698	6,767,586	-
In foreign currencies	-	-	-	-	-
	6,077,698	-	6,077,698	6,767,586	-

11.5 Particulars of write-offs		2006	2005
		Rupees in '000	
11.5.1 Against provisions	11.4	472,389	513,347
Directly charged to Profit & Loss account		<u>1,245</u>	<u>-</u>
		<u>473,634</u>	<u>513,347</u>
11.5.2 Write Offs of Rs. 500,000 and above	11.6	105,435	85,390
Write Offs of Below Rs. 500,000		<u>368,199</u>	<u>427,957</u>
		<u>473,634</u>	<u>513,347</u>

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, 2006 is given at Annexure-1.

11.7 Particulars of loans and advances to directors, associated companies, etc.		2006	2005
		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 beginning of year		15,412	12,303
Loans granted during the year		19,186	5,482
Repayments		<u>(5,355)</u>	<u>(2,373)</u>
Balance at end of year		29,243	15,412
Debts due by subsidiary company			
Balance at beginning of year		125,184	90,943
Loans granted during the year		25,000	60,000
Repayments		<u>(54,778)</u>	<u>(25,759)</u>
Balance at end of year		95,406	125,184
		<u>124,649</u>	<u>140,596</u>

12. OPERATING FIXED ASSETS

Capital work-in-progress	12.1	4,290	9,742
Property and equipment	12.2	145,646	143,629
Intangible assets	12.3	<u>6,448</u>	<u>7,067</u>
		<u>156,384</u>	<u>160,438</u>

12.1 Capital work-in-progress

Advances to suppliers and contractors for

assets subject to finance lease		1,403	2,487
other assets		<u>2,887</u>	<u>7,255</u>
		<u>4,290</u>	<u>9,742</u>

12.2 Property and equipment

	COST			DEPRECIATION			Net book value at December 31, 2006	Annual rate of depreciation %	
	As at January 1, 2006	Transfer to owned assets/ (from leased assets)	Additions/ (deletions)	As at December 31, 2006	As at January 1, 2006	Transfer to owned assets/ (from leased assets)			Charge for the year/ (disposals)
Owned assets:									
Rupees in '000									
Free hold land	2,813	-	-	-	-	-	-	-	-
			(2,813)						
Lease hold land	60,450	-	-	60,450	-	-	-	60,450	-
Buildings on free hold land	2,485	-	-	-	497	-	-	-	5
			(2,485)				(497)		
Buildings on lease hold land	15,725	-	69	15,794	86	790	876	14,918	
Furniture and fixture	11,577	-	1,912	13,152	6,661	2,522	8,891	4,261	20
			(337)				(292)		
Office equipment	11,702	-	6,667	18,138	3,693	2,374	5,916	12,222	15
			(231)				(151)		
Computer equipment	50,185	-	12,512	62,583	35,429	9,266	44,589	17,994	33 1/3
			(114)				(106)		
Vehicles	39,025	6,987	264	39,235	26,429	3,610	8,626	32,360	20
			(7,041)				(6,305)		
Leasehold improvements	5,552	-	11,146	16,636	3,777	-	2,067	5,794	33 1/3
			(62)				(50)		
Library books	19	-	-	19	16	-	3	19	20
	199,533	6,987	32,570	226,007	76,588	3,610	25,648	98,445	
			(13,083)				(7,401)		
Assets held under finance lease:									
Vehicles	27,070	(6,987)	5,651	25,167	6,386	(3,610)	4,505	7,083	20
			(567)				(198)		
2006	226,603	-	38,221	251,174	82,974	-	30,153	105,528	145,646
			(13,650)				(7,599)		
2005	182,201	-	54,038	226,603	64,081	-	25,208	82,974	143,629
			(9,636)				(6,315)		

12.3 Intangible assets

	COST			AMORTISATION			Net book value at December 31, 2006	Annual rate of amortisation %	
	As at January 1, 2006	Additions	As at December 31, 2006	As at January 1, 2006	Amortisation	As at December 31, 2006			
Rupees in '000									
Computer software	2006	16,621	2,415	19,036	9,554	3,034	12,588	6,448	33 1/3
	2005	10,704	5,917	16,621	7,293	2,261	9,554	7,067	

12.4 Disposal of operating fixed assets

Particulars of assets	Cost	Accumulated depreciation	Book value	Sale proceeds	Mode of disposal	Particulars of buyers
Rupees in '000						
Land and buildings						
Land at Multan	1,913	-	1,913	2,900	Auction	Mr Amanullah Qureshi
Land and building at Abbottabad	2,056	231	1,825	3,500	-do-	Mr Haji Ishaq
Building at Karachi	1,329	266	1,063	5,100	-do-	Mr Abdul Rasheed
Vehicles						
Honda City	660	650	10	132	As per Bank policy	Mr Sardar Usman Rashid - Executive
Honda City	660	650	10	132	-do-	Mr Naseer Durrani - Executive
Honda City	660	616	44	132	-do-	Mr Amir Shamim - Ex-Executive
Suzuki Cultus	567	198	369	369	-do-	Mr Mahmood A. Nasir - Ex-Executive
Suzuki Baleno	482	386	96	193	-do-	Mr Raja M. Altaf - Executive
Suzuki Baleno	508	415	93	203	-do-	Mr Ali Akbar Chaudhry - Executive
	<u>8,835</u>	<u>3,412</u>	<u>5,423</u>	<u>12,661</u>		
Other assets having book value of less than Rs 250,000 or cost of less than Rs 1,000,000	4,815	4,187	628	5,346		
2006	<u>13,650</u>	<u>7,599</u>	<u>6,051</u>	<u>18,007</u>		
2005	<u>9,636</u>	<u>6,315</u>	<u>3,321</u>	<u>7,490</u>		

12.5 Carrying amount of temporary idle property and equipment still in use was Rs 60,450 thousand (2005: Rs 10,450 thousand).

12.6 Cost of fully depreciated assets still in use was Rs 58,540 thousand (2005: Rs 37,542 thousand)

	2006	2005
	Rupees in '000	
13. DEFERRED TAX ASSETS		
Deferred taxation is in respect of:		
Deficit on revaluation of investment	53,415	38,495
Provision for non-performing loans related to defunct SBFC as at December 31, 2001	382,149	382,149
Preliminary expenses charged off in prior years	-	145
Accelerated tax depreciation	(2,305)	(1,916)
Excess of accounting book value of leased assets over corresponding liabilities	73	(520)
Provision for doubtful investments/ receivables	14,462	20,985
	<u>447,794</u>	<u>439,338</u>

2006
2005
Rupees in '000

14. OTHER ASSETS

Income / mark-up accrued in local currency	14.1	174,418	153,412
Advances, deposits, advance rent and other prepayments		43,096	45,008
VSS cost reimbursable by GOP		736,147	735,865
Refund due from defined benefit pension and gratuity fund		15,634	15,552
Receivable from subsidiary company		2,370	265
Receivable from Ravi Securities (Pvt) Limited and Taas Securities (Pvt) Limited		37,447	57,447
Receivable from Speedway Fondmetall Pakistan Limited		19,640	19,640
Receivable from Equity Participation Fund		2,638	1,904
Receivable against factorized portfolio		9,857	25,385
Others		35,001	36,466
		<u>1,076,248</u>	<u>1,090,944</u>
Less: Provision against other assets	14.2	<u>101,513</u>	<u>123,737</u>
Other assets (net of provision)		<u>974,735</u>	<u>967,207</u>

14.1 This balance has been arrived at after adjusting interest in suspense of Rs 4,640,366 thousand (2005: Rs 5,189,451 thousand).

2006
2005
Rupees in '000

14.2 Provision against other assets

Opening balance	123,737	53,063
Transfer from provision for impairment in value of investments	-	107,908
Charge for the year	-	19,640
Reversals	(20,000)	(56,285)
Amount written off	(2,224)	(589)
Closing balance	<u>101,513</u>	<u>123,737</u>

Provision balance is in respect of:

Income / mark-up accrued in local currency		
Asset Investment Bank Limited	15,780	15,780
Prudential Investment Bank Limited	506	506
Universal Leasing Limited	22	22
Receivable from Ravi Securities (Pvt) Limited and Taas Securities (Pvt) Limited	37,447	57,447
Receivable from Speedway Fondmetall Pakistan Limited	19,640	19,640
Other receivables		
Advance to Invest Capital and Securities (Pvt) Limited	372	372
Legal charges recoverable from borrowers	24,159	26,383
Others	3,587	3,587
	<u>101,513</u>	<u>123,737</u>

	2006	2005
	Rupees in '000	
15. BILLS PAYABLE		
In Pakistan	18,090	6,271
Outside Pakistan	-	-
	<u>18,090</u>	<u>6,271</u>
16. BORROWINGS		
In Pakistan	2,600,000	1,530,000
Outside Pakistan	-	-
	<u>2,600,000</u>	<u>1,530,000</u>
16.1 Particulars of borrowings with respect to currencies		
In local currency	2,600,000	1,530,000
In foreign currencies	-	-
	<u>2,600,000</u>	<u>1,530,000</u>
16.2 Details of borrowings - secured		
Repurchase agreement borrowings	<u>2,600,000</u>	<u>1,530,000</u>

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 8.95% to 9.40 % (2005: 1.20% to 9.00 %) per annum for periods upto 3 months (2005: 4 months). REPO transactions are secured against investment of the Bank in Government Securities.

	2006	2005
	Rupees in '000	
17. DEPOSITS AND OTHER ACCOUNTS		
Customers		
Fixed deposits	756,090	169,763
Savings deposits	574,238	347,057
Current accounts - non-remunerative	227,578	144,293
Margin accounts	48,140	622
	1,606,046	661,735
Financial Institutions		
Remunerative deposits	60,314	360,967
	<u>1,666,360</u>	<u>1,022,702</u>
17.1 Particulars of deposits		
In local currency	1,666,360	1,022,702
In foreign currencies	-	-
	<u>1,666,360</u>	<u>1,022,702</u>
17.2 Savings deposits include Rs 220.782 million (2005: Rs 207.732 million) related to Equity Participation Fund.		

		(Rupees '000)
18.	LOAN FROM THE STATE BANK OF PAKISTAN	
a)	Credit lines on service charge basis from SBP Extended to defunct SBFC	1,542,200
b)	Credit lines on profit & loss sharing basis from SBP	
	Extended to defunct RDFC	1,426,060
	Extended to defunct SBFC	9,718,220
		11,144,280
		12,686,480
Less:	Additional provision against advances in accordance with restructuring plan, charged to SBP	(1,283,196)
	Receivable from SBP against its share in profit/loss adjusted against borrowing from SBP	(3,275,752)
	Payment to SBP during 2003	(3,000,000)
	Balance at December 31, 2003	5,127,532
Less:	Payment by GOP to SBP against issue of 73,502,453 additional shares of Rs. 10 each to GOP	(735,025)
	Payment to SBP during 2004	(392,507)
	Balance at December 31, 2004	4,000,000
Less:	Payment to SBP during 2005	(1,500,000)
	Balance at December 31, 2005	2,500,000
Less:	Payment to SBP during 2006	(70,000)
	Balance at December 31, 2006	2,430,000

18.1 Effective January 1, 2004, return on loan from SBP is paid quarterly on the basis of weighted average yield of 3 years Pakistan Investment Bonds (PIB).

19. LIABILITIES AGAINST ASSETS SUBJECT TO FINANCE LEASE

	2006			2005		
	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	7,864	683	7,181	6,759	686	6,073
Later than one year and not later than five years	13,008	492	12,516	16,237	626	15,611
Over five years	-	-	-	-	-	-
	<u>20,872</u>	<u>1,175</u>	<u>19,697</u>	<u>22,996</u>	<u>1,312</u>	<u>21,684</u>

This represents liability against vehicle lease agreements with leasing companies. Monthly lease rentals are payable including financial charges at rates ranging between 6.46 % and 13.50 % (2005: 6.46 % and 16.52 %) per annum which rates 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.

20. OTHER LIABILITIES		2006	2005
		Rupees in '000	
Mark-up/ return/ interest payable in local currency		99,931	49,017
Unearned commission on guarantees		1,064	99
Accrued expenses		41,128	61,973
Advance payments		-	4,220
Current taxation		245,192	290,528
Accounts payable		15,058	14,388
Sundry creditors		13,847	22,426
Branch adjustment account		(92)	271
Industrial Credit for Rural Women - Promotional Fund	20.1	30,857	30,184
Provision for central excise duty	20.2	29,233	29,233
Payable against employees benefit plans			
Defined benefit unfunded gratuity scheme	33.2	13,857	11,115
Unfunded compensated absences	33.3.3	75,925	67,102
Benevolent fund	33.4	-	(12)
Security deposits against lease		284	514
Employees' VSS payments withheld		18,777	18,591
Payable to Cash Management Scheme		133	133
Income tax withheld payable		17,376	17,166
Others		249	149
		<u>602,819</u>	<u>617,097</u>

20.1 Industrial Credit for Rural Women - Promotional Fund

Funds received including accumulated profit	30,857	30,184
Loan outstanding - net of provision	-	-
	<u>30,857</u>	<u>30,184</u>

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. The Fund balance at year end date is included in assets of the Bank.

20.2 Provision for central excise duty

Central Excise Duty (CED) and penalty thereon was imposed on defunct RDFC in June 1999 by the Additional Collector, Central Excise, Rawalpindi. Defunct RDFC filed an appeal against the order and the case was set-aside by the Collector (Appeals) in November 1999 for due reconciliation and fresh examination by the Additional Collector, Central Excise, Rawalpindi.

The reconciliation and fresh examination of the records of the CED maintained by RDFC was carried out by a team of the office of Central Excise in 2005. Additional Collector of Customs, Sales Tax and Central Excise (Adjudication), Rawalpindi, issued an order on July 30, 2005, thereby, additional duties were levied and a recovery notice was issued to the Bank on May 23, 2006 against which notice, the Bank has obtained a stay order from the Appellate Tribunal, Customs, Sales Tax and Central Excise, Islamabad till final pronouncement of the judgment.

21. SHARE CAPITAL

21.1 Authorized capital

2006	2005		2006	2005
			Rupees in '000	
<u>1,000,000,000</u>	<u>1,000,000,000</u>	Ordinary shares of Rs 10 each	<u>10,000,000</u>	<u>10,000,000</u>

21.2 Issued, subscribed and paid up

Ordinary shares of Rs 10 each				
2006	2005		2006	2005
113,602,453	113,602,453	Fully paid in cash	1,136,025	1,136,025
50,000,000	-	Issued as bonus shares	500,000	-
36,397,547	36,397,547	Issued for consideration other than cash	363,975	363,975
<u>200,000,000</u>	<u>150,000,000</u>		<u>2,000,000</u>	<u>1,500,000</u>

	Number of shares	%		
21.3 Break-up of share capital is as follows:				
Federal Government	185,365,278	92.68	1,853,653	1,390,237
National Bank of Pakistan	6,121,095	3.06	61,211	45,909
United Bank Limited	3,975,003	1.99	39,750	29,813
Habib Bank Limited	1,987,501	0.99	19,875	14,907
MCB Bank Limited	1,490,619	0.75	14,906	11,180
Allied Bank Limited	774,351	0.39	7,744	5,808
Industrial Development Bank of Pakistan	286,146	0.14	2,861	2,146
Directors	7	-	-	-
	<u>200,000,000</u>	<u>100</u>	<u>2,000,000</u>	<u>1,500,000</u>

22. DEFICIT ON REVALUATION OF ASSETS

Deficit on revaluation of Available-for-sale securities

Federal Government securities

- Market Treasury Bill	(460)	33
- Pakistan Investment Bonds	(152,854)	(110,720)
	(153,314)	(110,687)

Fully paid up ordinary shares/ units

- Listed companies/ mutual funds	(73)	(166)
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Term Finance Certificates, Debentures, Bonds and Participation Term Certificates

- Listed TFCs	813	797
- WAPDA Bonds	700	700
	1,513	1,497

Deferred tax thereon

	(151,874)	(109,356)
	53,415	38,495
	<u>(98,459)</u>	<u>(70,861)</u>

	2006	2005
	Rupees in '000	
23. CONTINGENCIES AND COMMITMENTS		
23.1 Transaction-related contingent liabilities		
Guarantees in favour of:		
Government	-	-
Banks and financial institutions	-	-
Others	<u>32,941</u>	<u>17,080</u>
	32,941	17,080
23.2 Other Contingencies		
a) Claims not acknowledged as debt from various borrowers for loss sustained due to non-disbursement	37,472	32,866
b) Damages claim by a borrower for delay in recording repayment received from borrower, not acknowledged as debt	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 defunct SBFC for assessment years 2001-02 and 2002-03 related to excess perquisites, write-off of consumable stores and payment under voluntary separation scheme. No provision in this respect has been made in the financial statements pending decision of the appeal filed with the Income Tax Appellate Tribunal. The Bank is confident of a favourable decision	209,604	209,604
e) Benefits claimed by ex-employees pertaining to Voluntary Separation Scheme, not acknowledged as debt	162,000	162,000
f) Adjustment of loan guarantee amount against borrowing from IDBP repaid in prior years, disputed by IDBP	9,939	9,939
23.3 Commitments in respect of forward lending		
Commitments to extend credit	100,482	56,350
23.4 Commitments for the acquisition of operating fixed assets	4,224	9,103
23.5 Commitments in respect of REPO transactions		
Purchase and resale agreements	92,454	-
Sale and repurchase agreements	2,600,000	1,530,000
23.6 Other commitments		
Undrawn facilities	217,019	30,613
23.7 Bills for collection		
Payable in Pakistan	3,653	1,582

	2006	2005
	Rupees in '000	
24. MARK-UP/ RETURN/ INTEREST EARNED		
On loans and advances to		
Customers		
Extended by:		
Defunct RDFC	8,027	10,423
Defunct SBFC	301,643	273,733
SME Bank Limited	154,670	137,063
Employees	6,656	2,952
	<u>470,996</u>	<u>424,171</u>
Financial Institution - SME Leasing Limited	10,328	5,923
	<u>481,324</u>	<u>430,094</u>
On investments in		
Available for sale securities	409,632	402,151
Held to maturity securities	65,899	5,826
	475,531	407,977
On deposits with financial institutions	2,991	6,186
On securities purchased under resale agreements	151	409
Others	296	-
	<u>960,293</u>	<u>844,666</u>
25. MARK-UP/ RETURN/ INTEREST EXPENSED		
Deposits	62,852	8,244
Securities sold under repurchase agreements	140,257	112,142
Other short term borrowings	-	11
Loan from the State Bank of Pakistan	186,910	146,961
Amortisation of premium/ discount on investments	62,259	68,271
Brokerage and commission	670	536
Bank charges	1,114	1,272
	<u>454,062</u>	<u>337,437</u>
26. OTHER INCOME		
Net profit on sale of property and equipment	11,956	4,169
Profit on off-balance sheet items	26.1 734	17,634
Others	10,356	4,715
	<u>23,046</u>	<u>26,518</u>
26.1 Profit on off-balance sheet items		
Cash Management Scheme		
Net income	-	634
Reversal of provision against investment in First Leasing Corporation Limited	-	17,000
	-	17,634
Equity Participation Funds	734	-
	<u>734</u>	<u>17,634</u>

	2006	2005
	Rupees in '000	
27. ADMINISTRATIVE EXPENSES		
Salaries, allowances, etc.	333,406	320,575
Charge for defined benefit plans		
- pension fund	20,481	(10,092)
- unfunded gratuity scheme	6,020	7,152
Contribution to defined contribution plan - benevolent fund	745	672
Non-executive directors' fees, allowances and other expenses	552	639
Rent, taxes, insurance, electricity, etc.	48,504	45,555
Legal and professional charges	12,627	9,344
Communications	7,618	11,391
Repairs and maintenance	10,632	2,272
Finance charges on leased assets	743	833
Stationery and printing	4,211	6,284
Advertisement and publicity	5,796	7,006
Depreciation	12.2 30,153	25,208
Amortization	12.3 3,034	2,261
Donations	-	719
Auditors' remuneration	27.1 1,804	1,851
Staff separation costs	-	6,511
Staff recovery costs	16,437	11,371
Recovery expenses - outsourced portfolio	16,515	23,695
Recruitment expenses	518	247
Travel and transport	9,595	12,255
Vehicle running and maintenance expenses	10,804	9,998
Entertainment	1,163	1,078
Training	846	3,627
Books, subscription and newspapers	2,356	2,443
Other receivables written-off	-	25
Other expenses	9,307	4,795
	<u>553,867</u>	<u>507,715</u>
27.1 Auditors' remuneration		
Audit fee	1,100	1,000
Special certifications, half yearly review and audit of consolidated financial statements	525	665
Out-of-pocket expenses	179	186
	<u>1,804</u>	<u>1,851</u>
27.2 Operating lease rentals of office premises amounting to Rs 35,593 thousand (2005: Rs 35,114 thousand) have been charged in administrative expenses for arrangements identified as operating lease.		
	2006	2005
	Rupees in '000	
28. OTHER CHARGES		
Penalties imposed by the State Bank of Pakistan	<u>158</u>	<u>809</u>

	2006	2005
	Rupees in '000	
29. TAXATION		
For the year		
Current	72,034	144,817
Deferred	6,464	(5,800)
	<u>78,498</u>	<u>139,017</u>
For prior years		
Current	-	23,886
Deferred	-	-
	<u>-</u>	<u>23,886</u>
	<u>78,498</u>	<u>162,903</u>
29.1 Relationship between tax expense and accounting profit		
Accounting profit for the current year	<u>231,685</u>	<u>369,112</u>
	%	%
Applicable tax rate	35.00	38.00
Tax effect of		
- income chargeable at reduced tax rates	(0.15)	(0.03)
- temporary differences on which deferred tax has been accounted for at enacted reduced tax rate for subsequent years	-	(0.13)
- income exempt from tax	(0.99)	-
- expenses that are not deductible for tax purposes	0.02	(0.18)
Average effective tax rate	<u>33.88</u>	<u>37.66</u>
30. BASIC/ DILUTED EARNINGS PER SHARE	2006	2005
	Rupees in '000	
Profit for the year	<u>153,187</u>	<u>206,209</u>
	Number of shares	
Weighted average number of ordinary shares	<u>200,000,000</u>	<u>174,246,575</u>
	Rupees	
Basic/ diluted earnings per share	<u>0.77</u>	<u>1.18</u>
There is no dilutive effect on basic earnings per share of the Bank.		
Weighted average number of ordinary shares for 2005 has been restated to give effect of bonus shares issued during the year.		
31. CASH AND CASH EQUIVALENTS	2006	2005
	Rupees in '000	
Cash and balances with treasury banks	311,954	188,460
Balance with other banks	125,704	112,047
Call money lendings	200,000	-
	<u>637,658</u>	<u>300,507</u>
32. STAFF STRENGTH		
	Number	
Permanent	318	315
Temporary/ on contractual basis	333	317
Bank's own staff strength at the end of the year	<u>651</u>	<u>632</u>
Outsourced	16	12
Total staff strength	<u>667</u>	<u>644</u>

33. EMPLOYEE BENEFIT PLANS

33.1 Defined benefit pension and gratuity plan

33.1.1 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.

	2006	2005
	Rupees '000	
33.1.2 The amounts recognised in the balance sheet are as follows:		
Present value of defined benefit obligation	245,335	215,652
Fair value of plan assets	<u>(245,919)</u>	<u>(205,580)</u>
(Surplus)/ deficit	(584)	10,072
Unrecognized actuarial loss	(6,347)	(15,833)
Unrecognised past service cost	<u>(8,703)</u>	<u>(9,791)</u>
Net asset	<u><u>(15,634)</u></u>	<u><u>(15,552)</u></u>

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

Current service cost	18,386	11,900
Interest cost	21,565	12,207
Expected return on plan assets	(20,558)	(19,002)
Past service cost - over the vesting period	1,088	-
Asset ceiling effect	-	(1,570)
Reversal of amount not recognised as an asset	-	(13,627)
Expense for the year	<u>20,481</u>	<u>(10,092)</u>
33.1.4 Actual return on plan assets	<u>20,813</u>	<u>9,213</u>

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.

	2006	2005
	Rupees '000	
33.1.5 Changes in present value of defined benefit obligation		
Present value of obligation at the beginning of the year	215,652	135,631
Current service cost	18,386	11,900
Interest cost	21,565	12,207
Benefits paid	(1,037)	(1,325)
Unvested past service cost	-	9,791
Actuarial (gain)/ loss	<u>(9,231)</u>	<u>47,448</u>
Present value of obligation at the end of the year	<u><u>245,335</u></u>	<u><u>215,652</u></u>

	2006	2005
	Rupees '000	
33.1.6 Changes in fair value of plan assets		
Fair value of opening plan assets	205,580	288,426
Expected return on plan assets	20,558	19,002
Contributions	20,563	(90,734)
Benefits paid	(1,037)	(1,325)
Actuarial gain/ (loss)	255	(9,789)
Fair value of closing plan assets	<u>245,919</u>	<u>205,580</u>

The Bank expects to contribute Rs 19,431 thousand to its defined benefit pension and gratuity plans during 2007.

33.1.7 Break-up of category of assets	2006		2005	
	Rupees '000	% age	Rupees '000	% age
Defence savings certificates	140,901	57%	128,100	62%
Term deposits receipts	96,343	39%	76,367	37%
Bank deposit accounts	8,675	4%	1,113	1%
	<u>245,919</u>	<u>100%</u>	<u>205,580</u>	<u>100%</u>

33.1.8 Principal actuarial assumptions

Actuarial valuation is carried out annually. Latest actuarial valuation was carried out as at December 31, 2006 using Projected Unit Credit Method. Significant actuarial assumptions used are as follows:

	2006	2005
Discount rate - per annum	10.00%	10.00%
Expected return on plan assets - per annum	10.00%	10.00%
Salaries increase rate - per annum	9.00%	9.00%

33.1.9 Disclosure for current and previous four annual periods

	2006	2005	2004	2003	2002
	Rupees '000				
Present value of obligation	245,335	215,652	340,506	330,426	273,770
Fair value of plan assets	(245,919)	(205,580)	(288,426)	(224,553)	(182,281)
(Surplus)/ deficit	<u>(584)</u>	<u>10,072</u>	<u>52,080</u>	<u>105,873</u>	<u>91,489</u>
Experience adjustments on plan liabilities	<u>9,231</u>	<u>(47,448)</u>	<u>51,548</u>	<u>15,836</u>	<u>23,670</u>
Experience adjustments on plan assets	<u>255</u>	<u>(9,789)</u>	<u>38,669</u>	<u>1,034</u>	<u>5,131</u>

2006 2005
Rupees '000

33.2	Defined benefit unfunded gratuity scheme	<u>13,857</u>	<u>11,115</u>
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Based on the actuarial valuation, the opening liability for defined benefit unfunded gratuity scheme worked out to be Rs 11.018 million as against the provision of Rs 11.115 million carried as at December 31, 2005, resulting in a transitional asset of Rs 0.097 million. This decrease in liability is recognised immediately in accordance with the transitional provisions of IAS - 19 (Employee Benefits).

Had the change in the method of recognition of liability for gratuity scheme as referred to in note 5.7 above not taken place, the provision for gratuity scheme would have been higher and profit before tax would have been lower by Rs 2.162 million.

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

	2006 Rupees '000
Present value of obligation	14,418
Unrecognised actuarial loss	(561)
Net liability	<u>13,857</u>

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

Current service cost	5,015
Interest cost	1,102
Transitional asset recognised	(97)
	<u>6,020</u>

33.2.3 Movement in payable to defined benefit unfunded gratuity scheme

Obligation at the beginning of the year	11,115
Transitional asset recognised on application of IAS 19	(97)
Current service cost	5,015
Interest cost	1,102
Benefits paid	(3,278)
Actuarial loss	561
Present value of obligation at the end of the year	<u>14,418</u>

33.2.4 Significant actuarial assumptions are as follows:

Discount factor - per annum	10.00%
Salary increase rate - per annum	10.00%

33.3 Unfunded compensated absences

33.3.1 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.

33.3.2 Principal actuarial assumptions

Actuarial valuation was carried out as at December 31, 2006 using Projected Unit Credit Method. Significant actuarial assumptions used were as follows:

	2006	2005
Discount factor - per annum	10.00%	10.00%
Salaries increase rate - per annum	9.00%	9.00%

	2006 (Rupees '000)	2005 (Rupees '000)	
33.3.3 Movement in liability recognized in the balance sheet			
Balance at beginning of the year	67,102	32,733	
Expense for the year	23,350	40,819	
Benefits paid during the year	<u>(14,527)</u>	<u>(6,450)</u>	
Balance at end of the year	<u><u>75,925</u></u>	<u><u>67,102</u></u>	
33.3.4 The amounts recognised in the profit and loss account are as follows:			
Current service cost	3,565	2,071	
Interest cost	6,710	2,946	
Actuarial loss recognised	<u>13,075</u>	<u>35,802</u>	
	<u><u>23,350</u></u>	<u><u>40,819</u></u>	
33.4 Benevolent fund			
	Staff Benevolent Fund	Officers Benevolent Fund	Total
			(Rupees '000)
Total liability	12,896	24,439	37,335
Investment against funds			
Defence Savings Certificates (including accrued income)	9,945	13,136	23,081
Term deposit receipts	2,809	11,039	13,848
Bank deposit account	142	264	406
	<u>12,896</u>	<u>24,439</u>	<u>37,335</u>
Net liability/ (asset) - December 31, 2006	<u>-</u>	<u>-</u>	<u>-</u>
Net liability/ (asset) - December 31, 2005	<u><u>(375)</u></u>	<u><u>363</u></u>	<u><u>(12)</u></u>

34. COMPENSATION OF DIRECTORS AND EXECUTIVES

	President/ Chief Executive		Directors		Executives	
	2006	2005	2006	2005	2006	2005
	Rupees in '000					
Fees	25	26	195	172	-	-
Managerial remuneration	1,920	1,841	-	-	43,154	31,764
Charge for defined benefit plan	160	180	-	-	5,176	4,045
Rent and house maintenance	840	787	-	-	5,826	2,879
Utilities	96	92	-	-	4,311	3,177
Medical	20	31	-	-	3,226	2,050
Conveyance	-	-	-	-	622	212
Leave fare assistance	714	442	-	-	2,329	1,008
Bonus/ ex-gratia	476	538	-	-	7,985	6,583
Others	195	175	-	-	4,908	2,701
	<u>4,446</u>	<u>4,112</u>	<u>195</u>	<u>172</u>	<u>77,537</u>	<u>54,419</u>
Number of persons	<u>1</u>	<u>1</u>	<u>6</u>	<u>6</u>	<u>53</u>	<u>40</u>

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

35. FAIR VALUE OF FINANCIAL INSTRUMENTS

35.1 On-balance sheet financial instruments

	2006		2005	
	Book value	Fair value	Book value	Fair value
	Rupees in '000			
Assets				
Cash balances with treasury banks	311,954	311,954	188,460	188,460
Balances with other banks	125,704	125,704	112,047	112,047
Lending to financial institutions	292,454	292,454	-	-
Investments	5,584,582	5,584,582	4,807,743	4,807,743
Advances	1,731,271	1,731,271	1,184,844	1,184,844
Other assets	<u>929,058</u>	<u>929,058</u>	<u>936,619</u>	<u>936,619</u>
	<u>8,975,023</u>	<u>8,975,023</u>	<u>7,229,713</u>	<u>7,229,713</u>
Liabilities				
Bills payable	18,090	18,090	6,271	6,271
Borrowings	2,600,000	2,600,000	1,530,000	1,530,000
Deposits and other accounts	1,666,360	1,666,360	1,022,702	1,022,702
Loan from the State Bank of Pakistan	2,430,000	2,430,000	2,500,000	2,500,000
Liabilities against assets subject to finance lease	19,697	19,697	21,684	21,684
Other liabilities	<u>293,273</u>	<u>293,273</u>	<u>262,435</u>	<u>262,435</u>
	<u>7,027,420</u>	<u>7,027,420</u>	<u>5,343,092</u>	<u>5,343,092</u>

35.2 Off-balance sheet financial instruments

Commitments to extend credit	<u>100,482</u>	<u>100,482</u>	<u>56,350</u>	<u>56,350</u>
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35.3 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 5.3. The maturity profile and effective rates are stated in note 39.2.3.

36. 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	
2006		
Total income	496,556	724,461
Total expenses	<u>328,515</u>	<u>660,817</u>
Net income	168,041	63,644
Segment Assets (Gross)	6,937,758	8,889,456
Segment Non Performing Loans	-	6,119,396
Segment Provision Required	96,892	6,105,444
Segment Liabilities	2,797,408	4,539,558
Segment Return on net Assets (ROA) (%)	1.92%	0.73%
Segment Cost of funds (%)	1.91%	3.40%
2005		
Total income	409,263	769,165
Total expenses	<u>301,753</u>	<u>507,563</u>
Net income	107,510	261,602
Segment Assets (Gross)	5,662,119	9,128,821
Segment Non Performing Loans	-	6,798,211
Segment Provision Required	133,307	6,797,556
Segment Liabilities	1,723,927	3,973,827
Segment Return on net Assets (ROA) (%)	1.32%	3.22%
Segment Cost of funds (%)	1.97%	2.72%

Assumptions used:

- Unallocatable administrative expenses have been allocated to segments based on their respective incomes except for depreciation expense which has been allocated on the basis of net book value of segment operating fixed assets.
- Unallocatable assets representing 6.25% (2005: 6.42%) of the total assets have been allocated to segments based on their respective incomes.
- Unallocatable liabilities representing 6.03% (2005: 9.43%) of the total liabilities have been allocated to segments based on their respective incomes.

37. 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:

	2006	2005			
	Rupees in '000				
Balances outstanding at the year end					
SME Leasing Limited					
Investment in subsidiary	215,457	200,000			
Loan to SMEL	95,406	125,184			
Receivable from SMEL	2,370	265			
Liability against assets subject to finance lease	9,988	6,265			
Executive officers					
Loan to executives	29,243	15,412			
Transactions during the year					
SME Leasing Limited					
Investment made in subsidiary	15,457	-			
Interest income on loan to SMEL	10,328	5,923			
Loan disbursed	25,000	60,000			
Repayment of loan	54,778	25,759			
Repayment of interest on loan	8,525	7,072			
Principal terms of loan to SMEL					
Year	Amount (Rupees '000)	Term	Interest rate	Repayment	Number of installments
2003	110,000	5 years	7%	Quarterly	20
			6 months KIBOR +		
2005	60,000	3 years	1.5% with a floor of 11%	Quarterly	12
Mark-up on liability against assets subject to finance lease	379				94
Payment for liability against assets subject to finance lease	834				246
Down payment for acquisition of vehicles under finance lease	1,869				3,256
Income on loan to executives	782				464
Payment to/ (from) employees' funds					
Defined benefit pension and gratuity plan	20,563				(90,734)
Benevolent fund	745				672

Remuneration to chief executive officer and executives and fee paid to directors is disclosed in note 34 to the financial statements.

38. CAPITAL ADEQUACY

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

	2006		2005	
	Rupees in '000			
Regulatory capital base				
<i>Tier I capital</i>				
Shareholders capital/ assigned capital	2,000,000		1,500,000	
Reserves	177,275		146,638	
Unappropriated/ unremitted profits (net of losses)	209,096		586,546	
	2,386,371		2,233,184	
Less: Adjustments				
Investment in equity of subsidiary	(215,457)		(200,000)	
Deficit on revaluation of available for sale investments	(151,874)		(109,356)	
	(367,331)		(309,356)	
<i>Total tier I capital</i>	<u>2,019,040</u>		<u>1,923,828</u>	
<i>Tier II capital</i>	-		-	
<i>Eligible tier III capital</i>	-		-	
Total regulatory capital (a)	<u><u>2,019,040</u></u>		<u><u>1,923,828</u></u>	
Risk-weighted exposures				
	2006		2005	
	Book Value	Risk Adjusted Value	Book Value	Risk Adjusted Value
	Rupees '000			
<i>Credit risk</i>				
Balance sheet items:-				
Cash and other liquid assets	437,658	26,018	300,507	23,901
Money at call	292,454	58,491	-	-
Investments	5,584,582	1,776,653	4,807,743	936,546
Loans and advances	1,731,271	807,570	1,184,844	658,410
Fixed assets	156,384	156,384	160,438	160,438
Other assets	1,422,529	572,806	1,406,545	572,070
	<u>9,624,878</u>	<u>3,397,922</u>	<u>7,860,077</u>	<u>2,351,365</u>
Off balance sheet items				
Loan repayment guarantees	29,871	29,871	16,458	16,458
	<u>29,871</u>	<u>29,871</u>	<u>16,458</u>	<u>16,458</u>
Credit risk-weighted exposures	<u><u>9,654,749</u></u>	<u><u>3,427,793</u></u>	<u><u>7,876,535</u></u>	<u><u>2,367,823</u></u>
Market risk				
Market risk-weighted exposures	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total risk-weighted exposures (b)	<u><u>3,427,793</u></u>		<u><u>2,367,823</u></u>	
<i>Capital adequacy ratio [(a) / (b) x 100]</i>	<u><u>58.90%</u></u>		<u><u>81.25%</u></u>	

39. RISK MANAGEMENT

39.1 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.

39.1.1 Segment by class of business	2006					
	Advances (Gross)		Deposits		Contingencies and Commitments	
	Rupees in '000	Percent	Rupees in '000	Percent	Rupees in '000	Percent
Chemical and pharmaceuticals	219,414	2.81%	980	0.06%	15,389	0.44%
Agriculture, forestry, hunting and fishing	214,676	2.75%			1,153	0.03%
Textile	341,817	4.38%	2,380	0.14%	44,619	1.26%
Cement	53,920	0.69%			1,021	0.03%
Sugar	5,440	0.07%				
Footwear and leather garments	171,864	2.20%	8,113	0.49%	888	0.03%
Automobile and transportation equipment	215,418	2.76%	17,328	1.04%	16,698	0.47%
Financial	99,454	1.27%	427,670	25.66%	2,726,668	77.16%
Insurance	-	-	20,000	1.20%	-	-
Electronics and electrical appliances	244,448	3.13%	6,514	0.39%	38,580	1.09%
Power (electricity), gas, water and sanitary	-	-	122,055	7.32%	81,895	2.32%
Wholesale and trade	-	-	45,272	2.72%	31,131	0.89%
Communication	-	-	100,479	6.03%	5,652	0.16%
Individuals	2,779,591	35.59%	704,455	42.28%	349,108	9.88%
Services	-	-	-	-	10,340	0.29%
Government	-	-	-	-	209,604	5.93%
Others	3,462,927	44.35%	211,114	12.67%	842	0.02%
	<u>7,808,969</u>	<u>100%</u>	<u>1,666,360</u>	<u>100%</u>	<u>3,533,588</u>	<u>100%</u>
39.1.2 Segment by sector						
Public/ Government	-	-	493,178	30%	209,604	5.93%
Private	7,808,969	100%	1,173,182	70%	3,323,984	94.07%
	<u>7,808,969</u>	<u>100%</u>	<u>1,666,360</u>	<u>100%</u>	<u>3,533,588</u>	<u>100%</u>

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

	2006		2005	
	Rupees in '000			
	Classified Advances	Specific Provisions Held	Classified Advances	Specific Provisions Held
Chemical and pharmaceuticals	190,115	189,469	200,533	199,982
Agriculture, forestry, hunting and fishing	175,993	175,912	217,761	217,689
Textile	282,994	290,160	330,288	328,691
Cement	51,231	51,201	56,402	55,754
Sugar	5,440	5,440	5,440	5,440
Footwear and leather garments	156,063	155,883	181,612	180,615
Automobile and transportation equipment	191,546	191,413	63,184	62,759
Financial	4,047	4,047	3,247	3,247
Electronics and electrical appliances	179,399	168,080	157,169	155,954
Individuals	1,839,952	1,813,701	1,522,161	1,511,631
Others	3,042,616	3,032,392	4,060,414	4,045,824
	<u>6,119,396</u>	<u>6,077,698</u>	<u>6,798,211</u>	<u>6,767,586</u>

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

Public/ Government	-	-	-	-
Private	<u>6,119,396</u>	<u>6,077,698</u>	<u>6,798,211</u>	<u>6,767,586</u>
	<u>6,119,396</u>	<u>6,077,698</u>	<u>6,798,211</u>	<u>6,767,586</u>

39.1.5 GEOGRAPHICAL SEGMENT ANALYSIS

	2006			
	Profit before taxation	Total assets employed	Net assets employed	Contingencies and commitments
	Rupees in '000			
Pakistan	231,685	9,624,878	2,287,912	3,529,935
Asia Pacific (including South Asia)	-	-	-	-
Europe	-	-	-	-
United States of America and Canada	-	-	-	-
Middle East	-	-	-	-
Others	-	-	-	-
	<u>231,685</u>	<u>9,624,878</u>	<u>2,287,912</u>	<u>3,529,935</u>

39.1.5.1 Contingencies and commitments include amounts given in note 23 except bills for collection.

39.2 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.

39.2.1 Foreign exchange risk

Presently the Bank does not deal in foreign exchange.

	2006			Net foreign currency exposure
	Assets	Liabilities	Off-balance sheet items	
	Rupees in '000			
Pakistan rupee	9,624,878	7,336,966	-	-
United States dollar	-	-	-	-
Great Britain pound	-	-	-	-
Deutsche mark	-	-	-	-
Japanese yen	-	-	-	-
Euro	-	-	-	-
Other currencies	-	-	-	-
	9,624,878	7,336,966	-	-

39.2.2 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.

39.2.3 Mismatch of interest rate sensitive assets and liabilities

	Effective Yield/ Interest rate	2006										Non-interest bearing financial instruments
		Total	Exposed to Yield/ Interest risk									
			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												
On-balance sheet financial instruments												
Assets												
Cash and balances with treasury banks		311,954	229	-	-	-	-	-	-	-	-	311,725
Balances with other banks	2.62%	125,704	125,704	-	-	-	-	-	-	-	-	-
Lending to financial institutions	9.77%	292,454	292,454	-	-	-	-	-	-	-	-	-
Investments	10.86%	5,584,582	1,347,021	1,045,605	23,212	367,146	97,492	3,991	750,126	1,539,417	-	410,572
Advances	10.78%	1,731,271	255,109	276,152	304,796	258,926	230,977	118,025	78,936	80,165	117,999	10,186
Other assets		929,058	-	-	-	-	-	-	-	-	-	929,058
		<u>8,975,023</u>	<u>2,020,517</u>	<u>1,321,757</u>	<u>328,008</u>	<u>626,072</u>	<u>328,469</u>	<u>122,016</u>	<u>829,062</u>	<u>1,619,582</u>	<u>117,999</u>	<u>1,661,541</u>
Liabilities												
Bills payable		18,090	-	-	-	-	-	-	-	-	-	18,090
Borrowings	8.38%	2,600,000	1,950,000	650,000	-	-	-	-	-	-	-	-
Deposits and other accounts	6.55%	1,666,360	805,622	198,000	193,654	132,533	44,230	46,774	-	-	-	245,547
Sub-ordinated loans		-	-	-	-	-	-	-	-	-	-	-
Loan from the State Bank of Pakistan	7.50%	2,430,000	600,000	1,500,000	-	330,000	-	-	-	-	-	-
Liabilities against assets subject to finance lease	12.14%	19,697	308	620	941	5,312	5,143	4,484	2,889	-	-	-
Other liabilities		293,273	-	-	-	-	-	-	-	-	-	293,273
		<u>7,027,420</u>	<u>3,355,930</u>	<u>2,348,620</u>	<u>194,595</u>	<u>467,845</u>	<u>49,373</u>	<u>51,258</u>	<u>2,889</u>	<u>-</u>	<u>-</u>	<u>556,910</u>
On-balance sheet gap		<u>1,947,603</u>	<u>(1,335,413)</u>	<u>(1,026,863)</u>	<u>133,413</u>	<u>158,227</u>	<u>279,096</u>	<u>70,758</u>	<u>826,173</u>	<u>1,619,582</u>	<u>117,999</u>	<u>1,104,631</u>
Off-balance sheet financial instruments												
Commitments to extend credit		100,482	100,482	-	-	-	-	-	-	-	-	-
Off-balance sheet gap		<u>100,482</u>	<u>100,482</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total Yield/ Interest Risk Sensitivity Gap			<u>(1,435,895)</u>	<u>(1,026,863)</u>	<u>133,413</u>	<u>158,227</u>	<u>279,096</u>	<u>70,758</u>	<u>826,173</u>	<u>1,619,582</u>	<u>117,999</u>	<u>1,104,631</u>
Cumulative Yield/ Interest Risk Sensitivity Gap			<u>(1,435,895)</u>	<u>(2,462,758)</u>	<u>(2,329,345)</u>	<u>(2,171,118)</u>	<u>(1,892,022)</u>	<u>(1,821,264)</u>	<u>(995,091)</u>	<u>624,491</u>	<u>742,490</u>	<u>1,847,121</u>

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

39.2.3.2 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 8,975,023 million (2005: Rs 7,229.713 million), the financial assets which were subject to interest rate risk amounted to Rs 4,682.104 million (2005: Rs 2,858.351 million). Investments and other assets amounting to Rs 3,556.772 million (2005: Rs 3,635.497 million) and Rs 736.147 million (2005: Rs 735.865 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.

39.3 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.

39.3.1 Maturities of Assets and Liabilities

	Total	2006								
		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	311,954	311,954	-	-	-	-	-	-	-	-
Balances with other banks	125,704	125,704	-	-	-	-	-	-	-	-
Lending to financial institutions	292,454	292,454	-	-	-	-	-	-	-	-
Investments	5,584,582	1,346,948	1,240,793	23,212	367,146	97,492	3,991	750,126	1,539,417	215,457
Advances	1,731,271	255,459	276,818	305,730	260,320	232,500	119,220	81,080	81,566	118,578
Operating fixed assets	156,384	3	11	107	1,569	15,445	28,669	29,241	5,971	75,368
Deferred tax assets	447,794	-	-	-	-	-	-	-	65,645	382,149
Other assets	974,735	40,884	809,719	82,404	16,811	3,604	3,255	2,424	15,634	-
	9,624,878	2,373,406	2,327,341	411,453	645,846	349,041	155,135	862,871	1,708,233	791,552
Liabilities										
Bills payable	18,090	16,162	1,928	-	-	-	-	-	-	-
Borrowings	2,600,000	1,950,000	650,000	-	-	-	-	-	-	-
Deposits and other accounts	1,666,360	1,051,169	198,000	193,654	132,533	44,230	46,774	-	-	-
Sub-ordinated loans	-	-	-	-	-	-	-	-	-	-
Loan from the State Bank of Pakistan	2,430,000	600,000	1,500,000	-	330,000	-	-	-	-	-
Liabilities against assets subject to finance lease	19,697	308	620	941	5,312	5,143	4,484	2,889	-	-
Deferred tax liabilities	-	-	-	-	-	-	-	-	-	-
Other liabilities	602,819	88,080	14,621	44,935	253,064	79,098	96,433	12,731	-	13,857
	7,336,966	3,705,719	2,365,169	239,530	720,909	128,471	147,691	15,620	-	13,857
Net assets	<u>2,287,912</u>	<u>(1,332,313)</u>	<u>(37,828)</u>	<u>171,923</u>	<u>(75,063)</u>	<u>220,570</u>	<u>7,444</u>	<u>847,251</u>	<u>1,708,233</u>	<u>777,695</u>
Share capital	2,000,000									
Reserves	177,275									
Unappropriated profit	209,096									
Deficit on revaluation of assets	(98,459)									
	<u>2,287,912</u>									

39.4 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.

40. OFF BALANCE SHEET ITEMS

40.1 Equity participation funds

GOP provided funds aggregating Rs 173.621 million to defunct RDFC in prior years for investing in the shares of the private limited companies in the 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, 2006 was Rs 67.009 million (2005: Rs 60.651 million). Aggregate amount of Rs 20.348 million (2005: Rs 23.584 million) has been invested in shares of private limited companies and Rs 220.782 million (2005: Rs 207.732 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, 2006 amounts to Rs 2.993 million (2005: Rs 3.574 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.

40.2 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, 2006 was Rs 0.118 million (2005: Rs 0.118 million).

41. CORRESPONDING FIGURES

During the year, the State Bank of Pakistan vide BSD Circular No. 4 dated, February 17, 2006 has issued 'Revised forms of Annual Financial Statements which has replaced existing forms prescribed through BSD Circular No. 36 dated October 10, 2001. These revised forms are applicable for financial statements for the year ended December 31, 2006 and include certain additional disclosures which are also applicable for corresponding period. The corresponding figures have been rearranged to comply with the above requirements.

42. DATE OF AUTHORIZATION

These financial statements were authorized for issue by the Board of Directors of the Bank on March , 2007.

President/ Chief Executive

Director

Director

Director