# AUDITORS' REPORT TO THE MEMBERS

AUDITORS' REPORT
TO THE MEMBERS

**M. YOUSUF ADIL SALEEM & CO.**
CHARTERED ACCOUNTANTS

**FORD RHODES SIDAT HYDER & CO.**
CHARTERED ACCOUNTANTS

We have audited the annexed balance sheet of Allied Bank Limited (the bank) as at December 31, 2006 and the related profit and loss account, cash flow statement and statement of changes in equity, together with the notes forming part thereof (here-in-after referred to as the financial statements) for the year then ended, in which are incorporated the unaudited certified returns from the branches, except for twenty five branches which have been audited by us, and we state that we have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purposes of our audit.

It is the responsibility of the Bank's Board of Directors to establish and maintain a system of internal control and prepare and present the financial statements in conformity with approved accounting standards and the requirements of the Banking Companies Ordinance, 1962 (LVII of 1962), and the Companies Ordinance, 1984 (XLVII of 1984). Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with the International Standards on Auditing as applicable in Pakistan. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of any material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing accounting policies and significant estimates made by management, as well as, evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion and after due verification, which in case of loans and advances covered more than sixty percent of the total loans and advances of the bank, we report that :-

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

(b) in our opinion:

  (i) the balance sheet and profit and loss account together with the notes thereon have been drawn up in conformity with the Banking Companies Ordinance, 1962 (LVII of 1962) and the Companies Ordinance, 1984 (XLVII of 1984), and are in agreement with the books of account and are further in accordance with accounting policies consistently applied; except for the change as stated in note 6 to the financial statements, with which we concur;

  (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;

**M. YOUSUF ADIL SALEEM & CO.**
CHARTERED ACCOUNTANTS

**FORD RHODES SIDAT HYDER & CO.**
CHARTERED ACCOUNTANTS

(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, cash flow statement and statement of changes in equity, together with the notes forming part thereof, conform with the approved accounting standards as applicable in Pakistan, and give the information required by the Banking Companies Ordinance, 1962 (LVII of 1962), and the Companies Ordinance, 1984 (XLVII of 1984), in the manner so required and give a true and fair view of the state of the bank's affairs as at December 31, 2006 and its true balance of the profit, its cash flows and changes in equity 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.

The corresponding figures in the accompanying financial statements of the bank as at December 31, 2005 include balances of First Allied Bank Modaraba, which were reviewed by another firm of Chartered Accountants whose report dated February 17, 2006 expressed an unqualified review report thereon.

**M. YOUSUF ADIL SALEEM & CO.**
Chartered Accountants
Karachi

Date: February 26, 2007

**FORD RHODES SIDAT HYDER & CO.**
Chartered Accountants
Karachi

Date: February 26, 2007

# AUDITORS' REPORT TO THE MEMBERS

AUDITORS' REPORT TO THE MEMBERS

We have audited the annexed balance sheet of Allied Management Services (Private) Limited (the company) as at June 30, 2006 and the related profit and loss account, cash flow statement and statement of changes in equity together with the notes forming part thereof, for the year ended and we state that we have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purposes of our audit.

It is the responsibility of the company's management to establish and maintain a system of internal control, and prepare and present the above said statements in conformity with the accounting standards as applicable in Pakistan and the requirements of the Companies Ordinance, 1984. Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with the auditing standards as applicable in Pakistan. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the above said statements are free of any material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the above said statements. An audit also includes assessing the accounting policies and significant estimates made by management, as well as, evaluating the overall presentation of the above said statements. We believe that our audit provides a reasonable basis for our opinion and, after due verification, we report that:

(a) in our opinion, proper books of accounts have been kept by the company as required by the Companies Ordinance, 1984;

(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 Companies Ordinance, 1984, and are in agreement with the books of account and are further in accordance with accounting policies consistently applied;

  (ii) the expenditure incurred during the year was for the purpose of the company's business; and

  (iii) the business conducted, investments made and the expenditure incurred during the year were in accordance with the objects of the company;

(c) in our opinion and to the best of our information and according to the explanations given to us, the balance sheet, profit and loss account, cash flow statement and statement of changes in equity together with the notes forming part thereof conform with approved accounting standards as applicable in Pakistan, and, give the information required by the Companies Ordinance, 1984, in the manner so required and respectively give a true and fair view of the state of the company's affairs as at June 30, 2006 and of the loss for the year then ended; and

(d) in our opinion, no zakat was deductible at source under the Zakat and Ushr Ordinance, 1980 (XVIII of 1980).

Without qualify our opinion, we draw your attention towards note 1.1 to the financial statements, where it is stated that subsequent to the date of balance sheet, the Modaraba managed by the company has been merged and amalgamated with Allied Bank Limited. Thus, the company will cease to have business object.

**ANJUM ASIM SHAHID RAHMAN**
Chartered Accountants
Karachi

Dated: September 30, 2006

# Auditors' Review Report

Auditors' Review Report

**M. YOUSUF ADIL SALEEM & CO.**
CHARTERED ACCOUNTANTS

**FORD RHODES SIDAT HYDER & CO.**
CHARTERED ACCOUNTANTS

We have reviewed the Statement of Compliance with the best practices contained in the Code of Corporate Governance prepared by the Board of Directors of Allied Bank Limited (the bank) to comply with Regulation G-1 of the Prudential Regulations for Corporate/Commercial Banking issued by the State Bank of Pakistan, Listing Regulation No. 37 of the Karachi Stock Exchange, Chapter XIII of the Listing Regulations of the Lahore Stock Exchange and Chapter XI of the Listing Regulations of the Islamabad Stock Exchange, where the bank is listed.

The responsibility for compliance with the Code of Corporate Governance is that of the Board of Directors of the Bank. Our responsibility is to review, to the extent where such compliance can be objectively verified, whether the Statement of Compliance reflects the status of the bank's compliance with the provisions of the Code of Corporate Governance and report if it does not. A review is limited primarily to inquiries of the bank's personnel and review of various documents prepared by the bank to comply with the Code.

As part of our audit of the financial statements we are required to obtain an understanding of the accounting and internal control systems sufficient to plan the audit and develop an effective audit approach. We have not carried out any special review of the internal control system to enable us to express an opinion as to whether the Board's statement on internal control covers all controls and the effectiveness of such internal controls.

Based on our review, nothing has come to our attention which causes us to believe that the Statement of Compliance does not appropriately reflect the bank's compliance, in all material respects, with the best practices contained in the Code of Corporate Governance as applicable to the bank for the year ended December 31, 2006.

**M. YOUSUF ADIL SALEEM & CO.**
Chartered Accountants
Karachi

Date: February 26, 2007

**FORD RHODES SIDAT HYDER & CO.**
Chartered Accountants
Karachi

Date: February 26, 2007

# BALANCE SHEET
# AS AT DECEMBER 31, 2006

BALANCE SHEET

| | Rupees in '000 | Note | December 31, 2006 | December 31, 2005 (Restated) |
|---|---|---|---|---|
| **ASSETS** | Cash and balances with treasury banks | 8 | 23,039,577 | 14,742,711 |
| | Balances with other banks | 9 | 1,705,445 | 3,292,041 |
| | Lendings to financial institutions | 10 | 19,050,239 | 5,777,382 |
| | Investments | 11 | 46,953,241 | 44,926,652 |
| | Advances | 12 | 144,033,634 | 111,206,774 |
| | Operating fixed assets | 13 | 6,445,111 | 4,720,662 |
| | Deferred tax assets | 14 | 638,168 | 680,093 |
| | Other assets | 15 | 10,161,361 | 7,227,953 |
| | | | 252,026,776 | 192,574,268 |
| **LIABILITIES** | Bills payable | 16 | 2,278,007 | 2,448,620 |
| | Borrowings | 17 | 18,410,425 | 9,693,785 |
| | Deposits and other accounts | 18 | 206,031,324 | 161,410,268 |
| | Sub–ordinated loans | 19 | 2,500,000 | – |
| | Liabilities against assets subject to finance lease | | – | – |
| | Deferred tax liabilities | | – | – |
| | Other liabilities | 20 | 5,119,267 | 4,471,948 |
| | | | 234,339,023 | 178,024,621 |
| | **NET ASSETS** | | 17,687,753 | 14,549,647 |
| **REPRESENTED BY** | Share capital | 21 | 4,488,642 | 4,488,642 |
| | Reserves | | 6,133,209 | 5,693,484 |
| | Unappropriated profit | | 5,607,796 | 2,731,979 |
| | | | 16,229,647 | 12,914,105 |
| | Surplus on revaluation of assets – net of tax | 22 | 1,458,106 | 1,635,542 |
| | | | 17,687,753 | 14,549,647 |
| | **CONTINGENCIES AND COMMITMENTS** | 23 | | |

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

**Chief Financial Officer** **President and Chief Executive** **Director**

**Director** **Chairman**

# Board Committees

## Audit Committee

| | |
|---|---|
| Sheikh Mukhtar Ahmed | Chairman |
| Farrakh Qayyum | Member |
| Mubashir A. Akhtar | Member |
| Sheikh Jalees Ahmad | Member |

### Terms of Reference

- To determine adequate measures to safeguard the Bank's assets and to ensure effectiveness and efficiency of the internal control systems
- To monitor and analyze compliance with practices of corporate governance and to ensure compliance with relevant statutory requirements
- To review results and financial statements before their approval or publication
- To ensure coordination between external and internal auditors
- To assist the Board in matters arising out of audit activities including the analysis of any activity, response of the Board in any matter and in seeking approval of the Board in addition to taking up any matter with any third party in consultation with the President and Chairman
- To recommend to the Board in matters relating to the appointment, removal, fees of external auditors

## Strategic Planning And Monitoring Committee

| | |
|---|---|
| Abdul Aziz Khan | Chairman |
| Sheikh Jalees Ahmad | Member |
| Mohammad Waseem Mukhtar | Member |
| Khalid A. Sherwani | Member |

### Terms of Reference

- To consider and recommend the strategic plans of the Bank and to monitor progress against the performance of the Bank
- To consider and recommend annual operating plan/budget and proposal for acquisitions, divestures and alliances to the Board
- To consider and approve expenditure and incentive schemes
- To monitor the performance of designated groups and the management committees and to determine and amend the constitution, TORs of the management committees and the delegation of powers thereto
- To consider and decide proposals not delegated to the management or any of the management committees and to recommend changes to its TORs and consider any matter referred by the Board

## Human Capital Committee

| | |
|---|---|
| Sheikh Jalees Ahmad | Chairman |
| Abdul Aziz Khan | Member |
| Mohammad Waseem Mukhtar | Member |
| Tasneem M. Noorani | Member |
| Khalid A. Sherwani | Member |

### Terms of Reference

- To approve the organogram and the functional responsibilities of each group with the exception of the organizational structure, which is to be approved by the Board
- To consider and approve the staff strength, appointments of all personnel, salary enhancements/revisions and special allowance/facility not admissible under normal rules in addition to awarding performance or other bonuses to employees
- To monitor the performance of the human resource group, designated management committees and to determine their constitution, TORs and to delegate powers thereto
- Other responsibilities of the committee include recommending amendments to Human Resources policy, approving nomination of management personnel
- To recommend change in TORs to the Board and to consider any matter assigned by the Board from time to time

## Risk Management Committee

| | |
|---|---|
| Abdul Aziz Khan | Chairman |
| Muhammad Waseem Mukhtar | Member |
| Nazrat Bashir | Member |
| Khalid. A Sherwani | Member |

### Terms of Reference

- To manage credit, market and operational risk and mitigate its effect on the Bank effectively and efficiently
- To develop risk management principles so as to safeguard and nurture Bank's goodwill, to mitigate risk in banking operations and to ensure that return on portfolio compensates risk
- To receive reports on risk variations in a timely manner and to review provisions on non performing portfolio in addition to guiding business units on inherent risk in new opportunities
- To ensure compliance to Basel II and to provide approval to credit and other proposals regarding rescheduling, restructuring and the like and finally to consider and recommend changes in risk policies to the Board
- To review minutes of Assets and Liabilities Committee (ALCO) with respect to risk management
- To monitor the performance of designated groups and committees and further to determine and amend the constitution of the committees
- To delegate its powers to management/management committee, to recommend changes to TORs and to consider any matter referred by the Board

## e-Vision Committee

| | |
|---|---|
| Mohammad Naeem Mukhtar | Chairman |
| Mohammad Waseem Mukhtar | Member |
| Kamal Monnoo | Member |
| Khalid A. Sherwani | Member |

### Terms of Reference

- To provide strategic direction for e-banking and to enlighten the Board regarding any insight in evolving technologies across the globe that may fit into the Bank's strategic vision
- To review, approve and monitor the strategic and tactical plans of the Bank regarding automation/IT infrastructure including branch banking and alternate delivery channels
- To monitor performance of Information Technology (IT) Group and IT Steering Committee and determine/amend the constitution, TORs and delegation of powers to IT Steering Committee
- To delegate, as required, its powers to management / management committee, to consider any matter as advised by the Board along with recommending any change in TORs to the Board

# Statement of Ethics and Business Practices

## Statement of Ethics

All employees of Allied Bank Limited, hereinafter called ABL, shall

### Abidance of Laws / Rules

- Conform to and abide by the ABL rules and obey all lawful orders and directives which may from time to time be given by any person or persons under whose jurisdiction, superintendence or control they may for the time being, be placed. They shall comply with and observe all applicable laws, regulations and ABL policies.

- Stand firmly against supporting the activities of any group or individual that unlawfully threatens public order and safety. The employees shall not be a member of any political party, take part in, subscribe in aid of, or assist in any way, any political movement. They shall not express views detrimental to the ideology, sovereignty or integrity of Pakistan.

- Not canvass or otherwise interfere or use influence in connection with or take part in any election as a candidate to a legislative / local body or issue an address to the electorate or in any manner announce or allowed to be announced publicly as a candidate or prospective candidate. They may, however, exercise their right to vote.

- Not bring or attempt to bring political or other pressure/influence directly or indirectly to bear on the authorities / superior officers or indulge in derogatory pamphleteering, contribute, or write letters to the news papers, anonymously or in their own name with an intent to induce the authority/superior officers to act in a manner inconsistent with rules, in respect of any matter relating to appointment, promotion, transfer, punishment, retirement or for any other conditions of service of employment.

### Integrity

- Conduct themselves with the highest standards of ethics, professional integrity and dignity in all dealings with the public, clients, investors, employees, and fellow bankers and not engage in acts discreditable to ABL, profession and nation. If they become aware of any irregularity that might affect the interests of ABL, they shall inform the senior management immediately.

- Maintain all books, data, information and records with scrupulous integrity, reporting in an accurate and timely manner all transactions / reports.

- Avoid all such circumstance in which there is personal interest conflict, or may appear to be in conflict, with the interests of ABL or its customers.

- Not use their employment status to seek personal gain from those doing business or seeking to do business with ABL, nor accept such gain if offered. They shall not accept any gift, favour, entertainment or other benefits the size of frequency of which exceeds normal business contacts from a constituent or a subordinate employee of ABL or from persons likely to have dealings with ABL and candidates for employment in ABL.

- Not accept any benefits from the estate of, or a trust created by a customer, or from an estate or trust of which ABL's Company or business units is an executor, administrator or trustee.

### Confidentiality

- Maintain the privacy and confidentiality of all the information acquired during the course of professional activities and refrain from disclosing the same unless otherwise required by statutory authorities/law. All such information will remain as a trust and will only be used for the purpose for which it is intended and will not be used for the personal benefits of any individual(s). Inside information about ABL's customers/affairs shall not be used for their own gain, or for that of others either directly or indirectly.

### Professionalism

- Serve ABL honestly and faithfully and shall strictly serve ABL's affairs and the affairs of its constituents. They shall use utmost endeavor to promote the interest and goodwill of ABL and shall show courtesy and attention in all transactions/correspondence with officers of Government, State Bank of Pakistan, other Banks and Financial Institutions, others establishments dealing with ABL, ABL's constituents and the public.

- Disclose and assign to ABL all interest in any invention, improvement, discovery or work of authorship that they may make or conceive and which may arise out of their employment with ABL. If their employment is terminated, all rights to property and information generated or obtained as part of their employment relationship will remain the exclusive property of ABL.

- Not engage in Money Laundering and will be extremely vigilant in protecting ABL from being misused by anyone to launder money by strictly complying with "Know Your Customer" policies and procedures.

# Statement of Ethics and Business Practices

## Statement of Ethics

### Business/Work Ethics

- Respect fellow colleagues and work as a team. They shall at all times be courteous and not let any personal differences affect their work. They will treat every customer of ABL with respect and courtesy.

- Ensure good attendance and punctuality and demonstrate a consistently good record in this area. For any absence during working hours, they shall obtain written permission of their immediate supervisor. They shall not absent themselves from their duties, nor leave their station over night, without having first obtained the permission of the competent authority.

- Maintain a standard of personal hygiene and dress appropriately for attendance at work. Their appearance must inspire confidence and convey a sense of professionalism.

- As personal responsibility, safeguard both the tangible and intangible assets of ABL and its customer(s) that are under their personal control and shall not use ABL assets for their personal benefits except where permitted by ABL. They shall not use any ABL facilities including a telephone to promote trade union activities, or carry weapons into ABL premises unless so authorized by the management, or carry on trade union activities during office hours, or subject ABL officials to physical harassment.

- Not indulge in any kind of harassment including sexual harassment or intimidation whether committed by or against any senior/junior, co-worker, customer, vendor or visitor. They shall not use language, written or spoken in intra office communication(s) or communication(s) with individual(s) outside the office that may contain any statement or material that is offensive to others. They shall never use ABL's system to transmit or receive electronic image or text containing ethnic slurs, social epithets or any thing that might be construed as harassing, offensive or insulting to others.

- To meet their responsibilities to fellow employees, customers and investors they shall help in maintaining a healthy and productive work environment and shall not engage in the selling, manufacturing, distributing, using, any illegal substance or being under the influence of illegal drugs while on the job.

- Ensure strict adherence to all health and safety policies as may be implemented from time to time by ABL.

- Not to give any interview in the print/electronic media or have their photograph displayed or act in television / stage plays or in cinema without having permission from the competent authority.

- Intimate Human Resource Group of any changes in the personal circumstances relating to their employment or benefits.

Employees shall also not indulge in any of the following activities except with the prior permission of the competent authority:

- Borrow money from or in any way place themselves under pecuniary obligation to broker or moneylender or any employee of ABL or any firm or person having dealings with ABL.

- Buy or sell stock, share or securities of any description without funds to meet the full cost in the case of purchase or scrips for delivery in the case of sale. However, they can make a bona fide investment of their own funds in such stock, shares and securities as they may wish to buy.

- Lend money in their private capacity to a constituent of ABL or have personal dealings with a constituent in the purchase or sale of bills of exchange, Government paper or any other securities.

- Guarantee in their private capacity the pecuniary obligation of another person or agree to indemnify in such capacity any person from loss.

- Act as agent for an insurance company otherwise than as agent for on behalf of ABL.

- Be connected with the formation or management of a joint stock company.

- Engage in any other commercial business or pursuit either on their own account or as agent for another or others.

- Accept or seek any outside employment or office whether stipendiary or honorary.

- Undertake part time work for a private or public body or private person, or accept fee thereof.

# CASH FLOW STATEMENT
# FOR THE YEAR ENDED DECEMBER 31, 2006

CASH FLOW STATEMENT

| Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | |
| Profit before taxation | | 6,661,094 | 4,834,195 |
| Less: Dividend income | | (193,255) | (46,146) |
| | | 6,467,839 | 4,788,049 |
| **Adjustments for non cash charges** | | | |
| Depreciation/amortization | | 238,881 | 241,604 |
| Provision against non performing loans and advances (including general provision) | | 583,305 | 399,608 |
| (Reversal of provision) / provision for diminution in the value of investments | | (14,623) | 20,411 |
| Unrealized loss/(gain) on revaluation of held for trading securities | | 30,180 | (25,706) |
| Provision against off balance sheet items | | 2,546 | 79,095 |
| Provision against other assets | | 205,307 | 35,076 |
| Gain on sale of fixed assets | | (68,397) | (28,838) |
| Bad debts written off directly | | 136,189 | 160,059 |
| Others | | – | (14,999) |
| | | 1,113,388 | 866,310 |
| | | 7,581,227 | 5,654,359 |
| **(Increase)/decrease in operating assets** | | | |
| Lendings to financial institutions | | (13,272,857) | 10,427,990 |
| Held for trading securities | | 327,421 | (590,359) |
| Advances | | (33,546,354) | (52,121,676) |
| Other assets (excluding advance taxation) | | (2,961,688) | (1,625,853) |
| | | (49,453,478) | (43,909,898) |
| **Increase/(decrease) in operating liabilities** | | | |
| Bills payable | | (170,613) | (85,743) |
| Borrowings from financial institutions | | 8,496,595 | (2,788,411) |
| Deposits | | 44,621,056 | 35,089,232 |
| Other liabilities | | 640,267 | 1,155,457 |
| | | 53,587,305 | 33,370,535 |
| | | 11,715,054 | (4,885,004) |
| Income tax paid | | (2,386,844) | (1,008,337) |
| **Net cash flows from/(used in) operating activities** | | 9,328,210 | (5,893,341) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | |
| Net investments in available for sale securities | | (19,493,339) | (7,477,213) |
| Net investments in held to maturity securities | | 16,953,404 | 20,605,814 |
| Dividend income | | 193,537 | 46,937 |
| Investments in operating fixed assets | | (1,997,685) | (1,556,587) |
| Proceeds from sale of fixed assets | | 102,752 | 44,674 |
| **Net cash flows (used in)/from investing activities** | | (4,241,331) | 11,663,625 |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | |
| Proceeds from issuance of TFCs | | 2,500,000 | – |
| Dividend paid | | (1,096,654) | – |
| **Net cash flows from financing activities** | | 1,403,346 | – |
| **Increase in cash and cash equivalents** | | 6,490,225 | 5,770,284 |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR** | | 17,753,472 | 12,128,632 |
| **EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS** | | 123,950 | (21,494) |
| **CASH AND CASH EQUIVALENTS AT END OF THE YEAR** | 34 | 24,367,647 | 17,877,422 |

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

**Chief Financial Officer** **President and Chief Executive** **Director**

**Director** **Chairman**

# Chairman's Message

Chairman's Message

Dear Shareholders,

After assuming the management control of Allied Bank in August 2004, the Board formulated a comprehensive strategic plan to put the Bank on the path of sustainable competitive growth. We ensured that the strategic priorities address the needs to run a world class financial institution. To attain this goal, it is imperative to invest in human resources, systems and technology. With this approach, I would like to share with you our strategic priorities.

### Human Resource

Focusing on the importance of human resources and to ensure its strategic fit, we have outlined a clear direction to acquire best in class human resource assets. The Board's objective is to implement competency based recruitment process which is key to building a high performance culture. To retain quality human resources, the Bank has been pursuing aggressive human resource policies to ensure implementation of clearly defined performance management system, effective career development process, comprehensive succession plans and alignment of meritocracy.

### Technology

Continuing with the ongoing endeavors to have a world class technological base, Allied Bank has achieved the milestone of having the largest number of ATMs in the country. "Allied Direct" internet banking was introduced in January 2006, enabling customers to access financial services from their computers and mobile devices. A number of further initiatives are in the pipeline, including the implementation of a world class banking software solution which will provide state of the art banking solutions to our valued customers, and also enable seamless integration of the Bank's internal and external business processes.

### Branch Facilities

In order to provide international standard banking solutions to the Bank's customers, point of contact branch facilities are being upgraded. The concept of Model Branch including all facilities and infrastructure is being deployed for all branches regardless of size and location.

### Business Mix and Value Added Services

The management of your Bank is actively aligning the portfolios of corporate, investment, commercial, retail and consumer businesses which will be supported by value added services. This will ensure long term growth resulting from diversification along with profitability through value added products and services. To create new avenues of business opportunities, we plan to target Non Resident Pakistanis (NRPs) and the Bank is in the process of putting in place third party arrangements with banks in Europe, USA, Middle East and Far East for functioning as contact points for NRPs.

In the end, I would like to highlight the need to drive growth by focusing on the Bank's strategic priorities. The focus is on growing our business by serving our customers exceptionally well, expand the reach of our brand, and capitalizing on the broad array of opportunities available. The strategic focus will provide strong competitive advantage to grow the Bank's market share.

I thank all my colleagues for all their efforts during 2006 and am confident that Allied Bank will experience a similar demonstration of their commitment in 2007.

**Mohammad Naeem Mukhtar**
Chairman

# Statement of Compliance with Code of Corporate Governance



This statement is being presented to comply with the terms of the Code of Corporate Governance as contained in Prudential Regulation No.G-1, responsibilities of the Board of Directors advised vide SBP BSD Circular No.15 dated June 13, 2002 and Listing Regulations of Karachi, Lahore and Islamabad Stock Exchanges (Guarantee) Limited for the purpose of establishing a framework of good governance, whereby a listed company is managed in compliance with the best practices of Corporate Governance.

The Bank has adopted the Code of Corporate Governance and applied the principles contained in the Code in the following manner:

- The directors have confirmed that none of them is serving as a director in more than ten listed companies including the Bank.
- The Bank encourages representation of independent directors on its Board of Directors. At present, the Board includes three independent non executive directors, seven non executive directors and the President being the only executive director.
- All the directors of the Bank are registered as tax payers and none of them has defaulted in payment of any loan to a banking company, a DFI and NBFC.
- Election of the Directors was held on August 17, 2006 for a fresh term of three years.
- No casual vacancy occurred in the Board during the year under review.
- The Bank has adopted a "Statement of Ethics and Business practices", which has been signed by all the directors and employees of the Bank.
- The mission / vision statement, overall corporate strategy and significant policies have been approved by the Board. The Bank maintains a complete record of the particulars of significant policies along with the dates on which these were approved or amended.
- All the powers of the Board have been duly exercised and decision on material transactions, including appointment and determination of remuneration and terms and conditions of employment of the Chief Executive Officer are taken by the Board.
- The Chairman of the Board is a non executive director. The Board met at least once in every quarter. Written notices of the Board meetings along with agenda and working papers were circulated at least seven days before the meetings except in four instances. In two cases, delay of one day and in another two cases, delay of two days happened in sending agenda papers. The minutes of the meetings were appropriately recorded and circulated.
- The Directors have attended the orientation courses with the companies, where they are working or have worked earlier as directors. On their induction, they have been given detailed briefing on the affairs of the Bank. During the year under review, three seminars on Corporate Governance were offered to the Directors and were attended by some of them.
- The Board has approved appointment of CFO, Company Secretary and Head of Internal Audit including their remuneration and terms and conditions of employment, as determined by the CEO.
- The Directors' Report for the year ended December 31, 2006 has been prepared in compliance with the requirements of the Code and fully describes the salient matters required to be disclosed.
- The financial statements of the Bank were duly endorsed by the Chief Executive Officer and Chief Financial Officer before approval of the Board.
- The directors, Chief Executive Officer and executives do not hold any interest in the shares of the Bank other than that disclosed in the pattern of shareholding.
- The Bank has complied with all the corporate and financial reporting requirements of the Code.
- The Board has formed an Audit Committee which comprises of four members; all are non executive directors, including the Chairman of the Committee.
- The meetings of the Audit Committee are held at least once in every quarter, prior to the approval of interim and the annual financial statements of the Bank as required by the Code. The terms of reference of the Committee have been formulated and approved by the Board.
- An effective independent Internal Audit Department is in place.
- The statutory joint auditors of the Bank have confirmed that they have been given a satisfactory rating under the Quality Control Review Program of the Institute of Chartered Accountants of Pakistan, that they or any of the partners of the firm, their spouses and minor children do not hold shares of the Bank and that the firm and all its partners are in compliance with International Federation of Accountants (IFAC) guidelines on Code of Ethics as adopted by the Institute of Chartered Accountants of Pakistan.
- The statutory auditors or the persons associated with them have not been appointed to provide services other than approved services and the auditors have confirmed that they have observed IFAC guidelines in this regard.
- We confirm that all other material principles contained in the Code have been complied with.

On behalf of the Board

**Khalid A. Sherwani**
President

Date: February 26, 2007
Place: Lahore

Corporate Information

# Corporate Information

## Board of Directors

| | |
|---|---|
| Mohammad Naeem Mukhtar<br>*Chairman* | Non Executive Director |
| Sheikh Mukhtar Ahmed | Non Executive Director |
| Mohammad Waseem Mukhtar | Non Executive Director |
| Abdul Aziz Khan | Non Executive Director |
| Sheikh Jalees Ahmad | Non Executive Director |
| Farrakh Qayyum<br>*Government Nominee* | Non Executive Director |
| Nazrat Bashir<br>*Government Nominee* | Non Executive Director |
| Tasneem M. Noorani | Independent Director |
| Mubashir A. Akhtar | Independent Director |
| Kamal Monnoo | Independent Director |
| Khalid A. Sherwani<br>*President* | Executive Director |

### Company Secretary
Zia Ijaz, FCA

### Audit Committee
Sheikh Mukhtar Ahmed
*Chairman*

Farrakh Qayyum

Mubashir A. Akhtar

Sheikh Jalees Ahmad

### Auditors
Ford Rhodes Sidat Hyder and Co.
*Chartered Accountants*

M. Yousuf Adil Saleem and Co.
*Chartered Accountants*

### Legal Adviser
Haider Mota and Company,
*Advocates and Solicitors*

### Shares Registrar
Technology Trade (Pvt.) Ltd.

### Head Office / Registered Office
8-Kashmir / Egerton Road,
Lahore.
UAN: (92 42) 111-110-110

### Central Office
Bath Island, Khayaban-e-Iqbal,
Main Clifton Road,
Karachi-75600
UAN: (92 21) 111-110-110

### Website
www.abl.com.pk

### E-mail
info@abl.com.pk

### Helpline
0800 - 22522

Board of Directors *(left to right)*

Nazrat Bashir
Farrakh Qayyum
Sheikh Jalees Ahmad
Mohammad Waseem Mukhtar
Khalid A. Sherwani
Mohammad Naeem Mukhtar
Sheikh Mukhtar Ahmed
Tasneem M. Noorani
Abdul Aziz Khan
Mubashir A. Akhtar
Kamal Monnoo

Corporate and Social

# Corporate and Social Responsibility Statement

## "Live and let Live"

Central to the culture of Allied Bank is the commitment to develop the communities we serve. As a responsible institution, it is crucial that we invest in the communities where we operate and ensure that our resources make a positive impact. By serving the very communities that support us, we not only ensure the success of these communities but our success as well. These activities underpin our business and help us in growing stronger which, in turn, strengthens the very communities we serve.

"To be ethical, is not to upset the natural balances that nature has created"

Being one of the leading banks in Pakistan, we promote a corporate culture based upon the highest ethical standards which, on one hand, provides customers with value added products and services and on the other hand, strives to ensure sustainable returns for our shareholders. We are socially committed to contribute towards bringing a positive change in the communities by rendering various services and supporting activities aimed at education, health, environment and sports. We consciously undertake these social responsibilities beyond merely profit oriented considerations and legal obligations.

Our commitment to social responsibility goes well beyond philanthropic concerns. Across the country we bring this commitment to life through a broad range of initiatives.

### Education

"Education is the acquiring of ability in order to meet life's challenges"

Allied Bank has always been keen in championing the cause of education because it is our solemn belief that education is the cure for many of the problems we face today. The Bank has been involved in a range of initiatives to help elevate the academic achievements of young people and improve their vocational skills. In order to improve the quality of education besides providing monetary help to its staff and their dependents, during 2006, the Bank has made various donations, notably to

- Tameer-e-Millat Foundation, Islamabad
- Institute of Chartered Accountants of Pakistan
- OGS Trust Scholarship Fund for scholarship program
- Care Foundation, Lahore

### Health

"He, who has health, has hope; and he, who has hope, has everything."

We add value by focusing on issues that are universally important like health and development of the human capital in the communities we serve. We devote resources to develop programs that help communities overcome the challenges they face. For this purpose, the Bank made contributions to

- Shaukat Khanum Memorial Cancer Hospital
- Aga Khan Hospital
- Sahara for Life Trust
- The Kidney Centre

These esteemed organizations are engaged in providing health care to the masses around the clock. Allied Bank is always looking for opportunities to serve genuine cases that may emanate from anywhere in Pakistan. Keeping this in perspective, the Bank also reached out to help deserving individuals, such as, purchasing an artificial leg for a needy person and donating to SKMCH for the treatment of his leg cancer.

To ensure the health and safety of our people here at Allied Bank, the Bank contributed a significant amount during the year for the health issues of our employees and their families. We believe that by providing our employees with the right working environment, we increase the strength of our human capital. As a good working environment includes the health and safety concerns of our people, the Bank incurred substantial amount for the medical treatment and the upkeep of employees. Allied Bank is truly committed to its people and is ready to go a long way to ensure their well being, including medical treatment abroad.

The Bank also collectively participated with Shaukat Khanum Memorial Cancer Hospital in Run Lahore Run International Marathan held at Lahore for promoting the cause to fight cancer.

### Beautification of Roundabout at Turbat Airport

"A thing of beauty is a joy forever"

To contribute towards the economic development and infrastructure of the country, the Bank has approved a donation for the construction and beautification of a roundabout at Turbat Airport. The Bank always takes pride in working on projects that benefits society and adds to the goodwill of the Bank among the members of the society.

# Responsibility Statement

### Sports

"All great games have one thing in common,
people with a passion to succeed."

The zeal of sports runs high in the people of Pakistan. It is a passion to which the Bank is also an equal partner of. To share the sporting arena with our countrymen, the Bank has allocated an extensive budget in terms of sponsoring events, tournaments and awards for the players.

Cricket represents the greatest passion of our society. This cricketing fervor drove us to co-sponsor the cricket series held between Pakistan and India during January – February 2006.

The Bank also sponsored Lahore Gymkhana Cricket Cup 2006. Chief guest, Mr. Robert Marllar, President MCC, England presented the wining trophy to the triumphant.

Fostering sports among women society is also taken care of by the Bank as we had an honor of sponsoring Women International Squash Players Association Tournament held at Jahangir Khan Squash Complex, Wah Cantt. during this year.

The Bank was also privileged to sponsor / co-sponsor following events:

- Allied Bank Golf Tournament at Arabian Sea Country Golf Course, Karachi
- All Pakistan Allied Bank Open Golf Tournament at Faisalabad
- Olympic football qualifying match between Pakistan and Singapore at Lahore
- Tennis Series played between Pakistan and India at Lahore

### Earthquake Relief Operations

"No matter how tragic the circumstances
we must find hope where none exists"

On October 8, 2005 a great natural calamity struck Pakistan as a massive earthquake plunged Pakistan's northern areas into chaos. It was truly a sad day for the whole nation as thousand of our beloved ones were buried alive and a greater number were made homeless. This came on top when severe cold weather was about to start in the northern areas. It was in these hard and bitter times that Allied Bank came forward to assist our brethren in every possible way. The Bank contributed wholeheartedly to the President's Relief Fund for the earthquake survivors. This year, a number of individual staff members, still serving along with retired members affected by the earthquake, have been supported financially.

Our Bank has been and will continue to strive to be a good corporate citizen. It is crucially important and gratifying to us all. Our commitment to our communities is deep, broad and multifaceted. We want to be recognized not only as a successful Bank but also as a responsible partner for the communities we serve. We have essentially incorporated social responsibility as a part of our policy and plan to contribute a portion of our profits in the areas of health, education and welfare of the community every year.

"Never let your sense of morals
keep you from doing what is right."


DIRECTORS' REPORT

The Directors of Allied Management Services (Pvt.) Limited are pleased to present the 14th Annual Report together with the Audited Accounts of the company for the year ended June 30, 2006.

## FINANCIAL RESULTS

| Rupees | 2006 | 2005 |
|---|---|---|
| Aggregate losses for the year | (20,634) | (83,143) |
| Unappropriated profit brought forward | 1,443,920 | 1,527,063 |
| Unappropriated profit carried forward | 1,423,286 | 1,443,920 |
| Loss per share | (0.003) | (0.01) |
| Net asset value per share | 21.18 | 7.12 |

The Company sustained a net loss of Rs. 20,634/- after charging an amount of Rs. 211,900/- on account of administrative expenses. Due to losses, no provision for taxation has been made in the current year.

Being the Management Company of First Allied Bank Modaraba (FABM), it is entitled to charge upto 10% of the annual profit of Modaraba as Management Fee. However, it has not charged any amount on this account only to facilitate the Modaraba in reducing its accumulated losses. The other source of income is from profit earned on funds invested with Allied Bank Limited (ABL) and during the year the company earned a profit of Rs. 191,266/- on such investment of Funds.

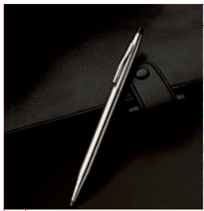
Subsequent to the date of Balance Sheet and as a consequence of amalgamation of FABM (managed by the Company) with and into ABL, the Company received 1,680,000 ABL Shares in exchange of seven (7) million FABM Certificates held by it. The ABL Shares so received has been sold to the Pension Fund of ABL employees at current market rate. The transaction has been executed at fair price and at arms length in the interest and benefit of the employees of the Holding Company hence no violation of any law.

The Company shall however book a capital gain of Rs. 74.400 million on this transaction

On behalf of the Board

**Sharique Umer Farooqui**
Chief Executive

Dated: September 30, 2006
Place: Karachi



# Directors' Report to the Shareholders

Directors' Report to

## Dear Shareholders

On behalf of the Board, we are pleased to present the annual report of the Bank for the year ended December 31, 2006.

This year proved to be yet another hallmark year in which we achieved continued progress in our drive for sustained earnings growth by executing key administrative and operational strategies.

## Economic Review

Pakistan has managed an appreciable economic turnaround during the last 5 years. From a tenuous position in 1999, the economy has transformed itself from one burdened by low economic growth, chronic fiscal deficits, increasing external debt into one characterized by vibrant growth, increased fiscal space and a stable external debt position. Real economic growth has averaged 7.6% in the last 3 years while exports have doubled in the last 6 years. Real investment, a lag for the initial part of the business cycle, is now starting to gain momentum. It grew by 9.26% in FY05 and 10.33% in FY06. The estimates of the population below the poverty line has fallen from 32% to 25%.

The most important drivers of the current year's economic growth are:

- Impetus to high growth in FY06 was principally from the performance of the services sector, as both the key commodity producing sectors, agriculture and industry saw growth fall well below the annual targets.
- Per capita income, increased from US$500 in 2001-2002 to US$847 in 2005-2006 owing to increase in real GDP, stable exchange rate and relatively lower increase in population compared to the previous years.
- Global economic growth reached to 5%.
- Massive credit flow of around PKR 345 billion to the private sector.
- Increase in total investment by 20% of GDP owing to rise in FDI.

Despite unexpectedly weak harvests of some key crops (cotton, sugarcane and wheat), the impact of the October 2005 earthquake, a tight monetary policy and an unprecedented rise in oil prices, real GDP growth remained strong at 6.6 percent during FY06.

The decline in the FY06 production of sugarcane and cotton, together with the modest growth in wheat was the principal reason for the 3.6 percent decline in the value addition by major crops, in sharp contrast to the 17.8 percent growth in the preceding year.

The provisional number for FY06 suggests that YoY industrial growth stood at 5.9 percent, substantially lower than the 11.4 percent YoY growth recorded during the preceding year. However, the industrial growth estimates based on full year data is expected to be a little higher than the provisional number. In particular, 9.0 percent growth in large scale manufacturing (LSM) could reach 10.7 percent during FY06, but this could still remain below the annual target (for the first time during the last four years) and also lower than the 15.6 percent growth recorded in FY05.

The services sector performed remarkably well, witnessing 8.8 percent growth during FY06, surpassing its annual target for the year as well as the 8.0 percent growth registered in FY05. This robust growth was mainly contributed by wholesale and retail trade, transport and communication and finance and insurance sub sectors which, although registered slower growth during FY06, was nonetheless well above the target for both sectors. On the other hand, transport, storage and communication sub sector has witnessed acceleration, with growth rising to 7.2 percent during FY06 against 3.6 percent in FY05, mainly on the back of improved performance of road transport and communication, which was supplemented by double digit growth in railway transport. Moreover, accelerated growth in community, social and personal services was witnessed and was probably a reflection of the increased social service activities in Pakistan's Northern areas in the aftermath of the October 2005 earthquake.

While Pakistan's economy suffered due to rising commodity prices, inflationary pressures eased somewhat in the domestic economy as headline Consumer Price Index (CPI) witnessed a deceleration from a peak of 9.3 percent (average annual inflation) in FY05 to 7.9 percent during FY06, mainly due to monetary tightening to soften demand pressures as well as administrative measures to counter supply shocks. FY06 deceleration is solely a result of ease in food inflation. Given high levels of CPI inflation and core inflation, resilience in non food inflation, which is still at high levels, acceleration in broader measures of inflation and a lower inflation target of 6.5 percent for the FY07, SBP has continued with its tight monetary policy in the period ahead. In this background, the current SBP forecast suggests that CPI inflation is likely to be in the range of 6.5–7.5 percent during FY07, a little above the annual target.

This is the fifth successive year that the Debt to GDP ratio has improved. More significantly, this is the first time in more than two decades that this ratio has fallen below 60 percent. In fact, “The Fiscal Responsibility and Debt Limitation Act, 2005” envisaged a Debt to GDP ratio at 60 percent by FY13.

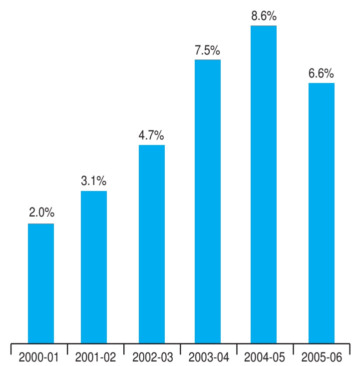
Pakistan once again accessed the global bond market to raise funding through the issuance of the Euro Bonds in FY06. Pakistan not only successfully generated inflows of US$800 million from this issuance, but also established a long term sovereign benchmark that would help local corporates to access global markets. The FY06 issuance consists of 10 year bonds of US$500 million, and US$300 million in 30 year bonds. Also, in FY06 the private sector registered fresh loans of US$522 million primarily on account of the long term loans to the communication sector and to Pakistan International Airline (PIA) for the purchase of aircrafts.

The External Account of Pakistan continued to remain under pressure during FY06 due to increase in aggregate demand, coupled with the rise in international oil and commodity prices. The country witnessed the highest ever current account deficit of US$5.0 billion during FY06 as compared to deficit of US$1.5 billion in the previous year. This rise in the current account deficit was mainly contributed by huge trade deficit of US$8.4 billion as compared to the US$4.5 billion in the preceding year. The expansion in the trade deficit was primarily due to a significant 31.3 percent YoY growth in imports that outpaced the 14 percent growth in exports.

The persistently rising international oil prices and the broad based increase in the aggregate demand led to a sharp rise in import bill to US$24.9 billion during FY06. The exceptional import growth and accompanying rise in services account payments (principally for freight payments for imports), contributed to a sharp widening of the country’s current account deficit, from a relatively manageable 1.4 percent of GDP in FY05 to a more threatening 4 percent of the GDP in FY06. However, the strong growth in remittances from Pakistanis and expatriates living abroad and gains from the lower net interest payment on external debt and liabilities partially offset the impact of the large trade gap.

The large current account deficit was however, easily financed through the improvement in the financial account. Specifically, financial account surplus increased substantially, from a meager US$0.45 billion in FY05, to a sizeable US$5.9 billion in FY06. The improvement in the financial account was quite broad based, contributed by higher FDI of US$3.5 billion (including privatization proceeds of US$1.54 billion); rise in portfolio investment on account of floatation of Euro bonds of US$800 million and other receipts. In addition to this, higher receipts of long term concessional loan from ADB and World Bank, and net inflow of supplier’s credit also helped in swelling the financial account surplus. Hence, despite the unprecedented YoY deterioration in trade account in FY06, the overall balance recorded a surplus of US$1.33 billion during the period.

**GDP - Growth**




The surplus in the overall external balance, that led to a net US$520 million increase in the country’s forex reserves (US$13.137 billion by June 2006) during FY06 also helps explain, in part, the relative stability of the rupee during the year. The rupee traded within a narrow band of 74 paisa for most part of FY06, depreciating only 0.84 percent during the period, to close at Rs. 60.12 / US$. However, due to comparatively higher domestic inflation in relation to trading partner countries and relative stability of the domestic currency, the rupee appreciated in real terms by around 1.9 percent.

National savings rose sharply by 16.5 percent during FY06 compared to the 7.5 percent growth in the preceding year, nonetheless this increase is lower than the rise in nominal GDP. As a result, the National Savings to GDP ratio dropped slightly (by 0.1 percentage) to 16.4 percent during FY06, the lowest level since FY01.

The total investment to GDP ratio rose to 20.0 percent during FY06 from 18.1 percent in the preceding year and an average of 17.1 percent in the last five years. Importantly, this is the highest level of the investment to GDP ratio in over a decade. The rise in the ratio is mainly attributed to improved confidence of local as well as foreign investors on the back of a good showing of the economy and a robust 22.3 percent growth in credit to private sector despite increasing interest rates.

Directors' Report to the Shareh

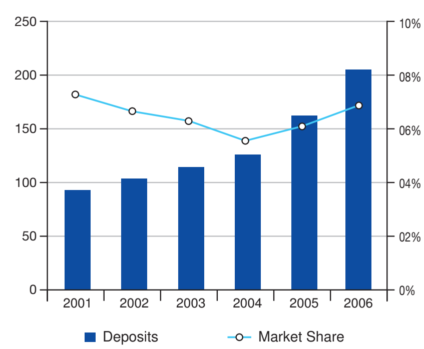
# Directors' Report to the Shareholders

## Bank's Financial Review

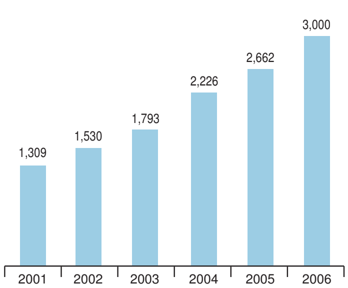
The Bank achieved another milestone by posting an after tax profit of Rs. 4,397 million, the highest ever earning in the Bank's history of over 60 years, depicting growth of 42% over FY05 profit of Rs. 3,090 million. During FY06, the operating profit before provisions and taxes surged by 37% to Rs. 7,574 million. The increase in gross advances by 27%, backed by significant improvement in yield resulted in higher mark up / return income of 74% from Rs. 9.9 billion in FY05 to Rs. 17.2 billion in FY06. Non mark up income witnessed a growth of 26% from Rs. 1.9 billion in FY05 to Rs. 2.4 billion in FY06. This was mainly driven by rise in core fee and commission income and gain on securities, which increased by 40% and 175% respectively over FY05. Despite such an increase in mark up / interest income, administrative expenses increased by only 24% .

Mark up / interest expense increased to Rs. 6.8 billion depicting an increase of 236% over FY05. This increase corresponds to the growth in deposits during FY06 coupled with increase in pricing of deposits. Despite this, the Bank has been able to maintain its cost of deposits below 3.5% during FY06, which eventually is reflected in the bottom line growth.

**ABL Deposits**
(Rs. in billion)

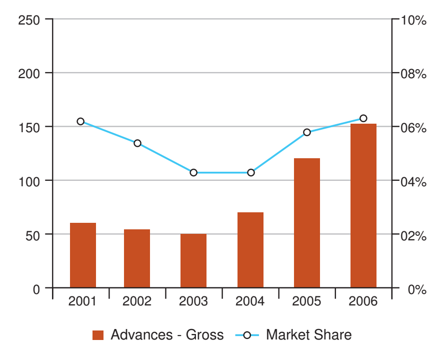



**Industry Deposits**
(Rs. in billion)

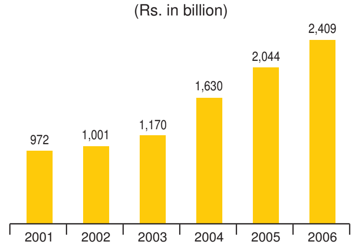



By the close of 2006, the advances portfolio of the Bank had increased by 27% to Rs. 151.7 billion from Rs. 119.9 billion at the close of last year, due to aggressive efforts towards growing private sector with concurrently continuing to exercise effective credit risk management and remaining watchful of the impact on capital adequacy. This has resulted in increase in market share of 50 basis points to 6.3%. The total deposits increased to Rs. 206.0 billion from last year's Rs. 161.4 billion, reflecting a growth of 28% with our market share increasing by 80 basis points to 6.9%. This milestone was achieved despite stiff competition for deposits mobilization during FY06. Total foreign trade handled by the Bank witnessed a growth of 15% as it increased from US$1.63 billion in FY05 to US$1.87 billion in FY06.

**ABL Advances - Gross**
(Rs. in billion)




**Industry Advances - Gross**
(Rs. in billion)




Non Performing Loans (NPLs) saw a noticeable net decline of 17% to reach at Rs. 10.5 billion from last year's Rs. 12.7 billion, when the industry NPLs augmented in the vicinity of 2.5% (based on September 06 position) over FY05.

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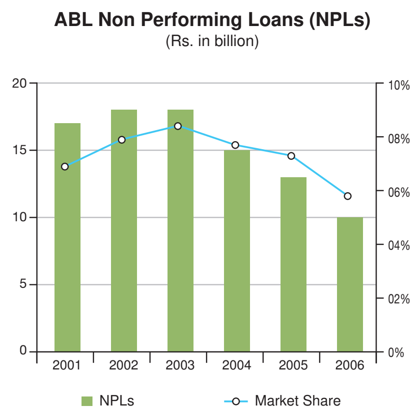


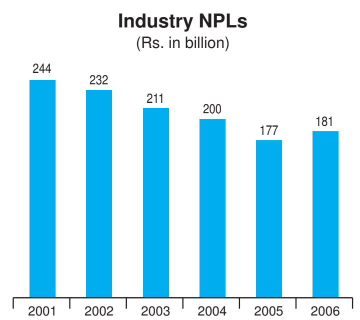


## Earnings Per Share

The Earnings per Share of the Bank for the year ended December 31, 2006 is Rs. 9.80 per share, which increased by 42% from last year's Rs. 6.88 per share.

## Appropriations

The Board of Directors has recommended the following appropriations of the profit for the year ended December 31, 2006.

| | Rs. in millions |
|---|---|
| Profit after tax for the year | 4,397 |
| Accumulated profits brought forward | 2,732 |
| Transfer from surplus on revaluation of fixed assets – net of tax | 19 |
| Profit available for appropriation | 7,148 |
| Final cash dividend for the year ended December 31, 2005 declared subsequent to the year end (Rs. 2.5 per share) | 1,101 |
| Transfer to Statutory Reserves | 440 |
| Accumulated profits carried forward | 5,607 |

The Board of Directors has proposed a cash dividend of Rs. 2.5 per share and to issue bonus shares in the proportion of one share for every five shares held, i.e., 20%, for the financial year 2006. This will be put up for approval in the forthcoming annual general meeting.

## Statement of Internal Control

The Board is pleased to endorse the statement made by the management relating to internal control to meet the requirements of the SBP's BSD Circular No. 7 of 2004 and the Code of Corporate Governance as issued by the Securities and Exchange Commission of Pakistan. The Management's Statement on Internal Control is included in the annual report.

## Risk Management Framework

The Bank manages risk through a framework of sound risk principles which includes an optimum organizational structure, risk assessment and monitoring process that are closely aligned with our long term strategy. The Risk Management Group (RMG) is mandated to implement this framework as a function independent of commercial lines of business.

In addition, a Risk Management Committee comprising members of senior management discusses significant risk issues that arise, as well as recommends risk policies prepared by RMG to the Board Risk Management Committee for approval. This ensures that risk oversight and governance occur at the highest levels of management.

During 2006, RMG took several steps to further strengthen the Risk Management Framework, for example:

- Initiated the Basel II implementation project by engaging PricewaterhouseCoopers (PwC) in the later half of 2006 to conduct a Gap Analysis with respect to Credit, Market and Operational Risks. We expect completion of the Gap Analysis Reports and preparation of the Basel II implementation plan by PwC during the second quarter of 2007. This is an important step in the alignment of regulatory and economic capital requirements.
- Implemented a new Credit Application Package, which incorporates a formalized and structured approach for credit analysis, and directs the focus of evaluation towards a balanced assessment of credit risk with identification of proper mitigants. These risks include industry risk, business risk, financial risk, security risk and account performance risk.
- Strengthened financial analysis through launch of separate financial spreadsheet templates for manufacturing and trading concerns, banks, leasing and insurance companies. To make the risk estimation more accurate and forward looking, RMG on a pilot basis also developed in house Risk Rating Templates to rate the various asset classes. These rating templates are targeted for launch in 2007 after they have been tested with the assistance of an external consultant.

- Solicited proposals from various market risk consultants during the last quarter of 2006 to seek their assistance in establishment of a market risk management framework. A comparative evaluation is underway and a consultant will be appointed so that the Bank can efficiently manage liquidity and market risk.
- Evaluated various risk management software to meet the sophisticated data management and reporting requirements under Basel II. The Bank intends to procure appropriate software that would enable the Bank to meet the regulatory requirements as set out by the State Bank of Pakistan to achieve compliance with Basel II.

The Bank devotes considerable resources in managing the risks to which it is exposed. The momentum attained thus far will be continued in the future through significant investments in technology and training.

## Temenos T24 Core Banking Software

We have selected Temenos T24 Core Banking Software Solution for implementation across our branches countrywide. Temenos is a software company based in Geneva, Switzerland and its T24 core banking software is rated as the leading product in the world with over 500 installed sites worldwide. The T24 software is considered as the most technologically advanced integrated banking system available worldwide which integrates with all major technology platforms including Oracle, Windows, UNIX, Linux, etc.

T24 will replace the existing branch banking software to automate and network all the branches of the Bank. We have selected the full suite of T24 modules covering all business function areas of the Bank. It will enable the Bank to bring to market new products very quickly and scale upwards both in terms of transaction volumes and customer services.

## Credit Rating

Acknowledging the significant improvement in your Bank's strength, JCR-VIS, in July 2006, upgraded the 'Outlook' one notch from last year's 'Stable' to 'Positive' while maintaining medium to long term entity rating at A+ (Single A Plus) and short term rating at A–1+ (Single A One Plus). We feel pleasure in apprising you of the fact that short term rating of A–1+ is the uppermost possible rating under this category. It represents highest certainty of timely payment with short term liquidity, including internal operating factors and / or access to alternative sources of funds, considered as outstanding and safety just below risk free Government of Pakistan's short term obligations. The long term credit rating assigned to the Bank represents good credit quality with adequate protection factors.

## Term Finance Certificates (TFCs)

In order to strengthen Bank's Tier II capital, as required under SBP's BSD Circular No.12, dated August 25, 2004 and to create more room for assets' growth, the Bank has raised TFCs amounting to Rs.2.5 billion through Initial Public Offering and Private Placements during the later part of the current year. The TFCs are sub ordinate in nature and have been rated 'A' (Single A) by JCR-VIS Credit Rating Company. The Karachi Stock Exchange has granted its approval in January 2007, for listing of the TFCs.

## Merger of First Allied Bank Modaraba (FABM) with and into ABL

During the current year, the Board of Directors, in their meeting held on April 28, 2006, decided to merge FABM with and into ABL, pursuant to Section 48 of the Banking Companies Ordinance, 1962 and approved the scheme of amalgamation to effect such transaction under Sections 284 to 288 read with Section 503(1)(C) of the Companies Ordinance, 1984. The effective date of the said amalgamation was fixed at January 01, 2006. The proposed scheme of amalgamation was adopted through special resolution in the Extraordinary General Meeting held on June 24, 2006. The scheme was approved by the State Bank of Pakistan on May 27, 2006 with subsequent sanctioning by the Lahore High Court on July 12, 2006 .

## Liquidation of Allied Management Services (Private) Limited (AMSL)

The Board, in their meeting held on October 30, 2006, approved the liquidation of AMSL, a wholly owned subsidiary of the Bank, consequent to the merger of FABM (earlier managed by AMSL) into the Bank.

## ATM Network

The Bank installed 190 ATMs during the current year, raising their number to 290 at the end of the year. This has led your Bank to achieve the distinction of having the largest ATM network in the country. Not only this, the ATM network was expanded to cover 95 cities, thereby, making it the widest geographical network for ATM based services amongst all the banks in Pakistan.

## Awards and Recognitions

We are pleased to inform that your Bank has been declared the "BANK OF THE YEAR 2006" by "The Banker" published by Financial Times Businss Limited, London. This is considered to be the most prestigious award in the world of finance. The award is given by the "The Banker" annually to one high performing

Bank in each country based on key performance indicators.

Your Bank has also been awarded "THE CORPORATE FINANCE HOUSE OF THE YEAR - BANK 2005-06" by CFA Association of Pakistan, during the year. This was given in recognition of the persistent endeavor to produce creative and technically challenging transactions with the intent to introduce to clients the different facets of investment banking.

## Statement Under Code of Corporate Governance

The Board of Directors is aware of its responsibilities under Code of Corporate Governance and is pleased to report that:

- The financial statements, prepared by the management of the Bank, present fairly its state of affairs, the result of its operations, cash flows and changes in equity.
- Proper books of account of the Bank have been maintained.
- Appropriate accounting policies have been consistently applied in preparation of financial statements. Accounting estimates are based on reasonable and prudent judgment.
- International Accounting Standards, as applicable in Pakistan, have been followed in preparation of financial statements and any departure from them has been adequately disclosed.
- The system of internal control is sound in design and has been effectively implemented and monitored.
- There are no significant doubts upon the Bank's ability to continue as a going concern.
- 'Management Discussion and Analysis' gives a detailed overview of the operating results and significant variations.
- There has been no material departure from the best practices of corporate governance.
- A summary of key operating and financial data for last six years is included in this Annual Report.
- The book value of investment and accrued profit on investment of Pension Fund, Provident Fund, Benevolent Fund, Gratuity Fund and Welfare Fund is Rs. 4,659 million, Rs. 2,011 million, Rs. 483 million, Rs. 275 million, Rs. 417 million respectively as per audited accounts of the funds for the year ended December 31, 2005.
- Pattern of Shareholding is annexed.
- Statement of Compliance with Code of Corporate Governance is annexed.
- We have criteria for nomination of Bank's executives on the Boards of other companies where Allied Bank is an investor company. According to the criteria, an executive of cadre 'Executive Vice President' or above having related knowledge and expertise can be nominated on the Boards of other companies.
- Board of Directors has the following sub committees with clearly laid down Terms of Reference.

1. Audit Committee
2. Human Capital Committee
3. Risk Management Committee
4. e-Vision Committee
5. Strategic Planning and Monitoring Committee

## Meetings of The Board

Ten meetings of the Board were held during the year under review. The numbers of meetings attended by each Director for this period are as under:

| Name | Designation | Attendance |
|---|---|---|
| Mohammad Naeem Mukhtar | Chairman | 10 |
| Sheikh Mukhtar Ahmed | Director | 5 |
| Mohammad Waseem Mukhtar | Director | 8 |
| Abdul Aziz Khan | Director | 10 |
| Sheikh Jalees Ahmad | Director | 10 |
| Farrakh Qayyum | Director | 5 |
| Nazrat Bashir | Director | 4 |
| Tasneem M. Noorani* | Director | 4 |
| Mubashir A. Akhtar* | Director | 4 |
| Kamal Monnoo* | Director | 4 |
| Khalid A. Sherwani | Director and President/CEO | 10 |

* Elected on 17.08.2006, since then four (04) meetings of the Board were held.

# Directors’ Report to the Shareholders

Directors’ Report to the Shareholders

## Auditors

Messrs Ford Rhodes Sidat Hyder and Co., Chartered Accountants and Messrs M. Yousuf Adil Saleem and Co., Chartered Accountants being eligible have offered themselves for re appointment. Audit Committee has also recommended appointment thereof for the year 2007.

## Year 2007 Prospects

The market scenario will be more challenging as banking industry in Pakistan is currently under a wave of Mergers and Acquisitions through local as well as foreign investors. One reason for the recent surge in bank mergers is Basel Accord II which is to be implemented from January 2008. Proactive asset liability management together with the Bank’s ability to offer improved and innovative products will play a vital role in producing better results.

Tight monetary policy has started inducing banks to accelerate mobilization of time deposits and offering higher returns to depositors. Some of the banks have already started introducing schemes of higher return on saving accounts, which should improve real return on deposits going forward.

Your Bank aspires to continue with the strategy of products and geographical expansion during FY07. Expansion is planned in niche markets with potential for consumer, agricultural and SME finance. The management believes that these markets, if explored, with risk control measures in place, can spur growth of the Bank as well as the nation’s economy as a whole.

## Events After The Balance Sheet Date

There have not been any material events that occurred subsequent to the date of the Balance Sheet that require adjustments to the enclosed financial statements.

## Acknowledgements

On the behalf of Board and management, we would like to express our sincere appreciation to our customers and shareholders for their patronage, State Bank of Pakistan and other regulatory bodies for their continuous guidance and support, and employees for all their continued dedication, enthusiasm and loyalty.

| | |
|---|---|
| **Khalid A. Sherwani** | **Mohammad Naeem Mukhtar** |
| President | Chairman |

Date: February 26, 2007
Place: Lahore


**Allied Bank introduced Internet Banking**

## Allied Direct

**during 2006**

# BALANCE SHEET
# AS AT JUNE 30, 2006

BALANCE SHEET

| | Rupees | Note | 2006 | 2005 |
|---|---|---|---|---|
| **SHARE CAPITAL** | Authorised | | | |
| | 10,000,000 (2005: 10,000,000) ordinary shares of Rs. 10 each | | 100,000,000 | 100,000,000 |
| | Issued, subscribed and paid–up capital | 3 | 62,500,000 | 62,500,000 |
| | Revaluation reserve on investments | | 68,450,000 | (19,400,000) |
| | Unappropriated profit | | 1,423,286 | 1,443,920 |
| | | | 132,373,286 | 44,543,920 |
| **CURRENT LIABILITIES** | Accrued and other liabilities | 4 | 110,490 | 83,090 |
| | | | 132,483,776 | 44,627,010 |
| | **LONG-TERM INVESTMENTS** | 5 | 128,450,000 | 40,600,000 |
| **CURRENT ASSETS** | Other receivables | 6 | 175,395 | 47,318 |
| | Advance tax | | 44,258 | 40,300 |
| | Short term investments | | 3,137,450 | 3,105,562 |
| | Cash and bank balances | 7 | 676,673 | 833,830 |
| | | | 4,033,776 | 4,027,010 |
| | | | 132,483,776 | 44,627,010 |

The annexed notes 1 to 14 form an integral part of these financial statements.

**CHIEF EXECUTIVE** **DIRECTOR** **DIRECTOR**

# PROFIT AND LOSS ACCOUNT
# FOR THE YEAR ENDED JUNE 30, 2006

PROFIT AND LOSS ACCOUNT

| Rupees | Note | 2006 | 2005 |
|---|---|---|---|
| Income | 8 | 191,266 | 93,107 |
| Administrative expenses | 9 | (211,900) | (176,250) |
| Loss before taxation | | (20,634) | (83,143) |
| Taxation | | – | – |
| Loss after taxation | | (20,634) | (83,143) |
| Loss per share | 10 | (0.003) | (0.01) |

The annexed notes 1 to 14 form an integral part of these financial statements.

**CHIEF EXECUTIVE** **DIRECTOR** **DIRECTOR**

# CASH FLOW STATEMENT
# FOR THE YEAR ENDED JUNE 30, 2006

CASH FLOW STATEMENT

| Rupees | Note | 2006 | 2005 |
|---|---|---|---|
| **CASH FLOW FROM OPERATING ACTIVITIES** | | | |
| Loss before taxation | | (20,634) | (83,143) |
| Operating profit before working capital changes | | (20,634) | (83,143) |
| Increase in other receivables | | (128,077) | (12,746) |
| Increase in accrued and other liabilities | | 27,400 | 54,650 |
| Cash used in operations | | (121,311) | (41,239) |
| Income tax paid | | (3,958) | (4,234) |
| Net cash used in operating activities | | (125,269) | (45,473) |
| **CASH FLOW FROM INVESTING ACTIVITIES** | | | |
| Proceeds from disposal of fixed assets | | – | 38,012 |
| **Net cash generated from investing activities** | | – | 38,012 |
| **Net decrease in cash and cash equivalents** | | (125,269) | (7,461) |
| **Cash and cash equivalents as at July 1** | | 3,939,392 | 3,946,853 |
| **Cash and cash equivalents as at June 30** | 11 | 3,814,123 | 3,939,392 |

The annexed notes 1 to 14 form an integral part of these financial statements.

**CHIEF EXECUTIVE** **DIRECTOR** **DIRECTOR**

# STATEMENT OF CHANGES IN EQUITY
# FOR THE YEAR ENDED JUNE 30, 2006

STATEMENT OF CHANGES IN EQUITY

| Rupees | Issued, subscribed and paidup capital | Revaluation reserve on investments | Unappropriated profit | Total |
|---|---|---|---|---|
| **Balance as at June 30, 2004** | 62,500,000 | (12,400,000) | 1,527,063 | 51,627,063 |
| Loss for the year | – | – | (83,143) | (83,143) |
| Loss on revaluation of investments | – | (7,000,000) | – | (7,000,000) |
| **Balance as at June 30, 2005** | 62,500,000 | (19,400,000) | 1,443,920 | 44,543,920 |
| Loss for the year | – | – | (20,634) | (20,634) |
| Gain on revaluation of investments | – | 87,850,000 | – | 87,850,000 |
| **Balance as at June 30, 2006** | 62,500,000 | 68,450,000 | 1,423,286 | 132,373,286 |

The annexed notes 1 to 14 form an integral part of these financial statements.

**CHIEF EXECUTIVE** **DIRECTOR** **DIRECTOR**

NOTES TO THE
FINANCIAL STATEMENTS

**1. STATUS AND NATURE OF BUSINESS**

Allied Management Services (Private) Limited (AMSL) was incorporated under Companies Ordinance 1984 on October 09, 1991 and was registered as Modaraba Management Company on October 13, 1992. The principal activity of the company is floatation and management of Modaraba for undertaking business operations aimed at Islamization of the country's economy. The company floated and managed First Allied Bank Modaraba. The Board of Director's in its 48th meeting held on September 21, 2004 decided to transfer the fixed assets of AMSL to First Allied Bank Modaraba at book values.

**1.1** Subsequent to the balance sheet date, the Lahore High Court, Lahore sanctioned the scheme of arrangement to effect amalgamation by way of merger of First Allied Bank Modaraba with and into Allied Bank Limited which involved transfer to vesting in Allied Bank Limited of the whole business of First Allied Bank Modaraba together with the all properties, assets, rights, liabilities obligations against allotment of ordinary shares of Allied Bank Limited to the certificate holders of First Allied Bank Modaraba. On the completion of amalgamation by way of merger and after issuance of ordinary shares by Allied Bank Limited, First Allied Bank Modaraba will be dissolved without going into winding–up.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**2.1 Statement of Compliance**

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

**2.2 Accounting convention**

These financial statements have been prepared on the basis of historical cost convention except for as modified in accordance with note 2.4.

**2.3 Use of estimates**

The preparation of financial statements in conformity with approved accounting standards requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the result of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates is revised if the revision affect only that period, or in the period of the revision and future periods if the revision affects both current and future period.

**2.4 Long term Investment–Available for sale**

Available for sale investments are those financial assets that are not (a) loans and receivables originated by the company (b) held to maturity investments or (c) financial assets held for trading. Available for sale investments are initially recognized at cost and subsequently re–measured to fair value. Unrecognized gains and losses are recognized directly in equity through the statement of changes in equity.

**2.5 Revenue recognition**

**2.5.1** Modaraba management fee is recognized as income on an accrual basis.

**2.5.2** Dividend income is recognized when right to receive a dividend is established.

**2.5.3** Return on deposits with bank is recognized on accrual basis.

**2.6 Taxation**

Provision for current taxation is based on taxable income at current tax rates after taking into account tax rebates and tax credit available, if any, and the provision of Section 113 of Income Tax Ordinance, 2001 whichever is higher.

**2.7 Impairment**

The carrying amounts of the company's assets are reviewed at balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the recoverable amount is estimated and impairment losses are recognized in the profit and loss account. Reversal of impairment loss if any, is restricted to the original cost of assets.

**2.8 Provisions**

A provision is recognized in the balance sheet when the company has a legal or constructive obligation as a result of a past event, 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.

**2.9 Financial instruments**

**Recognition**

Financial instruments are recognized when the company becomes a party to the contractual provisions of the instrument. The particular recognition methods adopted are disclosed in the individual policy statements associated with each item.

**2.10 Off-setting**

Financial assets and liabilities are set–off and the net amount is reported in the balance sheet if the company has a legal right to set-off the transactions and also intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

**2.11 Cash and cash equivalents**

Cash and cash equivalents are carried in the balance sheet at cost. For the purpose of cash flow statement, cash and cash equivalents comprise cash and bank balances and short term investments as stated in note 11.

## 3. ISSUED, SUBSCRIBED AND PAID–UP CAPITAL

| Rupees | 2006 | 2005 |
|---|---|---|
| 6,250,000 (2005 : 6,250,000) ordinary shares of Rs. 10 each fully paid in cash | 62,500,000 | 62,500,000 |

3.1 Allied Bank Limited, the holding company, holds 6,248,800 ordinary shares as at June 30, 2006 (2005: 6,248,800 ordinary shares)

## 4. ACCRUED AND OTHER LIABILITIES

| Rupees | 2006 | 2005 |
|---|---|---|
| Accrued expenses | 110,000 | 82,600 |
| Dividend payable | 490 | 490 |
| | 110,490 | 83,090 |

## 5. LONG–TERM INVESTMENT – Available for sale

| 2006 | 2005 | | | |
|---|---|---|---|---|
| No. of Shares | | | | |
| | | **Managed Modaraba – listed** | | |
| 7,000,000 | 7,000,000 | First Allied Bank Modaraba | 128,450,000 | 40,600,000 |

## 6. OTHER RECEIVABLES

| | | |
|---|---|---|
| Income receivable on certificates of investments | 175,395 | 23,718 |
| Claim receivables | 23,600 | 23,600 |
| | 198,995 | 47,318 |
| Provision for doubtful receivables | (23,600) | – |
| | 175,395 | 47,318 |

| Rupees | | 2006 | 2005 |
|---|---|---|---|
| **7. BANK BALANCES** | Bank accounts | | |
| | – current | 65,443 | 65,443 |
| | – saving | 611,230 | 768,387 |
| | | 676,673 | 833,830 |
| **8. INCOME** | Return on bank deposits | 4,158 | 738 |
| | Profit on TDR (ABL) | 187,108 | 92,369 |
| | | 191,266 | 93,107 |
| **9. ADMINISTRATIVE EXPENSES** | Annual renewal fee | 15,000 | 15,000 |
| | Legal and professional charges | 87,600 | 103,000 |
| | Auditors' remuneration (9.1) | 85,250 | 40,000 |
| | Bank charges | 450 | – |
| | Provision for doubtful receivables | 23,600 | – |
| | Retainer–ship fee | – | 18,000 |
| | Miscellaneous | – | 250 |
| | | 211,900 | 176,250 |
| **9.1 Auditors' Remuneration** | Audit fee | 40,000 | 40,000 |
| | Half year fee | 40,000 | – |
| | Out of pocket expenses | 5,250 | – |
| | | 85,250 | 40,000 |
| **10. LOSS PER SHARE** | Loss after tax | (20,634) | (83,143) |
| | Number of shares | 6,250,000 | 6,250,000 |
| | Loss per share | (0.003) | (0.01) |
| **11. CASH AND CASH EQUIVALENTS** | Short term investments | 3,137,450 | 3,105,562 |
| | Cash and bank balances | 676,673 | 833,830 |
| | | 3,814,123 | 3,939,392 |

## 12. FINANCIAL ASSETS AND LIABILITIES

| Rupees | Interest / markup bearing | | | Non–interest / mark up bearing | | | Total |
|---|---|---|---|---|---|---|---|
| | Maturity upto one year | Maturity after one year | Sub total | Maturity upto one year | Maturity after one year | Sub total | 2006 |
| **Financial assets** | | | | | | | |
| Long term investments | – | – | – | – | 128,450,000 | 128,450,000 | 128,450,000 |
| Other receivables | – | – | – | 175,395 | – | 175,395 | 175,395 |
| Short term investments | 3,137,450 | – | 3,137,450 | – | – | – | 3,137,450 |
| Bank balances | 611,230 | – | 611,230 | 65,443 | – | 65,443 | 676,673 |
| Total financial assets | 3,748,680 | – | 3,748,680 | 240,838 | 128,450,000 | 128,690,838 | 132,439,518 |
| **Financial liabilities** | | | | | | | |
| Accrued expenses | – | – | – | 100,490 | – | 100,490 | 100,490 |
| Total financial liabilities | – | – | – | 100,490 | – | 100,490 | 100,490 |

| Rupees | Interest / markup bearing | | | Non–interest / mark up bearing | | | Total |
|---|---|---|---|---|---|---|---|
| | Maturity upto one year | Maturity after one year | Sub total | Maturity upto one year | Maturity after one year | Sub total | 2005 |
| **Financial assets** | | | | | | | |
| Long term investments | – | – | – | – | 40,600,000 | 40,600,000 | 40,600,000 |
| Other receivables | – | – | – | 47,318 | – | 47,318 | 47,318 |
| Short term investments | 3,105,562 | – | 3,105,562 | – | – | – | 3,105,562 |
| Bank balances | 768,387 | – | 768,387 | 65,443 | – | 65,443 | 833,830 |
| Total financial assets | 3,873,949 | – | 3,873,949 | 112,761 | 40,600,000 | 40,712,761 | 44,586,710 |
| **Financial liabilities** | | | | | | | |
| Accrued expenses | – | – | – | 28,440 | – | 28,440 | 28,440 |
| Total financial liabilities | – | – | – | 28,440 | – | 28,440 | 28,440 |

## 13. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the Board of Directors on September 30, 2006.

## 14. GENERAL

The figures have been rounded to nearest rupees.

**CHIEF EXECUTIVE** **DIRECTOR** **DIRECTOR**

# FORM OF PROXY

ALLIED BANK LIMITED

fold here

fold here

I / We ______________________________

of ______________________________

being a shareholder of the Allied Bank Limited (ABL) do hereby appoint ______________________________

of ______________________________ also a shareholder of ABL, to be my / our proxy and to attend, act and vote for me / us on my / our behalf at the 61st Annual General Meeting of the Bank to be held on Thursday, 29th March 2007 and at any adjournment thereof in the same manner as I / we myself / ourselves would vote if personally present at such meeting.

Signed this ____________ day of ____________ 2007.

**AFFIX**
**Revenue**
**Stamp of Rs. 5/-**

**Witness:**

fold here

fold here

1. Signature ____________

   Name ____________

   Address ____________

   CNIC # ____________

Signature:
The signature should agree with the specimen registered with the Company

Folio No. ____________

Witness:

CDC A/c No. ____________

2. Signature ____________

   Name ____________

   Address ____________

   CNIC # ____________

Sub A/c No. ____________

No. of shares held ____________

Distinctive Numbers: ____________

From ____________ to ____________

fold here

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**IMPORTANT**

**1.** This Proxy Form, duly completed and signed must be received at the address given in the notice of meeting not less than 48 hours before the time of holding the meeting.

**2.** CDC Shareholders entitled to attend and vote at this meeting, must bring with them their Computerized National Identity Cards or Passport in original to prove his / her identity, and in case of Proxy, must enclose an attested copy of his / her CNIC or Passport. Representatives of corporate members should bring the usual documents required for such purpose.

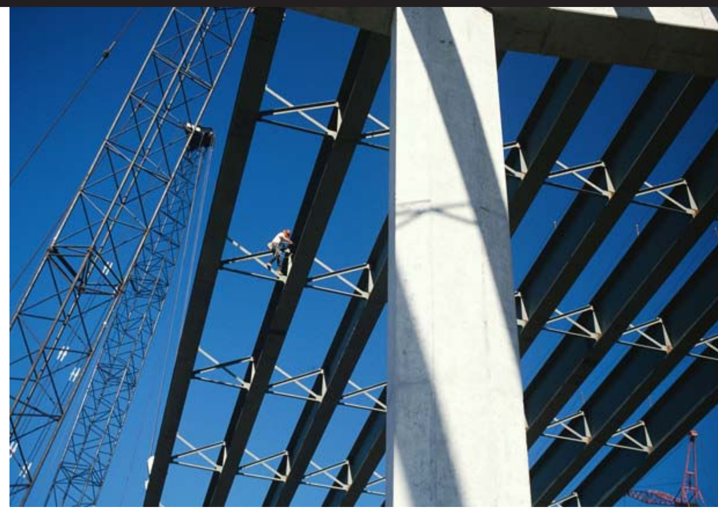
AFFIX
CORRECT
POSTAGE

**Allied Bank Limited**

**Head Office / Registered Office**
8-Kashmir / Egerton Road, Lahore.
UAN : (92 42) 111 110 110
Website: www.abl.com.pk

Groups' Review

## Corporate and Investment Banking




Corporate and Investment Banking Group (CIBG) offers a wide range of financial services to medium and large sized public and private sector entities. The financial services being offered include providing and arranging tenured financing, corporate advisory, underwriting, cash management, trade products, corporate finance products and customer services on all Bank related matters through relationship management concept.

CIBG has strategically placed its presence in all major corporate hubs of the country and presently enjoys a leading position in corporate lending in the country. The Bank played a key role in economic growth of the country by providing vast amount of funds in all the key sectors of the economy. The Group maintains a well diversified corporate portfolio of about 400 corporate relationships.

Allied Bank is ranked as one of top investment banks in the country because of its key role in the major investment and corporate banking transactions. In recognition of its achievements in this area, the Bank was awarded "The Corporate Finance House of the Year - Banks 2005-06" by CFA Association of Pakistan.

Some of the major transactions successfully concluded by us during the year were:

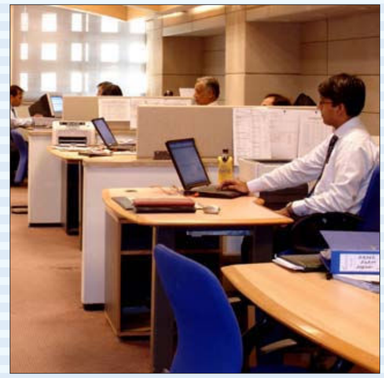
1. Joint Lead Arranger for Rs. 23,000 Million, for Non Recourse Project Finance Facility for Fatima Fertilizer.
2. Joint Lead Arranger of Rs. 8,600 Million, for Syndicated Term Finance for Orient Power Company Limited.
3. Lead Advisor and Arranger for Rs. 5,500 Million, Term Finance for Bestway Cement Limited.
4. Joint Lead Advisor and Arranger for Rs. 5,500 Million, 10 Year Expansionary financing of Century Papers and Board Mills Limited.
5. Joint Lead Advisor and Arranger for Rs. 3,500 Million, Term Finance for Marri Gas Company Limited.

Focus on top quality credit has substantially reduced the NPL ratio and we expect it to reduce further in the current year. We plan to further diversify our portfolio and focus on lending to low risk areas which will be the driver of our growth in near future.

Along with Corporate and Investment Banking business, we also focused on other corporate related businesses, namely Cash Management. This allows us to maximize on the business opportunities available in the corporate segment. We started to bring a defined structure to Cash Management activity by incorporating international best practices, coinciding with the Bank's activation of its 100% real-time online branch network. The true potential of this area began to be realized in 2006, with the full rollout of state of the art cash management products and services which harnessed the Bank's unparalleled real time architecture. A team of transactional banking specialists from a multinational banking background have driven a business development effort that has enabled the acquisition mandates of multinationals, large local corporates, public sector entities, as well as regional and global financial institutions. We offer a comprehensive range of services, including receivables management, bulk online disbursements, web banking and supply chain services.

In the realm of Financial Institutions, the Bank can today boast a vast international network of top tier global correspondents, enabling our business units to access a wide array of trade solutions. We have focused on the development of inbound trade and guarantee business from counterparties across the world. Also, we have emphasized the development of inbound remittances into Pakistan, investing in people and technology development to take the lead in delivering remittances in every nook and corner of the country, and accessing beneficiaries through our own extensive network as well as through innovative delivery channels such as Web Banking and next generation ATMs. Our aim is to utilize Financial Institutions network to facilitate Non Resident Pakistanis (NRPs) by putting in place third party arrangements with banks / exchange companies around the world for functioning as contact points for home remittances. In this regard, we have started directly crediting foreign remittances to individual accounts in remote for convenient home remittances.

We are also in the process of establishing our Asset Management Company to provide one window facility to NRPs as well as our local customers for management of their funds.



Commercial and Retail Banking Group (CRBG) was restructured in 2005 with the formation of 27 regions overseen by three Group Heads namely North, Central and South with the objective to be more close to our customers. As a result of this restructuring, focused attention is being paid to fulfill the needs of small to medium size industrial and commercial enterprises.

## Commercial and Retail Banking

The underlying strength of our strategy is to identify market needs and develop innovative products having technological edge. The products should match with customer needs and expectations by remaining receptive in the competitive business environment. We have been continuously improving service standards to achieve accelerated business growth. This process includes working on a number of initiatives to enhance our operational effectiveness like launching of internet banking, installation of flat bed printers in branches, further expanding ATM network etc.

Since restructuring of CRBG, we have aggressively expanded our deposit base, enhanced our assets portfolio with significant increase in the range of products and services. Consequently, the Bank has become an active and visible market player.

In line with the vision and mission of the Bank, we have defined our goals, targets and objectives as under:

i. To be the market leader in middle sized customers segment
ii. To become leading SME Bank in the diversified urban markets
iii. To focus on new avenues in agriculture sector financing
iv. To provide the customers with integrated financing and investment options
v. To provide speedy funds transfer and deposits solutions under one roof

In order to achieve these goals, we have defined our strategy keeping in view the market potential and dynamics. Major achievements are highlighted hereunder:

- Upgradation of customer services
- Hiring of professional and experienced staff in all functional areas
- Launching of new liability products addressing customer needs
- Renovation of branches
- Improvement in technology support
- Decentralization of authorities to provide prompt services to the customers
- Capacity building of employees and promoting business oriented values to accelerate business growth
- Promotion of performance based culture
- Emphasis on principle based banking for strict compliance and control

To address the changing business environment primarily due to merger/acquisition of banks and increasing market competition, comprehensive market study and research work is given due importance. We have already instituted a strategy to cope with the future challenges to achieve its goals and targets.

Our strategy for 2007 is to rapidly upgrade the service standards by accelerating the pace of induction of quality human resource in a phased manner. Simultaneously, progress is made in the deployment of the state of the art technology and improvement in service level.

We plan to continue our efforts by concentrating more on attractive liability products and enhancing our share of assets portfolio to SME sector by exploiting the advantage of our large branch network.

## Consumer and Personal Banking

In line with the policy of the Bank, the Bank started strategically structuring itself by focusing on business segments. This approach was carried out in a phased manner where Corporate and Investment Banking Group and Commercial and Retail Banking Group were established. Subsequently, during the later part of 2006, Consumer and Personal Banking Group (CPBG) was organized to optimize on the business opportunities exist in the market. The Group plans to cater to the financial needs of consumers and small businesses. With the largest online branch network, the platform is ready for the Bank to become one of the best consumer banks having a diversified portfolio of consumer products. We are planning to operate a multi channel service model through which it will provide a full range of financial services 24 hours a day and 7 days a week.

The Consumer and Personal Banking Group intends to build broader and deeper relationships both with existing and new customers. Our objective is "To Build A Truly World Class Consumer Bank".

To achieve this, we plan to put in place the following key "ingredients":

- Top class professionals
- State of the art technology
- Customer centric products
- Best in class Credit and Risk Management tools
- Strong Marketing and Sales Culture
- Strong Service Environment

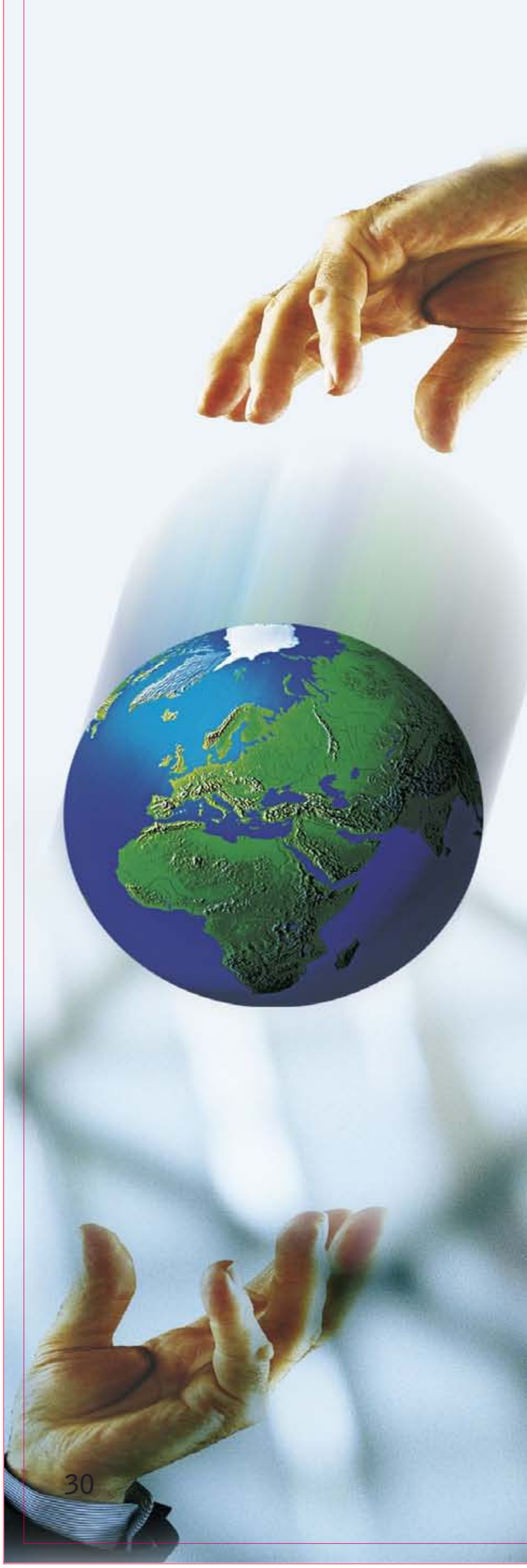
We see very little that differentiates the current product offerings in the market. By leveraging the ingredients to the fullest, we believe we would be able to provide enhanced value to our customers and our stakeholders.

Over the last few years, there has been tremendous growth in personal loans, auto loans, credit and debit cards, mortgages, etc. We expect this to continue to grow significantly over the medium and longer term. Consumer and Personal Banking Group will represent a considerable portion of the Bank's revenues and going forward, it will be one of the major contributors to the Bank's profitability.

Although there are several banks providing consumer products, we believe that Allied Bank, with its largest online branch network and commitment to superior technology infrastructure, can meet the personal financial needs of its franchise and non franchise customers more competitively.

During 2007 we will continue the process of recruiting the core team members and putting the technology in place. We will also strengthen our current credit and debit card offerings to ensure that the "value proposition" for this product group is further strengthened. In addition, a number of new and innovative products are planned for this year. Furthermore, we expect to fully leverage our existing branch network and customer base to optimize this huge untapped opportunity at our Bank.

## Risk Management

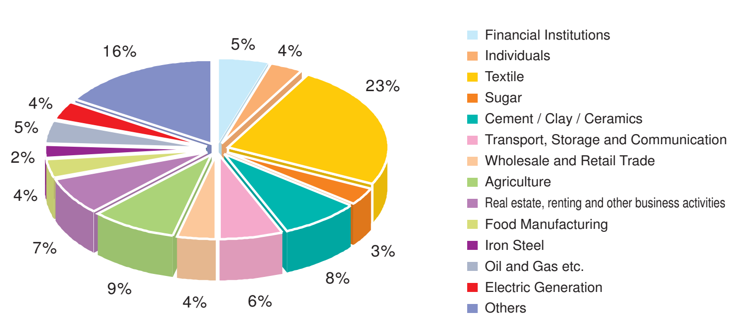


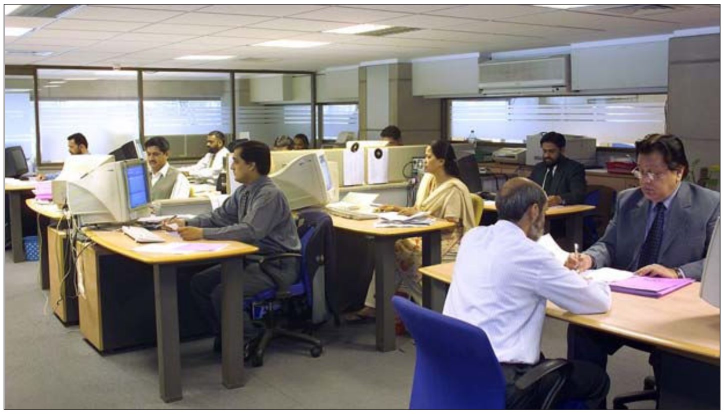
The Risk Management Group (RMG) was established in June 2005 as an integral part of Allied Bank's business activities, with key responsibility to identify, analyze, monitor and manage the principal risks to which the Bank is exposed. The risk management process begins with the formulation of business objectives and strategies, and encompasses the identification, assessment and measurement, monitoring and control of credit, market and operational risks across the Bank.

Risk functions have been segregated by business specialization i.e. Credit Risk, Operational Risk, Market Risk, Credit Administration, Risk Architecture and Portfolio Management. In pursuance of these objectives, RMG has taken up the challenge to foster a proactive risk culture by creating the following risk management functions by business specialization:

- Credit Risk: Credit Risk Management is divided into two units i.e. Commercial and Retail Risk, and Corporate and Financial Institutions Risk. These units ensure that risk exposures undertaken match the risk appetite of the Bank, and that proper credit approval procedures are adhered to.
- Operational Risk: The Operational Risk Management unit is developing an effective system for identification of critical risk areas, and developing processes / controls to mitigate these risks.
- Market Risk: The Bank intends to build an effective Market Risk Management unit to independently identify measure, monitor and control the potential losses that may arise from the Bank's activities in the financial markets.
- Credit Administration: The Credit Administration Division constantly monitors the security and documentation risks inherent in the existing credit portfolio through six regional credit administration departments located all over the country.
- Risk Architecture formulates credit policies and procedure guidelines and ensures that all risks in product program based lending in consumer finance is properly mitigated. This function also oversees the formulation of operational risk and market risk policies.
- Portfolio Management is an integral part of the credit process that has varied responsibilities. These include monitoring portfolio MIS and risk profile, establishing concentration limits, identify and analyze trends that could affect the risk and performance of the portfolio as well as coordinating the implementation of Basel II in the Bank, which is of utmost priority and is viewed by the Bank as an important step in the alignment of regulatory and economic capital requirements.

**Advances - Segment Wise Business**





Since formation of the Group, a number of initiatives have been taken. Some of the major initiatives are listed below:

- Formulation of essential credit policies
- Implemented a new Credit Application Package incorporating a formalized and structured approach for credit analysis, and directs the focus of evaluation towards a balanced assessment of credit risk with identification of proper mitigants. These risks include industry risk, business risk, financial risk, security risk and account performance risk
- Strengthened financial analysis through launch of separate financial spreadsheet templates for manufacturing and trading concerns, banks, leasing and insurance companies. To make the risk estimation more accurate and forward looking, RMG on a pilot basis also developed in house Risk Rating Templates to rate the various asset classes. These rating templates are targeted for launch in 2007 after they have been tested with the assistance of an external consultant
- Initiated Basel II implementation project by engaging PricewaterhouseCoopers (PwC) in the latter half of 2006. In this respect, we plan to undertake the following measures:
    - To conduct a Gap Analysis with respect to Credit, Market and Operational Risk
    - Establishment of a market risk management framework
    - Evaluation of various risk management software to meet the sophisticated data management and reporting requirements

We continue to promote sound business decisions consistent with the Bank's risk tolerance levels and drives the maximization of long term shareholder return. Our aim is to continue the pace of initiatives in 2007 with implementation of Basel II as well as formulation of operational risk and market risk guidelines.

## Treasury

Treasury group is actively involved in managing funds through interbank market, investments in securities and capital markets with the objective to provide healthy support to other businesses of the Bank as well as to the customers. At the same time, the Group also ensures that all regulatory requirements are being complied with.

The Group has qualified and experienced professionals who have specialized expertise in treasury functions. The Group is divided into desks of Money Market, Foreign Exchange, Treasury Marketing and Capital Market, functions of which are:

Money Market: The Desk is responsible to manage regulatory reserve requirements of the Bank, liquidity management by placement and borrowing through interbank money market, participate in auctions of Treasury Bills and other government papers and management and trading of investment in fixed income government securities. Interest rate risk management is also the responsibility of this area.

Foreign Exchange: The FX Desk is involved in fund management of foreign currencies through interbank placements and swaps, pricing support to TMU, quoting prices to overseas correspondents for higher home remittances volumes, managing currency exposure for adherence of regulatory limits.

Treasury Market Unit (TMU): It manages day to day liquidity needs of the Bank's customers to hedge their exposure/trade transactions in foreign currencies, manages regulatory reserve requirements of foreign currency accounts, provide funding to nostro accounts, quote competitive prices to the Bank's customers, quote spot and forward rates to customers and discounting of bills, as well as caters customer requirement of foreign currency loans for trade purposes.

Capital Market Desk: The Desk is responsible for all activities related to equity markets. The desk manages investment in listed shares, trades in securities to generate profit from short term price fluctuations, finds arbitrage opportunities for profit maximization through trading in ready and futures market and provides financing through Continuous Funding System (CFS).

During 2006, Bank's Treasury remained focused on its core objective of liquidity management. The Bank actively participated in Treasury Bills auctions, increased its FX trading volume and became an active player of Capital Market. These collective efforts from different areas increased Treasury's profit in particular and Bank's overall profitability in general.

Looking forward, in 2007 we will continue our focus on the core business of managing Bank's liquidity, support other areas by introducing innovative products for Banks customers and to enhance Bank's profitability by actively using Income Funds offering value in terms of yield and quality.

With the introduction of Treasury module of Temenos T24, greater volumes of interbank dealing in SWAPs and gap running activities in the area of foreign exchange and interest rate risk will be enhanced. Besides improving the profitability of the Bank, it will provide opportunity to be more aggressive in price quotations and image building of the Bank. With Temenos T24 in place, we will be able to target derivatives products that are used locally in the areas of interest rate SWAPS, Forward Rate Agreements (FRAS) and plain vanilla option. This will help our customers to hedge their exposures in an efficient manner.

## Finance

At ABL Finance Group plays pivotal role in strategic planning, formulation of business strategy, budgetary control, MIS, Tax management and Financial and Regulatory Reporting. The Group provides proactive support to business groups by providing analysis and information for efficient decision making.

Finance plays dynamic role in enhancing the economic value and realization of corporate objectives of the Bank. The Group also provides support in the following:

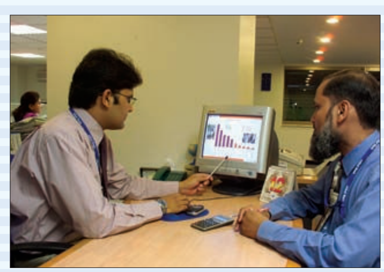
- Strategic planning and budgeting
- Automation initiatives
- Performance measurement for various business segments and products
- Formulation and implementation of effective cost control strategies
- Timely finalization and dissemination of periodical financial statements

Finance Group played key role in recapitalization and subsequent restructuring of the Bank. The group successfully managed the related accounting and audit requirements of merger of Ibrahim Leasing Limited (ILL) in 2005 and First Allied Bank Modaraba (FABM) in 2006.

The first priority of the new Board of Directors on acquisition of the Bank was to give a strategic direction and vision for transforming the Bank into a dynamic and world class financial institution. In this context, Finance Group played a key role in formulation of 5 years strategic plan of the Bank.

The Group in coordination with other business groups also prepares robust annual business and operating plans. The annual budgetary exercise is done in coordination with other supporting and business groups to have a realistic but challenging budgetary targets in the back drop of economic environment and business competition. A robust monitoring mechanism to track the actual results with the budgetary targets is in place.

We have structured management reporting system in place which gives the management key performance indicators and has drill down capability to trace variances. We have also developed MIS for various internal business segments of the Bank which helps the senior management in timely decision making and monitoring.



The Corporate Governance, financial and regulatory requirements have changed a lot over the last 2 to 3 years. In this context, we have successfully managed to adopt the new reporting requirements while ensuring completeness, accuracy and transparency. In the year 2006, we implemented the Reporting Chart of Account introduced by the SBP.

In order to strengthen the financial and MIS capability of the Bank, we initiated the implementation of Oracle ERP / financials which is now at the final stage of implementation. Additionally, we managed various automation initiatives in coordination with IT Group, such as accruals/accounting processes.

Going forward, the Group plans to proactively participate in implementation of Basel II, Internal Control Guidelines and new core banking software. The Group will continue to work with other support and business groups to ensure the completeness and transparency of financial reporting.

# Audit and Inspection

The primary objective of the Audit and Inspection Group (AIG) is to review the effectiveness of internal controls and risk management practices to minimize business risk. The Group performs an ongoing evaluation of the Bank's operations vis-a-vis quality, comparability and transparency of the financial information. The Audit and Inspection Group also verifies that the Bank is in compliance with pertinent laws, regulations and directives of the State Bank of Pakistan and other regulatory authorities.

The Bank has undergone a number of changes in respect of its administrative infrastructure, technology base, management philosophy, and control environment under the leadership of new management of the Bank since 2004. In order to enable the Group to operate effectively in the changing environment, meeting with enhanced regulatory requirements, expectations of the stakeholders and requirements of modern internal auditing techniques, a comprehensive strategic plan is under implementation. The strategic plan is based on a four pronged strategy to bring about a quality change in the internal audit function.

This strategy focuses on the following four dimensions:

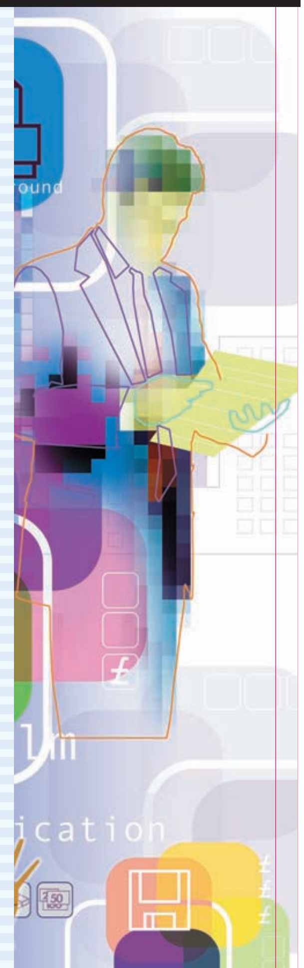
- Re-engineering of systems and policies
- Development of human resources
- Development of IT resources and infrastructure
- Reorganization of the Group and upgradation of internal setup at Regional Audit Offices

We have achieved all targets set in Audit Plan for the year 2006. Moreover, policy documents of AIG like risk based internal audit policy, charters of the Group and Audit Committee were reorganized as per requirements of code of corporate governance issued by SECP and SBP. Also during 2006 a risk based internal audit framework has been developed and internal audit checklists of branches were updated. The concept of soft audit for branches has been introduced besides establishment of special task force for investigation of fraud and forgeries cases in the Bank.

During 2007, we intend to automate the workflows of the Group from audit planning, its execution, monitoring to follow up of audit issues. Special emphasis will be laid on accelerating the pace of the transformation process and to make the internal audit function in the Bank more effective and result oriented. Professionally qualified staff having requisite banking audit experience and IT background will be hired to perform these assignments. Our main objective will remain improving the quality of Internal Audit and changing the audit approach from conventional transaction testing to a risk based and value adding management consultancy in line with the latest definition of internal auditing and requirements of international standards.

We hope that after implementation of the strategic plan, Audit and Inspection Group will be able to transform its approach from conventional auditing to IT enabled risk based value added management consultancy conforming to international standards and best practices in the field of internal auditing.

## Compliance and Control



The Compliance and Control Group (CCG) is responsible for safeguarding the Bank against any risk arising from legal or regulatory sanctions, financial loss, or any other loss to the Bank's reputation that it may suffer as a consequence of non compliance with laws, regulations, code of conduct and standards of good practices.

The Group oversees the implementation of all relevant regulations and procedures of the Bank. In light of which, we strive to make the internal control more effective and efficient so that the branches operate within the framework of internal and external rules and regulations.

The functions performed by the Group are as follows:

- Legal and regulatory matters
- Internal control and its overall framework
- Compliance with policies
- Anti Money Laundering , Know Your Customer and fraud control program
- Regulatory reporting
- Compliance of internal, external auditors and SBP reports
- Compliance of SBP prudential regulations

For the Group, the pressure stems from all sides to protect the institution mainly from any embarrassing loss to reputation. Failure to comply with regulatory compliance, can lead to serious business consequences in terms of lost revenue, customer confidence and legal liability. In short, this is the challenging and exhilarating role of the Group, which is vital in promoting healthy practices in today's demanding Banking sector.

During 2006, to maintain an effective control environment has been a rigorous testing assignment for us. We have been playing a dynamic role in carrying out this enormous task effectively and efficiently. Some of the major achievements of the Group are as follows:

- Enforcing "Know Your Customer" standards across the branch network
- Monitoring high value unusual transactions on a daily basis
- Following up the rectification process of slackness in controls and issues raised by audit

Going forward, we plan to address the following:

- Introduction of an automated Anti Money Laundering solution
- Introduction of an automated solution to the control function
- Add value towards the core activities of the Bank
- Safeguard the reputation of the Bank in the eyes of customers, regulators, markets and society
- Inculcate business ethics at all levels of management

With the implementation of Temenos T24 core banking system, we will be geared up for the system support for KYC, AML and other critical functions. This will allow us to have effective control, monitoring and followup of such functions.

Groups' Review

## Information Technology

The key aim of Information Technology Group (IT) is to provide strong technological support to the business. This aligns the Group with the overall objective of the management to transform the Bank into technology-based financial institution which provides convenient banking to its customers and at the same time allows strong control environment.

IT Group continued to play its role in the progress of the Bank by supporting technology based products and services. During the year, we provided support required to maintain its leadership in branch based online services through its network of 742 branches. This unique position was leveraged to attract new business in addition to enhancing the convenience for the existing customers. Consequently, the utilization of previously introduced services on the online branch network continued to grow while additional services were introduced. Such services include Cash Management for corporate and commercial clients, convenient home remittance services by directly crediting to individual accounts in remote branches, efficient Demand Draft payment process, etc. We also provided our expertise in branch connectivity to enhance MIS through a centralized Central Database where information on transactions is updated daily. Business Intelligence Portal was also introduced on the Bank's intranet for the availability of vital information for the senior management in a digital dashboard format.

During 2006, the Group played a pivotal role in installing 190 ATMs, raising the number of ATMs to 290 (December 31, 2006), thereby achieving the distinction of having the largest ATM network in the country. Moreover, during the year, the Group worked on various value added features for ATMs and internet, such as funds transfers, availability of Mini Statement of Account, introduction of Alerts through SMS / email to customers and utility bills payment.

Involvement of the IT Group in office automation continued to grow during 2006 with additional users being provided email and other facilities. Email facilities were made available on the Bank's Wide Area Network for the branches through Linux mail. In addition, MS Exchange email facilities were expanded to cover additional users. Use of SharePoint Portal for sharing information amongst users on the Bank's intranet also increased. Consequently, reliance on electronic modes of communication such as BlackBerry grew exponentially during the year resulting in quicker decision making and more responsive management.

With increasing volume of transactions being routed through branch connectivity, a full fledged Disaster Recovery Site was created and an associated Disaster Recovery Plan has been implemented to ensure continuity of services on the electronic delivery channels.

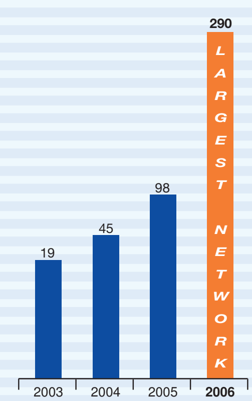
During the year, the Bank decided on the acquisition of a latest, internationally recognized core banking software. An agreement was signed with Temenos, Switzerland for acquiring software license for their core system T24 and its associated modules as well as for implementing the same. Under the agreement, Temenos will also carry out necessary parameterization / customization of the system. The implementation project has already been initiated and is expected to be completed by the middle of 2008. The new system will not only bring the bank at par with the international banks in terms of processes and technology, it will also enable the bank to offer customer centric services to enhance its capability to launch new products and services.

# Operations

Operations Group is well positioned to meet the challenges of the changing business environment. To achieve it, the Group is working on optimal use of information technology coupled with increased awareness of the customer's preferences. The Group is involved in achieving efficiencies through reengineering the existing processes and procedures. This will allow the Bank to offer easy, convenient and hassle free products and services at most economical pricing. It was considered imperative to introduce latest and state of art technology in banking operations which will considerably reduce manual intervention ensuring enhanced productivity, accuracy and economy in processing cost.

During the short span of two years, the Bank managed to upgrade its image and captured a visible market share. Besides automation of process, the Engineering Division initiated the remodeling and renovation of the branch network to introduce a corporate outlook across the branches as well as to provide comfortable and convenient environment to its customers. Alternate Delivery Channel function focus greatly on reducing the transactions on the counters. We were instrumental in establishing the niche for its ATMs throughout the country by extending the network of 290 ATMs in more than 90 cities (December 31, 2006). This is an impressive milestone as number of ATMs was only 45 in September 2004 when the Bank was recapitalized. The Bank has clearly emerged out as market leader in establishing the largest network of ATMs while offering value added services like interbank / branch funds transfer and facility for utility bills payment. The Bank also managed to cross 300,000 landmarks of ATM card holders and became the largest issuer and acquiring bank among the member banks. Internet bank facility was launched in the beginning of the year which further boosted the Bank's image in the local market equally supported by helpdesk facility being run on 24/7 basis.

**Number of ATMs**
as at December 31




We played an important role in keeping the branches well informed about the changes in rules and regulation. It also ensured that adequate controls from risk perspective are in place and initiatives like online verifications of customer information were timely implemented. Alternate back up sites for SWIFT and other sensitive areas of production were established.

We would focus on widening the scope of electronic distribution channels to reduce the dependencies on the branches, reducing the transactions costs and enhancing the value added services. This coupled with the repositioning of the branches and helps in increasing the market share and customer satisfactions. There would be special focus on creating awareness programs for the staff about the retention of customers by fulfilling their demands, cross selling and managing their expectation proactively.

## Human Resources


The core objective of the human resource group is to recruit and retain competent pool of human resource for the Bank and to look after the employees, in terms of their motivation, competency enhancement and training and development. Allied Bank is an equal opportunity and affirmative action employer where females and minorities are given equal opportunity to apply. However, merit and individual competence are the most significant factors for the selection in the Bank.

The Human Resource Group (HRG) is sub divided into six wings, namely, Personnel Wing, Compensation and Benefits Wing, Management Development Wing, Employee Relations Wing, Human Resource Planning Wing and Human Capital Management Wing. All the human resource management practices and activities are uniformly distributed amongst these wings.

In early 2005, a major reorganization was undertaken across the Bank and various activities were structured on functional basis. The purpose of this reorganization was to achieve the maximum professionalism and specialization in various functions and to put internal check and balances in place, for the implementation of best management practices. Along with this reorganization, a constant process of induction of best available resources from within and outside the country was initiated and as a result, the Bank now has professionals with number of years of experience in specified fields. Uptil now, we have completed placement of all key positions for the top two tiers of the management.

One of the major tasks which are also undertaken as a continuous process is to change the culture of the Bank by not only introducing technology but also to induct fresh human capital by way of an efficient and effective management training program. So far, six batches of these trainees have been inducted and after comprehensive training at Allied Bank Management Development Centers, they have been placed in various functions. We have ambitious training and development programs with three management development centers at Karachi, Lahore and Islamabad, with full time principals and faculty members imparting training on a wide variety of subjects, including the training in soft skills. We have a plan to upgrade these management development centers and to bring them to the international standards. We are also planning to work with the leading educational institutions to provide training to our employees specific to banking requirements. Last year, the management development centers conducted 109 different in house training courses. In addition to these in house training courses, 20 employees holding key positions were sent to 14 international courses around the world. In addition, 334 staff members were sent for 154 local training courses in reputable training institutes within Pakistan.

At HRG, the activities grow with a constant change, to incorporate the best and latest management practices to induct and retain the world class personnel and to further develop them.

## Special Assets Management

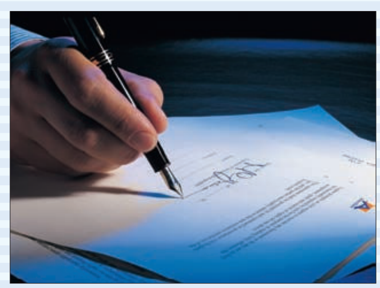
The primary purpose of Special Assets Management Group (SAM) is to keep Non Performing Loans at optimal level in a timely and cost efficient manner. It persuades defaulting borrowers in a variety of ways which includes dialogues, negotiations, suits and third party intervention to come to an amicable settlement of their dues. The Group plays a pivotal role to establish its value, shaping its vision and accomplishing its mission about eradication of Non-Performing Loans/Assets (NPLs/NPAs). Our objective is to resolve disputes with clients preferably through negotiations and if necessary through legal action.

SAM Group also seeks to ensure compliance of Prudential Regulations and risk management guidelines issued by SBP with regard to NPL accounts.

During the year 2006, the NPLs reduced by 17.5% from Rs. 12.7 billion to Rs. 10.5 billion as a result of aggressive recovery efforts by SAM group.

We have adopted a proactive approach instead of a reactive approach to avoid NPLs in the future through effective coordination with Risk Management and other business group and keeping a close watch on our clients' activities. This strategy has worked out well as NPLs reduced from Rs. 17.3 billion (Sep. 30, 2004) to Rs. 10.5 billion, NPL ratio improved from 34% to 7% in December 2006. Similarly, net infection ratio of 17% in September 2004 reduced to only 1.96% in December 2006 whereas loan loss coverage ratio improved from 61% to 73% in the same period.

## Corporate Affairs



Corporate Affairs Group facilitates the Board of Directors in discharging their fiduciary responsibilities by providing timely input on corporate Governance, shareholders matters and statutory regulations. It acts as an agent for disseminating the decisions and directives of the Board, various sub Committees of the Board and shareholders.

Consequent to recapitalisation of the Bank, the Corporate Affairs Group played a key role in listing of the Banks shares on the Stock Exchanges, merger of Ibrahim Leasing Limited and First Allied Bank Modaraba, and issuance / listing of the Bank's Term Finance Certificates.

In order to cater for future capital requirement, the Group also administered statutory approvals for increase in authorised capital during the year 2006.

In 2006, the Board Committees and their TORs were restructured in line with Corporate Governance and best practices.

Corporate Affairs Group also assisted the management in formulation of management committees and follow up on matters arising out of minutes of such committees' meetings. The Group coordinate with management for inculcating the good governance and best practices across the Bank.

In 2007, the Group will be involved in following initiatives:

- Establishment of Asset Management Company
- Liquidation of Allied Management Services Limited (AMSL)
- Dividend payments and issuance of Bonus shares

Corporate Affairs Group will continue to ensure compliance with legal requirements of SECP, SBP, Stock Exchanges and other statutory laws.

# Important Events - 2006

**January**

- Launched internet banking product "Allied Direct"

**February**

- Co-sponsored Pakistan - India cricket series

**March**

- Sponsored All Pakistan Allied Bank Open Golf Tournament at Faisalabad

**April**

- Sponsored First South Asian Accounting Summit

**June**

- Initiated implementation of Basel II Project by engaging PricewaterhouseCoopers (PwC)

**July**

- JCR-VIS Credit Rating Company upgraded the outlook of the Bank to 'Positive' and maintained the medium to long term entity rating at A+ (Single A Plus) and for short term A1 + (Single A One Plus)
- The Honourable Lahore High Court sanctioned the merger of First Allied Bank Modaraba (FABM) with and into the Bank

**August**

- Election of directors held, three additional Independent Directors were elected to the Board of Directors
- Agreement signed with Temenos, Switzerland for implementation of Temenos T24 Core Banking Software Solution

**November**

- Allied Bank was awarded the "BANK OF THE YEAR 2006" by "The Banker" published by Financial Times Business Ltd., UK
- Allied Bank was awarded "THE CORPORATE FINANCE HOUSE OF THE YEAR - BANKS 2005-06" by CFA Association of Pakistan
- Initiated the process for the establishment of a Market Risk Management Framework

**December**

- Raised Term Finance Certificates (Tier II Capital) amounting to Rs.2.5 billion
- Allied Bank achieved distinction of having the largest ATM network of 290 in the country with widest geographical network

*Khalid A. Sherwani, President (center) receiving*
*"Bank of the year 2006" award at awards distribution ceremony held in London*

## The **Banker** Awards 2006

This is to certify that the banker has awarded

# Allied Bank

Bank of the year 2006 for

# Pakistan

**Brian Caplen** Editor

**Angus Cushley** Publishing director

# Management Committees

## Management Committee (MANCO)

| | |
|---|---|
| Khalid A. Sherwani *(Chairman)* | President |
| M. Naveed Masud, | Group Chief, CRBG |
| Muhammad Jawaid Iqbal | Group Chief, CIBG |
| Fareed Vardag | Group Chief, RMG |
| Tariq Mahmood | Group Chief, Operations |
| Javed Iqbal | Group Chief, IT |
| Zia Ijaz | CFO |
| Shafique Ahmed Uqaili | Group Chief, HRG |

### Terms of Reference

- To consider all matters pertaining to the Bank's operations / day to day affairs requiring collective wisdom of the senior management
- To give input on new initiatives / products
- To consider and recommend the Annual Business Plan / Budget / Operational model / Structure
- To recommend changes in its own TORs to the concerned Board Committee
- To take up any other matter referred by any of the Committees, President or Group Chiefs

## Human Resources Committee (HRC)

| | |
|---|---|
| Khalid A. Sherwani *(Chairman)* | President |
| M. Naveed Masud | Group Chief, CRBG |
| Muhammad Jawaid Iqbal | Group Chief, CIBG |
| Tariq Mahmood | Group Chief, Operations |
| Zia Ijaz | CFO |
| Shafique Ahmed Uqaili | Group Chief, HRG |

### Terms of Reference

- To ensure that policy guidelines provided by the Human Capital Committee (HCC) and by the Board of Directors (BOD) are followed and ensure transparency in the entire process and functions of human resources
- To review and propose to HCC, amendments in the HR Policy, from time to time
- To introduce fresh and / or modify existing service rules including the salaries in line with market trends
- To ensure that all the required personnel procedures and practices are market driven and are appropriately benchmarked vis-a-vis banking industry
- To review and devise ways and means to attract and retain the best talent through performance evaluation and rewards on a timely basis
- To place quarterly report to the HCC for its feedback on the important decisions taken by HRC
- To review appeals of punishment by all staff imposed upon them by Administrative Action Committees
- Any other task or assignment given by the HCC and the BOD

## Risk Management Committee (RMC )

| | |
|---|---|
| Khalid A. Sherwani *(Chairman)* | President |
| Fareed Vardag | Group Chief, RMG |
| Tariq Mahmood | Group Chief, Operations |
| Zia Ijaz | CFO |
| Muhammad Yaseen | Treasurer |
| Khalid Mehboob | Group Chief, Compliance and Control |
| M. Naveed Masud | Group Chief, CRBG |
| Muhammad Jawaid Iqbal | Group Chief, CIBG |
| Mohammad Abbas Sheikh | Group Chief, SAM |

### Terms of Reference

- To assess the ever changing risk profile of the Bank and monitor the management adherence to prudent and sound risk policies and practices
- To review asset quality trends and banking operations that could affect the risk and performance of the portfolio
- To give guidance on risk appetite for new business opportunities to business units and define pricing objectives ensuring that the expected return on the portfolio compensates for the risks taken
- To receive quarterly reports on significant variations in the risk profile of exposures and provisions made against the non performing portfolio
- To consider and recommend to the Board the approval of new/amendments to risk policies and procedures and take responsibility for regulatory and Basel II compliance
- To approve all credit proposals including rescheduling/ restructuring/waivers/write offs and filing of recovery suits as well as relaxation in risk policy / prudential regulations
- To review minutes of the ALCO with respect to risk management
- To monitor performance of the Risk Management Group, Compliance and Control Group, Special Assets Management Group as well as RMC and the Compliance Committee. Also to determine / amend the constitution, TORs and delegation of powers to these aforementioned committees
- To delegate, as deemed necessary, its powers to the Management / Management Committee(s)
- To recommend changes in its own TORs to the Board

# Committees

## Assets And Liabilities Committee (ALCO)

| | |
|---|---|
| Khalid A. Sherwani *(Chairman)* | President |
| Mohammad Yaseen | Treasurer |
| Zia Ijaz | CFO |
| Fareed Vardag | Group Chief, RMG |
| Muhammad Jawaid Iqbal | Group Chief, CIBG |
| M. Naveed Masud | Group Chief, CRBG |
| Azhar A. Jaffri | Group Chief, CPBG |

### Terms of Reference

- To review the structure and composition of Bank's assets and liabilities and decide the overall pricing strategy and to manage Bank's capital position
- To manage Bank's liquidity position, maturity and yield profile and to implement the transfer pricing policy
- To review and recommend to Risk Management Group, asset/liability policies and procedures related to Market Risk
- To review or suggest actions with respect to related examination report by regulatory agencies, auditors or special examination or pertaining to pending legislation or regulation
- To articulate interest and FX rate view and the funding policy of the Bank and to decide on the future business strategy in this regard
- To review foreign currency exposure, investment activities, issues, strategies including related limits and market prognosis
- To recommend changes in its own TORs to the concerned Board Committee and to discuss any other matter assigned by any of the Committees or Chairman

## Compliance Committee

| | |
|---|---|
| Khalid Mehboob *(Chairman)* | Group Chief, CCG |
| Muhammad Sardar Khawaja | Group Chief, AIG |
| Tariq Mahmood | Group Chief, Operations |
| Fareed Vardag | Group Chief, RMG |
| Zia Ijaz | CFO |
| Freddy Sethna | Chief Anti Money Laundering |

### Terms of Reference

- Periodical review of framework for implementation of guidelines on anti money laundering and Know Your Customer (KYC)
- To review thresholds for due diligence of transactions from KYC points of view, and monitoring system of suspicious transactions
- To suggest quality assurance process for SBP reporting and modalities for ensuring Bank wide observance of SBP Prudential Regulations and other laws and regulations
- Periodical review of compliance M.I.S.
- To consider, decide and wherever so warranted, recommend to the Management Committee, issues referred to it by the Compliance Officer

## I.T. Steering Committee

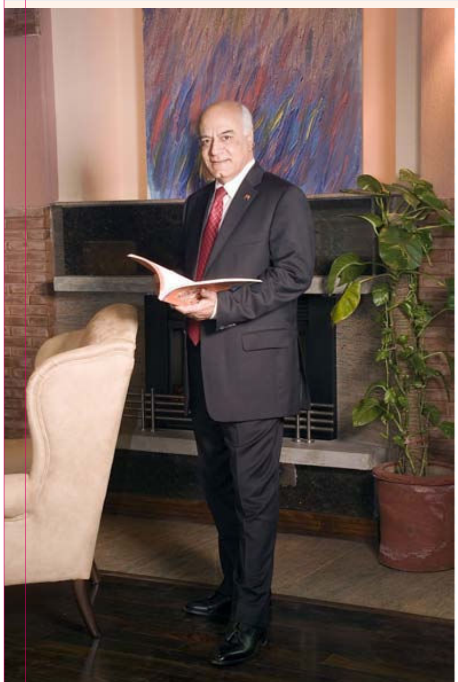
| | |
|---|---|
| Khalid A. Sherwani *(Chairman)* | President |
| Javed Iqbal | Group Chief, IT |
| Zia Ijaz | CFO |
| M. Naveed Masud | Group Chief, CRBG |
| Tariq Mahmood | Group Chief, Operations |
| Azhar A. Jaffri | Group Chief, CPBG |

### Terms of Reference

- To provide strategic directions to IT Group for formulation of IT Plans and to prioritize projects for implementation by the IT Group
- To review and approve policies for all major hardware and software acquisitions for e-Banking / automation
- To monitor the progress of major projects like core banking
- To review the performance of IT Group quarterly taking into account budgetary compliance, project management, quality assurance and achievement of objectives
- To act as an effective liaison between user departments and IT Group
- To access and approve training requirements of IT Group in the light of the new technologies
- To recommend changes in its own TORs to the concerned Board Committee
- To discuss any other matter assigned by any of the Committees or President

*- TORs in brief*

# Management Discussion and Analysis

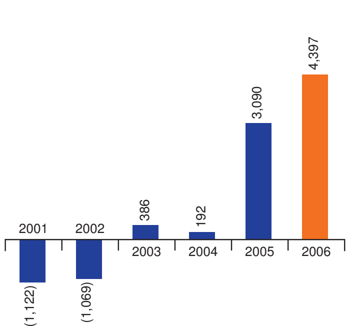


*Khalid A. Sherwani*
*President*

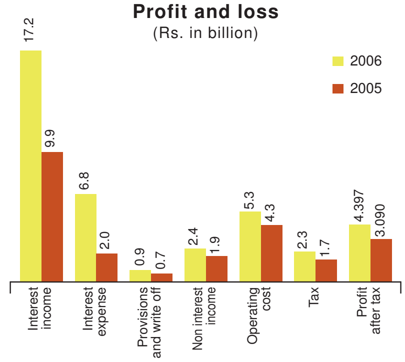
## Profit

By taking advantage of favorable economic environment complemented by strong branch network and customers' confidence in our bank, we have successfully generated higher revenue, in spite of rising cost of deposits. This resulted in significant bottom line profit growth during 2006.

**Profit after tax**
(Rs. in million)



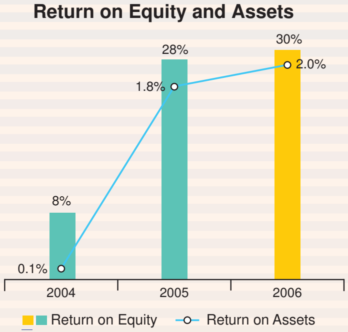

**Profit and loss**
(Rs. in billion)




The after tax profit of the Bank rose significantly to Rs.4,397 million, portraying an impressive growth of 42% over 2005 profit of Rs.3,090 million. The operating profit before provisions and taxes surged by 37% to Rs.7,574 million during the current year. The key driver to this growth was Mark up / Interest income, which rose by 74% over 2005. However, this growth was significantly offset by 236% surge in Mark up / Interest expense. This increase is partially attributed to increased pricing of deposits amid stiff market competition and changing market dynamics.

On the back of strong bottom line growth, Return on Equity improved to 30% from last year's 28%, with Return on Assets improving from 1.78% last year to 1.98% this year.

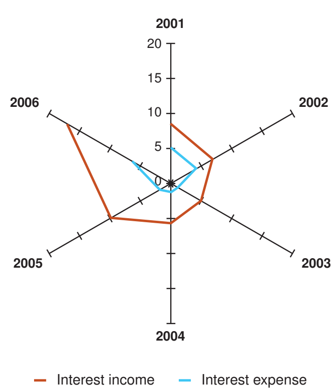
**Return on Equity and Assets**



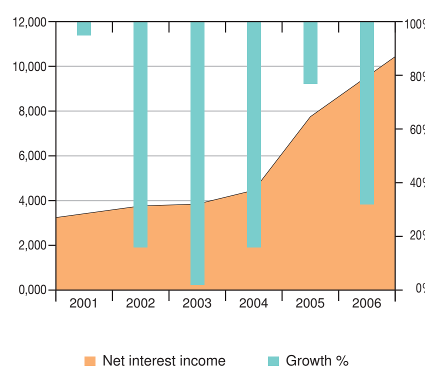

## Net Markup / Interest Income

The Bank was able to yet again improve its spread by registering 32% growth in net mark up / interest income to Rs.10.4 billion during 2006. The benefit of yield curve escalation, affecting interest earning assets across the banking industry during the second half of 2006, was significantly offset by the effect of narrower spreads. However, owing to our Bank's continuous efforts to realign its asset portfolio, we have maintained our spread in the vicinity of 5.2% during 2005 as well as 2006.

**Interest income and Interest expense**
(Rs. in billion)




**Net interest income**
(Rs. in million)

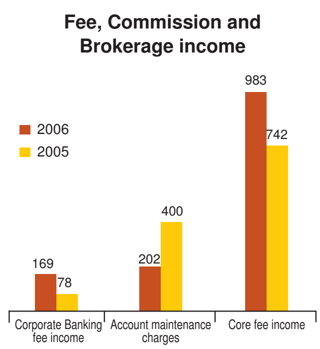


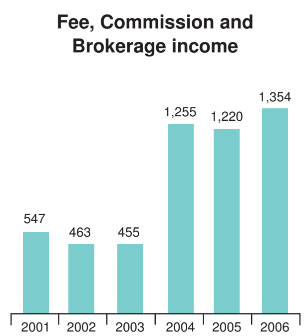
The gross mark up / return income rose by 74% from Rs.9.9 billion in 2005 to Rs.17.2 billion in 2006. This increase is attributable to the increase in average gross advances by 58% (YoY increase is 27%) and surge in yield, mainly during second half of the 2006.

Mark up / interest expense increased significantly to Rs.6.8 billion depicting an increase of 236% over 2005. This increase corresponds to the growth in average deposits by 37% (YoY increase is 28%) and increased pricing. During the current year, the Bank launched two new fixed deposit schemes namely Allied Monthly Income Scheme and Allied Bachat Scheme, offering higher returns to customers. The increase in deposit pricing was principally driven by the changing market scenario and stiff competition. Despite this, the Bank has been able to maintain its cost of deposits below 3.5% during 2006.

## Fee, Commission And Brokerage Income

Fee, Commission and Brokerage Income increased by 11% from Rs.1.2 billion during 2005 to reach Rs.1.4 billion. Taking advantage of generally favorable economic and market environment coupled with our aggressive approach in corporate and investment banking, we have managed 116% growth in fee income. This resulted from several large corporate deals in the capacity of Lead Arranger and Advisor. Excluding Account Maintenance Charges, other areas also performed well by marking a growth of 16%, principally due to increased local remittance combined with growing online banking transactions. This growth was achieved despite waiver / reduction of various service charges on certain transactions.



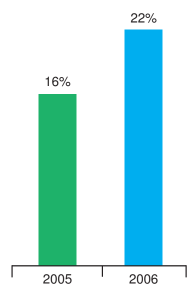

Consistent with the strategy of facilitating our depositors, we waived our charges on minimum balance requirement until the account falls under 'Dormant' status. Account Maintenance Charges have thus reduced by 50% to reach Rs.202 million for 2006.

## Capital Gains / Losses and Dividend Income

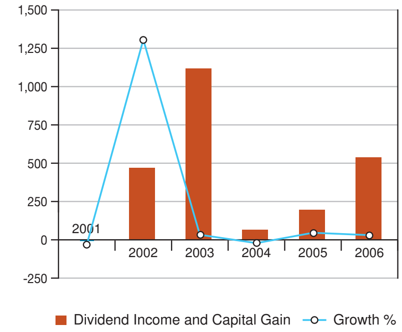
With a view to lessen capital market volatility effects, we focused on wisely diversifying capital market portfolio. We also continued with capitalizing on the opportunities created by buoyant equity market. This has proven its results by attaining 175% growth in capital gain and dividend income to reach Rs.540 million compared to Rs.196 million during 2005. The yield on portfolio thus improved to 22% from last year's 16%.

Management Discussion and Analysis

**Average investment yield**
on capital market portfolio



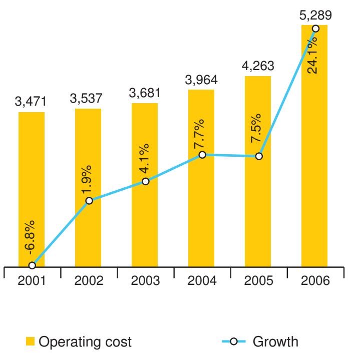

**Dividend income and Capital gain**



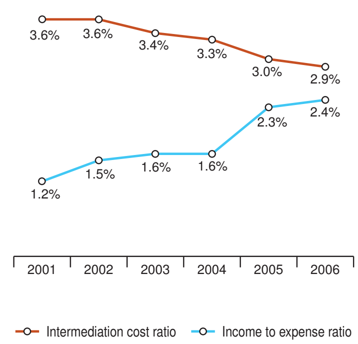

## Operating Expenses

Operating expenses experienced a rise of 24% as it aggregated to Rs.5.3 billion in 2006 compared to Rs.4.3 billion in 2005. This increase was mainly driven by 24% surge in staff costs, which were increased strategically to bring employees' remuneration closer to market.

**Operating cost**




**Intermediation cost ratio and Income to expense ratio**



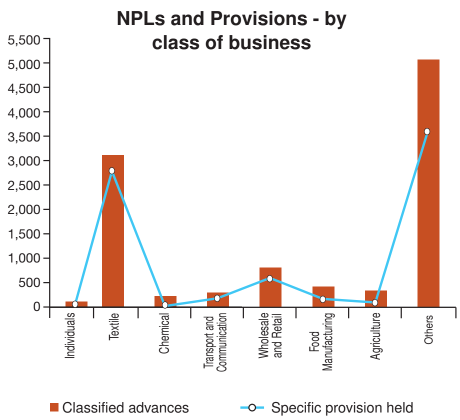

Increased business activities, improving branch infrastructure, growing advertisement needs also led to the increased operating expenses. However, the strong cost control measures resulted in relatively low level of rise in expenses compared to the large increase in operating income. As a result, the income to cost ratio improved to 2.43 times from last year's 2.30, which is a testament of utilizing increased expenses in a productive manner.

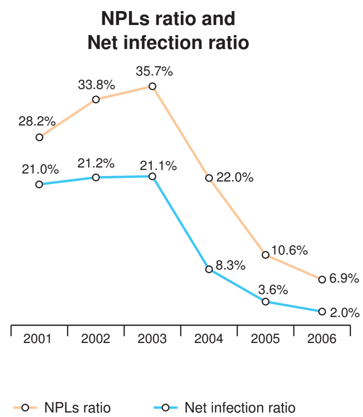
## Loans Quality Analysis

In determining the classification of loan portfolio, we apply series of criterias that are derived from SBP guidelines. The following table sets forth, as of the dates indicated, the distribution of our loan portfolio by five category loan classification.

| Rupees in thousands | December 31, 2006 | | December 31, 2005 | |
|---|---|---|---|---|
| Performing | 141,226,829 | 93.1% | 107,166,333 | 89.4% |
| Other assets especially mentioned | 35,811 | 0.02% | – | 0.0% |
| Substandard | 534,865 | 0.4% | 673,263 | 0.6% |
| Doubtful | 659,307 | 0.4% | 441,982 | 0.4% |
| Loss | 9,248,606 | 6.1% | 11,584,093 | 9.7% |
| | 151,705,418 | 100% | 119,865,671 | 100% |

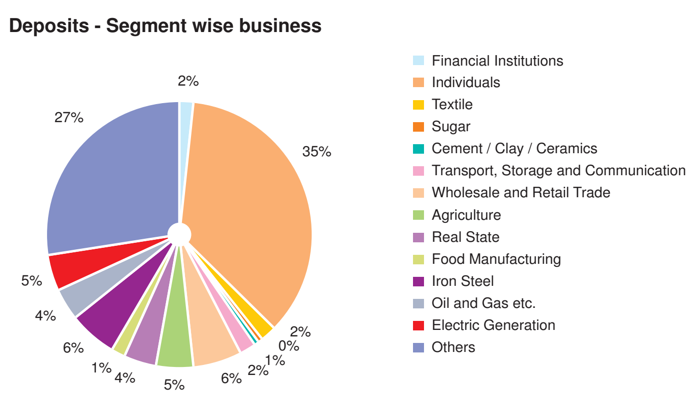
Strengthening credit risk management and internal control resulted in loan quality improvement. This is reflective through decrease of NPL ratio from 11% at the end of 2005 to 7% at the end of 2006. Simultaneously, Net Infection ratio improved impressively from 3.64% at the end of 2005 to 1.96% at the current year end. The Loan Loss Coverage ratio increased from 68% to 73%.



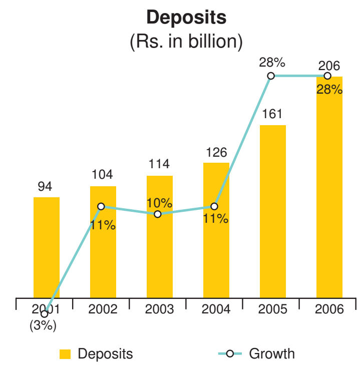




## Deposits

The total deposits increased to Rs.206 billion from last year's Rs.161.4 billion, reflecting a growth of 28% with our market share increasing by 80 basis points to 6.9%. This growth was achieved despite stiff competition for deposit mobilization during FY06.



Deposits continued to be our major source of funding as we maintained an extensive customer base. Continuous expansion in Pakistan's economy, growth in per capita income, and rising interest rates for time deposits were the main reasons for the continued increase in the deposits.

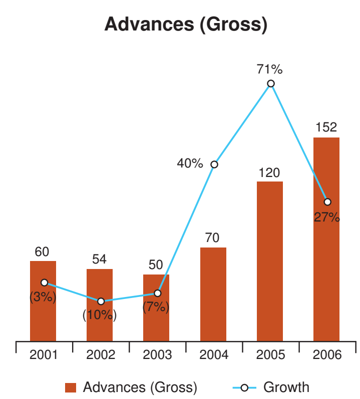



Owing to tight market liquidity, banking industry resorted to costlier deposits. Our Bank was not an exception to this as fixed deposits and remunerative current accounts, in aggregate, rose by 83% to reach Rs.82.7 billion. Despite tough market conditions, we were able to not only maintain our core deposits but posted a growth of 6% to reach Rs.123.4 billion from last year's Rs.116 billion.

## Advances

The advances portfolio grew by 27% to Rs.151.7 billion from Rs.120 billion for last year, due to aggressive big ticket quality corporate lending.

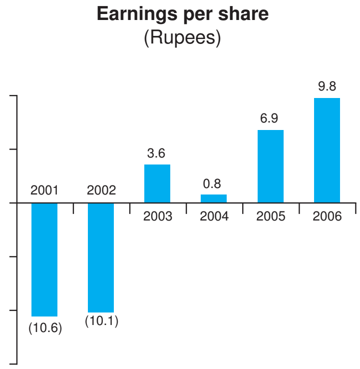
Corporate loans are the largest component of our advances portfolio. At year end 2006, corporate loans amounted to Rs.115.4 billion, growing significantly by 45% from last year's Rs.79.6 billion. This strong growth is well diversified among various segments as well as in different tenors.




In recognition of persistent endeavor to close creative and challenging investment banking transactions, we were awarded "THE CORPORATE FINANCE HOUSE OF THE YEAR - BANK 2005-06", by CFA Association of Pakistan.

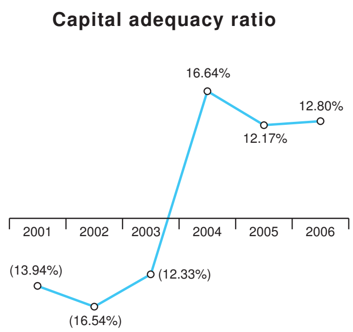
## Earnings Per Share (EPS)

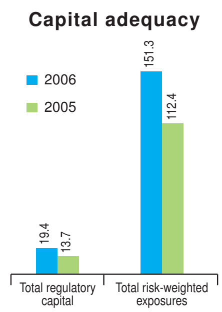
The EPS of the Bank for the year ended 2006 is Rs.9.80 per share, which increased by 42% from last year's Rs.6.88 per share.




## Capital Adequacy

The capital adequacy ratio increased to 12.8% as at December 31, 2006 in contrast to 12.17% as at December 31, 2005. This improvement is attributed to the increased retained earnings and Tier II capital.



# Management Team

Management Team

Khalid A. Sherwani
**President**

Muhammad Jawaid Iqbal
**Group Chief - CIBG**

M. Naveed Masud
**Group Chief - CRBG**

Azhar. A. Jaffri
**Group Chief - CPBG**

Muhammad Yaseen
**Treasurer**

Fareed Vardag
**Group Chief - RMG**

Zia Ijaz
**CFO**

Muhammad Sardar Khawaja
**Group Chief - AIG**

Tariq Mahmood
**Group Chief - Operations**

Javed Iqbal
**Group Chief - IT**

Shafique Ahmed Uqaili
**Group Chief - HRG**

Mohammad Abbas Sheikh
**Group Chief - SAM**

Khalid Mehboob
**Group Chief - CCG**

Syed Shahid Raza
**Head - BTT**

Bilal Mustafa
**Group Chief - CAG**


Allied Bank

NOTES TO THE
FINANCIAL STATEMENTS

## 1. STATUS AND NATURE OF BUSINESS

Allied Bank Limited (the bank), incorporated in Pakistan, is a scheduled Bank, engaged in commercial banking and related services. The bank is listed on all stock exchanges in Pakistan. The bank operates a total of 742 (2005: 741) branches in Pakistan. The medium to long term credit rating of the bank rated by JCR– VIS Credit Rating Company Limited is 'A+' with a positive outlook. Short term rating of the bank is 'A– 1+'. The bank is a holding company of Allied Management Services (Private) Limited.

The registered office of the bank is situated in Lahore whereas the principal office is situated at Khayaban-e-Iqbal, Main Clifton Road, Bath Island, Karachi.

**1.1** During the year, the Board of Directors of the bank, in their meeting held on April 28, 2006, decided to merge First Allied Bank Modaraba (FABM) with Allied Bank Limited (ABL), pursuant to Section 48 of the Banking Companies Ordinance, 1962 and approved the Scheme of Amalgamation of the FABM with and into ABL under section 284 to 288 read with section 503(1)(C) of the Companies Ordinance, 1984. The effective date of the said amalgamation was fixed at January 01, 2006. The proposed Scheme of Amalgamation was adopted by the shareholders of the bank through a special resolution passed in the Extraordinary General Meeting held on June 24, 2006. The said Scheme of Amalgamation was approved by the State Bank of Pakistan (SBP) in principle through its letter No. BPD (PU– 31)/625– 74/10473/ JD/2006/4742 dated May 27, 2006. The Lahore High Court, subsequently, sanctioned the above referred Scheme of Amalgamation vide its order dated July 12, 2006.

**1.2** As a result of the amalgamation of the FABM with the bank on the above– mentioned effective date, the results of both entities have been combined for the purposes of preparation of these financial statements. International Accounting Standard– 22 "Business Combinations" is not applicable to the amalgamated financial statements, as the amalgamation is between two enterprises under common control. The bank has applied the "uniting of interests" method to account for the amalgamation. In applying the "uniting of interests" method, the financial statement items of bank and FABM for all periods presented are included in these financial statements as if they had been combined from the beginning of the earliest period presented, i.e., January 01, 2005, except for the treatment accorded to 8,400,000 Ordinary shares of Rs.10 each, determined pursuant to the Scheme of Amalgamation in accordance with the share– swap ratio stipulated therein. The resulting effects of the above have been included in the Statement of Changes in Equity in the relevant period on account of the fact that the Ordinary shares were issued subsequent to the beginning of the earliest period presented.

**1.3** The comparatives in the accompanying balance sheet of the bank as at December 31, 2005 and comparatives in the accompanying profit and loss account, cash flow statement and statement of changes in equity relating to the year ended December 31, 2005 comprise (a) balances of ABL and (b) balances of FABM.

## 2(a). BASIS OF PRESENTATION

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

## 2(b). BASIS OF MEASUREMENT

These financial statements have been prepared under the historical cost convention except that certain operating fixed assets are stated at revalued amounts, certain investments are stated at market value and derivative financial instruments have been marked to market.

## 3. STATEMENT OF COMPLIANCE

**3.1** These financial statements are prepared in accordance with the directives issued by the State Bank of Pakistan, the Banking Companies Ordinance, 1962, the Companies Ordinance, 1984 and approved accounting standards as applicable in Pakistan. Approved accounting standards comprise of such International Financial Reporting Standards as are notified under the provisions of the Companies Ordinance, 1984. Wherever the requirements of the Banking Companies Ordinance, 1962, the Companies Ordinance, 1984 or directives issued by the State Bank of Pakistan differ with the requirements of these standards, the requirements of Banking Companies Ordinance, 1962, the Companies Ordinance, 1984 and the said directives take precedence.

**3.2** Amendments to the following standard have been published that are applicable to the bank's financial statements covering annual periods, beginning on or after the following date:

| | | **Effective from** |
|---|---|---|
| (i) | IAS – 1 Presentation of financial statements – Capital Disclosures | January 01, 2007 |

Adoption of the above amendment would result in an impact to the extent of disclosures presented in the future financial statements of the bank.

In addition to above, a new series of standards called "International Financial Reporting Standards (IFRSs)" have been introduced and seven IFRSs have been issued by IASB. Out of these, following three IFRSs have been adopted by SECP vide its S.R.O. (I)2006 dated December 06, 2006.

(i) IFRS – 2 "Share– based Payments";
(ii) IFRS – 3 "Business Combinations"; and
(iii) IFRS – 5 "Non– current Asset Held for Sale and Discontinued Operations".

The bank expects that the adoption of these standards mentioned above will have no significant impact on the bank's financial statements in the period of initial application.

**3.3** The SBP, vide BSD Circular No. 10, dated August 26, 2002 has deferred the applicability of International Accounting Standard 39, Financial Instruments: Recognition and Measurement (IAS 39) and International Accounting Standard 40, Investment Property (IAS 40) for banking companies till further instructions. Accordingly, the requirements of these standards have not been considered in the preparation of these financial statements. However, investments have been classified in accordance with the categories prescribed by the SBP, vide BSD Circular No. 10, dated July 13, 2004.

**3.4** The bank has obtained a waiver from the Securities and Exchange Commission of Pakistan for the preparation of consolidated financial statements.

## 4. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

The preparation of financial statements in conformity with approved accounting standards requires the use of certain critical accounting judgments. It also requires management to exercise its judgment in the process of applying the bank's accounting policies. Estimates and judgments are continually evaluated and are based on historical experience, including expectations on future events that are believed to be reasonable under these circumstances. The areas where various assumptions and estimates are significant to the banks financial statements or where judgment was exercised in application of accounting policies described in notes 7.1 to 7.16 are as follows:

**4.1 Investments**

As described in note 7.4, held for trading are securities which are either acquired for generating a profit from short– term fluctuations in market prices or dealer's margin or are securities included in a portfolio in which a pattern of short– term profit taking exists, held to maturity are investments where the management has positive intent and ability to hold to maturity and available for sale securities are investments that do not fall under the held for trading or held to maturity categories. The classification of these securities involves management judgement at the time of purchase whether the financial assets are held for trading, held to maturity or available for sale investments.

**4.2 Provision against non– performing advances**

Apart from the provision determined on the basis of time– based criteria given in Prudential Regulations, the management also applies the subjective criteria of classification, and, accordingly, the classification of advances is downgraded on the basis of credit worthiness of the borrower, its cash flows, operations in account and adequacy of security in order to ensure accurate measurement of the provision.

In addition to the specific provision held against loans and advances, the bank also makes a general provision of 5% of unsecured and 1.5% of the fully secured consumer/credit card financing portfolio.

**4.3 Retirement Benefits**

The key actuarial assumptions concerning the valuation of defined benefit plans and the sources of estimation are disclosed in note 36 to the financial statements.

**4.4 Useful life of property and equipment**

Estimates of useful life of the property and equipment are based on the management's best estimate. Changes in the expected useful life are accounted for by changing the depreciation/amortization period or method, as appropriate, and are treated as changes in accounting estimate.

## 5. CHANGE IN ACCOUNTING ESTIMATE

**5.1 Property and equipment/Intangible assets**

During the year, the management decided to charge depreciation/amortization expense on its property and equipment and intangible assets on a proportionate basis. Previously, the bank was charging full year's depreciation on assets acquired during the year and no depreciation was charged on assets disposed off during the year. As per the new method, depreciation on additions is charged from the month the asset is available for use and on disposals up to the month preceding the month of disposal. This change has been accounted for prospectively, in accordance with the revised **IAS-8 "Accounting Policies, Changes in Accounting Estimates and Errors".**

Had there been no change in estimate, the profit for the year and the carrying value of property and equipment at the end of the current year would have been lower by Rs. 91.21 million.

## 6. CHANGE IN ACCOUNTING POLICY

The accounting policies adopted are consistent with those used in the previous financial years except that during the year, the Institute of Chartered Accountants of Pakistan issued a Circular No. 06/2006 dated June 19, 2006 which requires all declarations of dividend to holders of equity instruments, including declaration of bonus issues and other appropriations, except appropriations which are required by law after the balance sheet date not to be recognized as liabilities or change in reserves at the balance sheet date, which also is in compliance with the requirements set out in BSD Circular No.4, dated February 17, 2006. Previously all declarations of dividends to holders of equity instruments and transfers to reserves relating to profit for the year, although declared subsequent to year end, were accounted for in the year to which they were related. This change has been applied retrospectively and comparatives have been restated, in accordance with the treatment specified in **IAS-8 "Accounting Policies, Changes in Accounting Estimates and Errors".**

| Rupees in '000 | December 31, 2006 | December 31, 2005 |
|---|---|---|
| The change in accounting policy has the following impact on the financial statements: | | |
| Other liabilities would have been higher by | 1,122,160 | 1,101,160 |
| Unappropriated profit would have been lower by | (1,122,160) | (1,101,160) |
| Share premium would have been lower by* | (897,728) | – |
| Reserve for issue of bonus shares would have been higher by | 897,728 | – |

The effect of change in accounting policy has been reflected in the statement of changes in equity. The change in accounting policy has not resulted in any change in the profit for the current year.

* As disclosed in note 46, the Board of Directors in its meeting held on February 26, 2007 announced bonus issue of 20%, which shall be applied against share premium.

## 7. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### 7.1 Cash and cash equivalents

Cash and cash equivalents include cash and balances with treasury banks and balances with other banks (net of overdrawn nostro balances) in current and deposit accounts.

### 7.2 Lendings to / borrowings from financial institutions

The bank enters into transactions of borrowing (repurchase) from and lending (reverse repurchase) to financial institutions, at contracted rates for a specified period of time. These are recorded as under:

**(a) Sale under repurchase obligations**

Securities sold subject to a re-purchase agreement are retained in the financial statements as investments and the counter party liability is included in borrowings from financial institutions. The differential in sale and re-purchase value is accrued on a prorata basis and recorded as interest expense.

**(b) Purchase under resale obligations**

Securities purchased under agreement to resell (reverse repurchase) are included in lendings to financial institutions. The differential between the contracted price and resale price is amortised over the period of the contract and recorded as interest income.

### 7.3 Trade date accounting

All "regular way" purchases and sales of financial assets are recognised on the trade date, i.e., the date that the bank commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

### 7.4 Investments

The management determines the appropriate classification of its investments at the time of purchase and classifies these investments as held for trading, available for sale or held to maturity. These are initially recognized at cost, being the fair value of the consideration given including the acquisition cost.

**(a) Held for trading**

These are securities which are either acquired for generating a profit from short-term fluctuations in market prices or dealer's margin or are securities included in a portfolio in which a pattern of short-term profit taking exists.

**(b) Held to maturity**

These are securities with fixed or determinable payments and fixed maturity that the bank has the positive intent and ability to hold to maturity.

**(c) Available for sale**

These are investments that do not fall under the held for trading or held to maturity categories.

In accordance with the requirements of the SBP, quoted securities, other than those classified as held to maturity and investments in subsidiaries are carried at market value. Investments classified as held to maturity are required to be carried at amortized cost whereas investments in subsidiaries are accounted for in accordance with the relevant International Accounting Standard as applicable in Pakistan.

The unrealized surplus/(deficit) arising on revaluation of the bank's held for trading investment portfolio is taken to the profit and loss account.

The surplus/(deficit) arising on revaluation of quoted securities classified as available for sale is kept in a separate account shown in the balance sheet below equity. The surplus/(deficit) arising on these securities is taken to the profit and loss account when actually realised upon disposal.

Unquoted equity securities are valued at the lower of cost and break-up value. Subsequent increases or decreases in the carrying value are credited/charged to profit and loss account. Break-up value of equity securities is calculated with reference to the net assets of the investee company as per the latest available audited financial statements. Investments in other unquoted securities are valued at cost less impairment losses, if any.

Provision for diminution in the value of securities (except for debentures, participation term certificates and term finance certificates) is made after considering impairment, if any, in their value. Provision for diminution in value of debentures, participation term certificates and term finance certificates are made in accordance with the requirements of the Prudential Regulations issued by the SBP.

Profit and loss on sale of investments is included in income currently.

**7.5 Advances (including net investment in finance lease)**

Advances are stated net of general and specific provisions:

Specific provision against funded loans are determined in accordance with the requirements of the Prudential Regulations issued by the SBP and charged to the profit and loss account. General provision is maintained at 1.5% of the fully secured consumer portfolio and 5% of the unsecured consumer portfolio.

Leases, where the bank transfers substantially all the risks and rewards incidental to the ownership of an asset are classified as finance leases. A receivable is recognized at an amount equal to the present value of the minimum lease payments, including guaranteed residual value, if any.

Advances are written off when there are no realistic prospects of recovery.

**7.6 Operating fixed assets and depreciation**

**Owned**

Property and equipment, other than land which is not depreciated, are stated at cost or revalued amount less accumulated depreciation and impairment losses, if any.

Depreciation is calculated using the straight line method, except buildings which are depreciated using the reducing balance method to write down the cost of property and equipment to their residual values over their estimated useful lives. The rates at which the fixed assets are depreciated are disclosed in note 13.2.

Surplus arising on revaluation of fixed assets is credited to surplus on revaluation of fixed assets account. Deficit arising on subsequent revaluation of fixed assets is adjusted against the balance in the above mentioned surplus account as allowed under the provisions of the Companies Ordinance, 1984. The surplus on revaluation of fixed assets to the extent of incremental depreciation charged on the related assets, is transferred to equity.

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset is recognized in the profit and loss account in the year the asset is derecognized, except that the related surplus on revaluation of fixed assets (net of deferred tax) is transferred directly to equity.

The cost of day to day servicing (normal repairs and maintenance) are charged to the profit and loss account as and when incurred.

**Intangible assets**

Intangible assets are carried at cost less any accumulated amortization and impairment losses, if any. The cost of intangible assets is amortized over their estimated useful lives, using the straight line method. Amortization is charged at the rate stated in note 13.3.

**Capital work– in– progress**

Capital work– in– progress is stated at cost.

**7.7 Taxation**

**Current**

Provision for current taxation is based on taxable income for the year determined in accordance with the prevailing laws for taxation on income earned. The charge for current tax is calculated using the prevailing tax rates or tax rates expected to apply to the profits for the year. The charge for current tax also includes adjustments, where considered necessary relating to prior years, arising from assessments finalised during the year for such years.

**Deferred**

Deferred tax is recognised on all major temporary differences at the balance sheet date between the amounts attributed to assets and liabilities for financial reporting purposes and amounts used for taxation purposes. In addition, the bank also records a deferred tax asset on available tax losses. Deferred tax is calculated at the rates that are expected to apply to the periods when the differences will reverse, based on tax rates that have been enacted or substantially enacted by the balance sheet date.

Deferred tax assets are recognized only to the extent that it is probable that future taxable profits will be available against which the assets can be utilized.

The bank also recognizes a deferred tax asset/liability on deficit/surplus on revaluation of fixed assets and securities which is adjusted against the related deficit/surplus in accordance with the requirements of **IAS–12 "Income Taxes"**.

**7.8 Revenue Recognition**

Revenue is recognized to the extent that the economic benefits will flow to the bank and the revenue can be reliably measured. The following recognition criteria must also be met before revenue is recognized.

**(a) Advances and investments**

Mark–up/return on regular loans/advances and investments is recognized on accrual basis. Where debt securities are purchased at premium or discount, the same is amortized through the profit and loss account using the effective interest rate method.

Interest or mark-up recoverable on classified loans and advances and investments is recognized on receipt basis. Interest/return/mark-up on rescheduled/restructured loans and advances and investments is recognized as permitted by the regulations of the SBP.

Dividend income is recognized when the right to receive the dividend is established.

**(b) Lease financing**

Financing method is used in accounting for income from lease financing. Under this method, the unearned lease income (excess of the sum of total lease rentals and estimated residual value over the cost of leased assets) is deferred and taken to income over the term of the lease period so as to produce a constant periodic rate of return on the outstanding net investment in lease.

Gains/losses on termination of lease contracts, documentation charges, front-end fees and other lease income are recognised as income on receipts basis.

**(c) Fees, brokerage and commission**

Fees, brokerage and commission on letters of credit/guarantee and others are recognized on an accrual basis.

**7.9 Staff retirement and other benefits**

**7.9.1 Staff retirement benefit schemes**

**a) For employees who opted for the new scheme introduced by the management:**

An approved pension scheme (defined benefit scheme) under which the benefits on the basis of frozen basic salary service and age as on June 30, 2002 are payable to all employees whose date of joining the bank is on or before July 01, 1992, i.e., who have completed 10 years of service as on June 30, 2002; and

An approved gratuity scheme (defined benefit scheme) under which the benefits are payable as under:

i) For members whose date of joining the bank is on or before July 01, 1992, their services would be calculated starting from July 01, 2002 for gratuity benefit purposes.

ii) For members whose date of joining the bank is after July 01, 1992 their services would be taken at actual for the purpose of calculating the gratuity benefit.

A Contributory Provident Fund scheme with the bank making equal contribution to that made by employees (defined contribution scheme).

**b) For employees who did not opt for the new scheme, the bank continues to operate the following:**

An approved pension scheme (defined benefit scheme) under which the benefits on the basis of frozen basic salary as on June 30, 2002 are payable to all employees opting continuation of the previous scheme and whose date of joining the bank is on or before July 01,1992, i.e., who had completed ten years of service as on June 30, 2002; and

A contributory benevolent fund for all its employees (defined benefit scheme).

Annual contributions towards the defined benefit schemes are made on the basis of actuarial valuation carried out using the Projected Unit Credit Method. Actuarial gains/losses are amortized over the future expected remaining working lives of the employees, to the extent of the greater of ten percent of the present value of the defined benefit obligation at that date (before deducting plan assets) and ten percent of the fair value of any plan assets at that date.

**7.9.2 Other benefits**

a) Employees' compensated absences

The bank provides for compensated vested and non-vested absences accumulated by its employees on the basis of actuarial advice under the Projected Unit Credit Method.

b) Post retirement medical benefits

The bank provides post retirement medical benefits to eligible retired employees. Provision is made annually to meet the cost of such medical benefits on the basis of actuarial advice under the Projected Unit Credit Method. Actuarial gains/losses are amortized over the future expected average remaining lives of the employees.

**7.10 Assets acquired in satisfaction of claims**

The bank occasionally acquires assets in settlement of certain advances. These are stated at lower of the net realizable value of the related advances and the current fair value of such assets.

**7.11 Impairment**

At each balance sheet date the bank reviews the carrying amounts of its assets to determine whether there is an indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the assets is estimated in order to determine the extent of the impairment loss, if any. Recoverable amount is the greater of net selling price and value in use. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the assets is reduced to its recoverable amount. Impairment losses are recognized as an expense immediately.

**7.12 Provisions**

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

Provision against identified non– funded losses is recognized when intimated and reasonable certainty exists for the bank to settle the obligation. The loss is charged to profit and loss account net of expected recovery and is classified under other liabilities.

**7.13 Stock and cash dividends**

Stock and cash dividend declared subsequent to balance sheet date are considered as non– adjusting event and are not recorded in financial statements of the current year.

**7.14 Foreign currencies**

**a) Foreign currency transactions**

Transactions in foreign currencies are translated into rupees at the foreign exchange rates ruling on the transaction date. Monetary assets and liabilities in foreign currencies are expressed in rupee terms at the rates of exchange ruling on the balance sheet date. Forward foreign exchange contracts are valued at forward rates applicable to their respective maturities.

**b) Translation gains and losses**

Translation gains and losses are included in the profit and loss account.

**c) Commitments**

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

**7.15 Financial instruments**

**7.15.1 Financial assets and liabilities**

Financial instruments carried on the balance sheet include cash and bank balances, lendings to financial institutions, investments, advances, certain receivables, bills payable, borrowings from financial institutions, deposits, sub-ordinated loan and other payables. The particular recognition methods adopted for significant financial assets and financial liabilities are disclosed in the individual policy statements associated with them.

**7.15.2 Derivative financial instruments**

Derivative financial instruments are initially recognized at fair value on the date on which the derivative contract is entered into and are subsequently re– measured at fair value using appropriate valuation techniques. All derivative financial instruments are carried as assets when fair value is positive and liabilities when fair value is negative. Any change in the fair value of derivative financial instruments is taken to profit and loss account.

**7.16 Off setting**

Financial assets and financial liabilities are set off and the net amount is reported in the financial statements when there is a legally enforceable right to set off and the bank intends to either settle on a net basis, or to realise the assets and to settle the liabilities simultaneously.

## 8. CASH AND BALANCES WITH TREASURY BANKS

| Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|
| **In hand** | | | |
| Local currency | | 3,906,829 | 2,600,347 |
| Foreign currencies | | 258,328 | 142,195 |
| **Remittances in transit** | | 606,569 | 372,626 |
| **With State Bank of Pakistan (SBP) in** | 8.1 | | |
| Local currency current accounts | | 14,396,794 | 8,359,676 |
| Foreign currency deposit accounts | | | |
| – Non remunerative | | 332,264 | 248,560 |
| – Remunerative | 8.2 | 996,792 | 745,679 |
| **With National Bank of Pakistan in** | | | |
| Local currency current accounts | | 2,506,138 | 2,236,624 |
| **National Prize Bonds** | | 35,863 | 37,004 |
| | | 23,039,577 | 14,742,711 |

8.1 Deposits with the SBP are maintained to comply with the statutory requirements issued from time to time.

8.2 This represents special cash reserve maintained with the SBP. The special cash reserve carries mark–up at rates ranging between 3.39% and 4.39% (2005: 1.40% and 3.29%) per annum.

## 9. BALANCES WITH OTHER BANKS

| Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|
| **In Pakistan** | | | |
| On current account | | 48,057 | 249 |
| On deposit account | 9.1 | 300,000 | 2,000,000 |
| **Outside Pakistan** | | | |
| On current account | 9.2 | 1,196,561 | 962,601 |
| On deposit account | 9.3 | 160,827 | 329,191 |
| | | 1,705,445 | 3,292,041 |

9.1 This represents placement with a local bank. The placement carries mark– up at the rate of 11.75% (2005: 11.75% to 12%) per annum and will mature on January 19, 2007.

9.2 Included in nostro accounts are balances, aggregating to Rs. 75.08 million (2005: Rs. 123.16 million), representing balances held with a related party outside Pakistan.

9.3 This represents placement with a related party outside Pakistan. The placement carries interest at the rate of 3.63% (2005: 4.47 % to 4.62 %) per annum and will mature on January 04, 2007.

## 10. LENDINGS TO FINANCIAL INSTITUTIONS

| Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|
| Call money lendings | 10.1 | 475,000 | – |
| Letters of placement | 10.2 | 384,500 | 785,000 |
| Repurchase agreement lendings (Reverse Repo) | 10.3 & 10.6 | 15,385,739 | 4,272,382 |
| Certificates of investment | 10.4 | 2,805,000 | 720,000 |
| | | 19,050,239 | 5,777,382 |

10.1 These are unsecured lendings to Financial Institutions, carrying mark-up at the rate of 12% (2005: nil) per annum and will mature on January 04, 2007.

10.2 These are clean placements with Non-Banking Finance Companies, carrying mark-up at rates, ranging between 12% and 13.50% (2005: 11% and 13%) per annum and maturing on various dates, latest by January 22, 2007.

10.3 These are short-term lendings to various financial institutions against the government securities shown in note 10.6 below. These carry mark-up at rates ranging between 8.25% and 9.40% (2005: 7% and 8.50%) per annum and will mature on various dates, latest by March 12, 2007.

10.4 The certificates of investment carry mark-up at rates ranging between 11.25% and 12.50% (2005: 10.25% and 12.10%) per annum and will mature on various dates, latest by March 28, 2007.

| Rupees in '000 | December 31, 2006 | December 31, 2005 |
|---|---|---|
| **10.5 Particulars of lending** | | |
| In local currency | 19,050,239 | 5,777,382 |
| In foreign currencies | – | – |
| | 19,050,239 | 5,777,382 |

**10.6 Securities held as collateral against lending to financial institutions**

| Rupees in '000 | December 31, 2006 Held by bank | Further given as collateral | Total | December 31, 2005 Held by bank | Further given as collateral | Total |
|---|---|---|---|---|---|---|
| Market Treasury Bills | 15,385,739 | – | 15,385,739 | 4,272,382 | – | 4,272,382 |
| | 15,385,739 | – | 15,385,739 | 4,272,382 | – | 4,272,382 |

## 11. INVESTMENTS

| Rupees in '000 | Note | December 31, 2006 Held by bank | Given as collateral | Total | December 31, 2005 Held by bank | Given as collateral | Total |
|---|---|---|---|---|---|---|---|
| **11.1 Investments by types:** | | | | | | | |
| **Held for trading securities** | | | | | | | |
| Ordinary shares of listed companies | | 267,290 | – | 267,290 | 594,711 | – | 594,711 |
| **Available for sale securities** | | | | | | | |
| Market Treasury Bills | 11.1.1 | 18,143,360 | 5,188,065 | 23,331,425 | 5,459,960 | 478,256 | 5,938,216 |
| Federal Investment Bonds | | – | 5,000 | 5,000 | – | 5,000 | 5,000 |
| Pakistan Investment Bonds | | 298,625 | – | 298,625 | – | – | – |
| Ordinary shares/certificates of listed companies | | 1,457,860 | – | 1,457,860 | 681,854 | – | 681,854 |
| Preference shares of listed companies | | 275,000 | – | 275,000 | 200,000 | – | 200,000 |
| Investment in mutual funds | | 266,229 | – | 266,229 | 206 | – | 206 |
| Ordinary shares of unlisted companies | | 17,099 | – | 17,099 | 62,878 | – | 62,878 |
| Pre IPO investment in TFC | | 555,000 | – | 555,000 | – | – | – |
| Listed term finance certificates (TFCs) | | 1,320,863 | – | 1,320,863 | 1,145,608 | – | 1,145,608 |
| | | 22,334,036 | 5,193,065 | 27,527,101 | 7,550,506 | 483,256 | 8,033,762 |
| **Held to maturity securities** | | | | | | | |
| Market Treasury Bills | 11.1.1 | – | – | – | 12,825,430 | 2,875,414 | 15,700,844 |
| Pakistan Investment Bonds | | 13,881,122 | 6,073 | 13,887,195 | 14,354,866 | 1,288,800 | 15,643,666 |
| Foreign Currency Bonds (US$) | | 212,087 | – | 212,087 | 260,076 | – | 260,076 |
| TFCs, Debentures, Bonds and PTCs | | 4,867,258 | – | 4,867,258 | 4,439,812 | – | 4,439,812 |
| | | 18,960,467 | 6,073 | 18,966,540 | 31,880,184 | 4,164,214 | 36,044,398 |
| **Related parties** | | | | | | | |
| **Subsidiary** | | | | | | | |
| Allied Management Services (Pvt) Ltd. | | 62,488 | – | 62,488 | 62,488 | – | 62,488 |
| **Others** | | 451,219 | – | 451,219 | 451,219 | – | 451,219 |
| **Investment at cost** | | 42,075,500 | 5,199,138 | 47,274,638 | 40,539,108 | 4,647,470 | 45,186,578 |
| **Less: Provision for Diminution in value of Investments** | 11.3 | (203,038) | – | (203,038) | (342,115) | – | (342,115) |
| **Investments (Net of Provisions)** | | 41,872,462 | 5,199,138 | 47,071,600 | 40,196,993 | 4,647,470 | 44,844,463 |
| Unrealized (loss)/gain on revaluation of Held for trading securities | 11.5 | (30,180) | – | (30,180) | 25,706 | – | 25,706 |
| (Deficit)/surplus on revaluation of Available for sale securities | 22.2 | (87,162) | (1,017) | (88,179) | 56,483 | – | 56,483 |
| **Total investments at market value** | | 41,755,120 | 5,198,121 | 46,953,241 | 40,279,182 | 4,647,470 | 44,926,652 |

11.1.1 Pursuant to the requirements of BSD Circular no. 7, dated May 30, 2006, which allows a one time reclassification of securities between the three categories, the bank reclassified Market Treasury Bills, aggregating to Rs 7,801 million (book value) from Held to maturity to Available for sale category.

| | Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|---|
| 11.2 | **Investments by segments:** | | | |
| | **Federal Government Securities:** | | | |
| | – Market Treasury Bills | 11.2.1&11.2.2 | 23,331,425 | 21,639,060 |
| | – Pakistan Investment Bonds | 11.2.1&11.2.2 | 14,185,820 | 15,643,666 |
| | – Federal Investment Bonds | 11.2.2 | 5,000 | 5,000 |
| | – Foreign Currency Bonds (US$) | | 212,087 | 260,076 |
| | **Fully Paid up Ordinary Shares:** | | | |
| | – Listed Companies | | 1,725,150 | 1,276,565 |
| | – Unlisted Companies | | 17,099 | 62,878 |
| | **Investment in Mutual Funds** | | 266,229 | 206 |
| | **Fully paid up Preference Shares** | 11.2.3 | 275,000 | 200,000 |
| | **Pre IPO Investment in TFC** | | 555,000 | – |
| | **Term Finance Certificates, Debentures, Bonds and Participation Term Certificates:** | | | |
| | Term Finance Certificates | | | |
| | – Listed | | 1,676,436 | 1,524,972 |
| | – Unlisted | | 3,262,128 | 2,288,712 |
| | Debentures | | 65,392 | 68,534 |
| | Bonds – Government guaranteed | | 938,497 | 1,683,862 |
| | – Others | | 238,645 | – |
| | Participation Term Certificates | | 7,023 | 19,340 |
| | **Related parties** | | | |
| | Investment in subsidiary | | 62,488 | 62,488 |
| | Others | 11.2.4 | 451,219 | 451,219 |
| | **Total investments at cost** | | 47,274,638 | 45,186,578 |
| | Less: Provision for diminution in the value of investment | 11.3 | (203,038) | (342,115) |
| | **Investments (Net of Provisions)** | | 47,071,600 | 44,844,463 |
| | Unrealized (loss)/gain on revaluation of held for trading securities | 11.5 | (30,180) | 25,706 |
| | (Deficit)/surplus on revaluation of available for sale securities | 22.2 | (88,179) | 56,483 |
| | **Total investments at market value** | | 46,953,241 | 44,926,652 |

11.2.1 Included herein are Market Treasury Bills and PIBs having a book value of Rs. 4,855.86 million and nil respectively (2005: Market Treasury Bills Rs. 3,331.78 million and PIB's Rs. 900 million), given as collateral against repurchase agreement borrowings from financial institutions.

11.2.2 These include Market Treasury Bills and PIBs, having a face value of Rs. 339.80 million (2005: Rs. 339.80 million), held by the SBP and National Bank of Pakistan against Demand Loan and TT/DD discounting facilities sanctioned to the bank. In addition, PIBs and FIBs, with an aggregate face value of Rs. 10 million (2005: Rs. 10 million), have been pledged with the Controller of Military Accounts on account of Regimental Fund.

11.2.3 These represent 20,000,000 (2005: 20,000,000) KIBOR plus 2% Cumulative Preference Shares of Masood Textile Mills Limited, with Call Option available to the issuer and Conversion Option available to the bank, after completion of four years from the date of issue, i.e., June 29, 2005 and 7,500,000 (2005: Nil) KIBOR plus 2.5% Cumulative Preference Shares of Fazal Cloth Mills Limited having redemption term for ABL within 60 days after completion of 5 years from the date of issue, i.e., May 13, 2006.

11.2.4 This includes Rs. 200 million contributed by the bank towards the equity of Khushhali Bank, as per SBP Letter No. BSD (RU–26/625–MFB/13317/00), dated August 07, 2000. In accordance with the restrictions imposed by Khushhali Bank Ordinance, 2000, the bank cannot sell/transfer these shares before a period of five years from the date of subscription.

Thereafter, such sale/transfer shall be subject to the prior approval of State Bank of Pakistan, pursuant to section 10 of the Khushhali Bank Ordinance, 2000.

11.2.5 Information relating to investments in shares of listed and unlisted companies, redeemable capital, debentures and bonds, required to be disclosed as part of the financial statements under State Bank of Pakistan's BSD Circular No. 4 dated February 17, 2006, is given in Annexure "I", which is an integral part of these financial statements.

| Rupees in '000 | December 31, 2006 | December 31, 2005 |
|---|---|---|
| **11.3 Particulars of Provision** | | |
| Opening balance | 342,115 | 354,297 |
| Charge for the year | 24 | 83,393 |
| Reversals | (14,647) | (62,982) |
| Net (reversal)/charge | (14,623) | 20,411 |
| Amounts written off | (124,454) | (32,593) |
| Closing balance | 203,038 | 342,115 |
| **11.3.1 Particulars of Provision in respect of Type and Segment** | | |
| **By Type** | | |
| **Available for sale securities** | | |
| Ordinary shares of listed companies | 65,298 | 78,558 |
| Ordinary shares of unlisted companies | 2,173 | 38,266 |
| | 67,471 | 116,824 |
| **Held to maturity securities** | | |
| TFCs, Debentures, Bonds and PTCs | 132,997 | 222,721 |
| **Related parties** | | |
| Ordinary shares of unlisted companies | 2,570 | 2,570 |
| | 203,038 | 342,115 |
| **By Segment** | | |
| **Fully Paid up Ordinary Shares:** | | |
| – Listed companies | 65,298 | 78,558 |
| – Unlisted companies | 2,173 | 38,266 |
| | 67,471 | 116,824 |
| **Term Finance Certificates, Debentures, Bonds and Participation Term Certificates:** | | |
| Term Finance Certificates – unlisted | 60,582 | 134,847 |
| Debentures | 65,392 | 68,534 |
| Participation Term Certificates | 7,023 | 19,340 |
| | 132,997 | 222,721 |
| **Related parties** | | |
| Ordinary shares of unlisted companies | 2,570 | 2,570 |
| | 203,038 | 342,115 |

11.4 **Quality of Available for Sale Securities**

Information relating to quality of available for sale securities required to be disclosed as part of the financial statements under SBP's BSD Circular No. 4 dated February 17, 2006, is given in Annexure "I", which is an integral part of these financial statements.

| Rupees in '000 | December 31, 2006 | December 31, 2005 |
|---|---|---|
| **11.5 Unrealized (loss)/gain on revaluation of investments classified as held for trading** | | |
| Ordinary shares of listed companies | (30,180) | 25,706 |

| Rupees in '000 | | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|---|
| **12. ADVANCES** | Loans, cash credits, running finances, etc. - in Pakistan | | 143,383,499 | 113,630,400 |
| | Net investment in finance lease - in Pakistan | 12.2 | 777,878 | 658,716 |
| | Bills discounted and purchased (excluding treasury bills) | | | |
| | Payable in Pakistan | | 2,942,960 | 2,687,766 |
| | Payable outside Pakistan | | 3,493,264 | 2,561,112 |
| | | | 6,436,224 | 5,248,878 |
| | | | 150,597,601 | 119,537,994 |
| | Financing in respect of continuous funding system (CFS) | 12.3 | 1,107,817 | 327,677 |
| | Advances - gross | | 151,705,418 | 119,865,671 |
| | Provision for non-performing advances | 12.5 | (7,657,737) | (8,648,742) |
| | General provision for consumer financing | 12.5 | (14,047) | (10,155) |
| | Advances - net of provision | | 144,033,634 | 111,206,774 |

**12.1 Particulars of advances (Gross)**

| | | December 31, 2006 | December 31, 2005 |
|---|---|---|---|
| 12.1.1 | In local currency | 150,783,971 | 117,892,374 |
| | In foreign currencies | 921,447 | 1,973,297 |
| | | 151,705,418 | 119,865,671 |
| 12.1.2 | Short term (for upto one year) | 100,024,999 | 84,066,027 |
| | Long term (for over one year) | 51,680,419 | 35,799,644 |
| | | 151,705,418 | 119,865,671 |

**12.2 Net investment in finance lease**

| | December 31, 2006 | | | | December 31, 2005 | | | |
|---|---|---|---|---|---|---|---|---|
| Rupees in '000 | Not later than one year | Later than one and less than five years | Over five years | Total | Not later than one year | Later than one and less than five years | Over five years | Total |
| Lease rentals receivable | 317,623 | 455,475 | – | 773,098 | 346,070 | 272,645 | – | 618,715 |
| Residual value | 47,653 | 94,295 | – | 141,948 | 40,557 | 82,079 | – | 122,636 |
| Minimum lease payments | 365,276 | 549,770 | – | 915,046 | 386,627 | 354,724 | – | 741,351 |
| Financial charges for future periods | (67,503) | (69,665) | – | (137,168) | (49,611) | (33,024) | – | (82,635) |
| Present value of minimum lease payments | 297,773 | 480,105 | – | 777,878 | 337,016 | 321,700 | – | 658,716 |

**12.3** This represents secured financing in respect of purchase of shares from the CFS market. These carry markup at the rate of 16.50% (2005: 17.97% ) per annum.

**12.4** Advances include Rs.10,478.589 million (2005: Rs. 12,699.338 million) which have been placed under non-performing status as detailed below:-

| | December 31, 2006 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Classified Advances | | | Provision Required | | | Provision Held | | |
| Category of Classification<br>Rupees in '000 | Domestic | Overseas | Total | Domestic | Overseas | Total | Domestic | Overseas | Total |
| Other assets especially mentioned | 35,811 | – | 35,811 | – | – | – | – | – | – |
| Substandard | 534,865 | – | 534,865 | 88,574 | – | 88,574 | 88,574 | – | 88,574 |
| Doubtful | 659,307 | – | 659,307 | 229,548 | – | 229,548 | 229,548 | – | 229,548 |
| Loss | 9,248,606 | – | 9,248,606 | 7,339,615 | – | 7,339,615 | 7,339,615 | – | 7,339,615 |
| | 10,478,589 | – | 10,478,589 | 7,657,737 | – | 7,657,737 | 7,657,737 | – | 7,657,737 |

**12.5 Particulars of provision against non–performing advances in local currency**

| Rupees in '000 | Note | December 31, 2006 Specific | December 31, 2006 General | December 31, 2006 Total | December 31, 2005 Specific | December 31, 2005 General | December 31, 2005 Total |
|---|---|---|---|---|---|---|---|
| Opening balance | | 8,648,742 | 10,155 | 8,658,897 | 10,572,225 | 5,402 | 10,577,627 |
| Charge for the year | | 1,561,347 | 3,892 | 1,565,239 | 1,505,377 | 4,753 | 1,510,130 |
| Reversals | | (981,934) | – | (981,934) | (1,110,522) | – | (1,110,522) |
| | | 579,413 | 3,892 | 583,305 | 394,855 | 4,753 | 399,608 |
| Amounts written off | 12.6 | (1,570,418) | – | (1,570,418) | (2,318,338) | – | (2,318,338) |
| Closing balance | | 7,657,737 | 14,047 | 7,671,784 | 8,648,742 | 10,155 | 8,658,897 |

**12.5.1 Particulars of provisions against non–performing advances**

| Rupees in '000 | December 31, 2006 Specific | December 31, 2006 General | December 31, 2006 Total | December 31, 2005 Specific | December 31, 2005 General | December 31, 2005 Total |
|---|---|---|---|---|---|---|
| In local currency | 7,657,737 | 14,047 | 7,671,784 | 8,648,742 | 10,155 | 8,658,897 |
| In foreign currencies | – | – | – | – | – | – |
| | 7,657,737 | 14,047 | 7,671,784 | 8,648,742 | 10,155 | 8,658,897 |

**12.5.2** During the year, in order to comply with the requirements of the BSD Circular No. 2, dated January 14, 2006, issued by the SBP, the bank changed the method of computation of provision against the non–performing advances. The Circular requires the bank to create provision at a rate of 25 percent, instead of 10 percent of non–performing advances, in the substandard category after adjustment of the Forced Sale Value (FSV) of assets held as collateral against such non performing advances while determining the provision requirement. Additionally, BSD Circular No. 7, dated November 01, 2005, issued by the SBP restricted the benefit of the Forced Sale Value (FSV) of the collateral to financing facilities of Rs.10 million and above with effect from December 31, 2006, as against the previous requirement to restrict the same to financing facilities of Rs.5 million and above, for the purposes of determining provision against non–performing advances. The bank has made a provision of Rs. 260.02 million in order to comply with the requirements of above circulars.

Had the above referred increase in the rate of provision for substandard category and increase in the limit of financing for taking the benefit of the FSV not taken place, profit before taxation for the year and advances (net of provision) at the end of the year would have been higher by Rs. 260.02 million.

| | Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|---|
| **12.6** | **Particulars of write offs:** | | | |
| **12.6.1** | Against Provisions | 12.5 | 1,570,418 | 2,318,338 |
| | Directly charged to Profit & Loss account | | 136,189 | 160,059 |
| | | | 1,706,607 | 2,478,397 |
| **12.6.2** | Write Offs of Rs. 500,000 and above | 12.7 | 1,196,664 | 2,437,559 |
| | Write Offs of Below Rs. 500,000 | | 509,943 | 40,838 |
| | | | 1,706,607 | 2,478,397 |

**12.7 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 and above allowed to a person(s) during the year ended December 31, 2006 is given in Annexure - II. However, this write off does not affect the bank's right to recover debts from these customers.

| | Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|---|
| 12.8 | **Particulars of loans and advances to directors, related parties, etc.** | | | |
| | Debts due by directors, executives or officers of the bank or any of them either severally or jointly with any other persons | | | |
| | Balance at beginning of year | | 3,887,659 | 2,684,482 |
| | Loans granted during the year | | 939,585 | 1,626,009 |
| | Repayments | | (626,390) | (422,832) |
| | Balance at end of year | | 4,200,854 | 3,887,659 |
| **13. OPERATING FIXED ASSETS** | Capital work–in–progress | 13.1 | 516,047 | 163,443 |
| | Property and equipment | 13.2 | 5,899,386 | 4,530,262 |
| | Intangible assets | 13.3 | 29,678 | 26,957 |
| | | | 6,445,111 | 4,720,662 |
| 13.1 | **Capital work–in–progress** | | | |
| | Civil works | | 249,263 | 61,287 |
| | Equipment | | 44,703 | 14,612 |
| | Advances to suppliers and contractors | | 222,081 | 87,544 |
| | | | 516,047 | 163,443 |

**13.2 Property and equipment**

| | | Cost / Revaluation | | | | Accumulated Depreciation | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Description | Note | At January 1, 2006 | Additions/ (deletions) | Adjustment/ surplus/ (deficit) on revaluation | At December 31, 2006 | At January 1, 2006 | Charge for the year/ adjustment/ (depreciation on deletions) | Adjustment/ depreciation reversed on revaluation | At December 31, 2006 | Net book value at December 31, 2006 | Annual rate of depreciation % |
| Rupees in ' 000 | | | | | | | | | | | |
| Land | 13.4 | 2,882,599 | 852,585<br>(12,418) | (18,599) | 3,704,167 | – | –<br>– | – | – | 3,704,167 | – |
| Buildings | 13.4 | 1,256,759 | 284,919<br>(1,746) | (1,550) | 1,538,382 | 75,293 | 61,465<br>(165) | – | 136,593 | 1,401,789 | 5 |
| Furniture and fixtures | | 367,198 | 8,650<br>(14,592) | – | 361,256 | 265,015 | 23,801<br>(13,530) | – | 275,286 | 85,970 | 10 |
| Electrical, office and computer equipment | | 891,789 | 280,917<br>(23,025) | – | 1,149,681 | 614,306 | 110,697<br>(21,206) | – | 703,797 | 445,884 | 14.28 – 50 |
| Vehicles | | 219,749 | 201,839<br>(73,079) | – | 348,509 | 152,924 | 28,388<br>(55,604) | – | 125,708 | 222,801 | 20 |
| Building improvements (rented premises) | | 25,932 | 26,163 | – | 52,095 | 6,226 | 7,094 | – | 13,320 | 38,775 | 20 |
| **2006** | | 5,644,026 | 1,655,073<br>(124,860) | (20,149) | 7,154,090 | 1,113,764 | 231,445<br>(90,505) | –<br>– | 1,254,704 | 5,899,386 | |
| 2005 | | 3,525,829 | 1,403,394<br>(97,140) | 811,943 | 5,644,026 | 1,016,623 | 235,405<br>(81,305) | (56,959) | 1,113,764 | 4,530,262 | |

**13.3 Intangible assets**

| (Rupees in ' 000) | | Cost: At January 1, 2006 | Cost: Additions/ (Deletions) | Cost: At December 31, 2006 | Accumulated Amortization: At January 1, 2006 | Accumulated Amortization: Amortizations/ (Amortizations on deletion) | Accumulated Amortization: At December 31, 2006 | Net book value at December 31 2006 | Rate of amortization % |
|---|---|---|---|---|---|---|---|---|---|
| Computer software | **2006** | 46,733 | 10,157 | 56,890 | 19,776 | 7,436 | 27,212 | 29,678 | 14.28 |
| | 2005 | 33,631 | 13,127<br>(25) | 46,733 | 13,602 | 6,199<br>(25) | 19,776 | 26,957 | 14.28 |

**13.4** During the previous year the bank arranged for valuation of properties from M/s. Iqbal A. Nanjee & Co. as at September 30, 2005. The revalued amounts of properties have been determined on the basis of Fair Value Model. The revaluation resulted in increase in the carrying values of the properties by Rs. 868.90 million, as at December 31, 2005. Had there been no revaluation, the carrying amount of revalued assets would have been as follows:

| | Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|---|
| | Land | | 1,647,789 | 1,660,208 |
| | Building | | 503,395 | 591,391 |
| | For information regarding location of revalued properties, refer Annexure III. | | | |
| **13.5** | Fair value of property and equipment is not materially different from their carrying amount. | | | |
| **13.6** | Effect in the current year on profit and loss account of surplus arising on revaluation of buildings carried out last year | 22.1 | 29,926 | 31,559 |

**13.7** The land and buildings currently in use of the bank include certain properties that have been acquired in satisfaction of claims. The total cost and net book value of these properties as at December 31, 2006 amounted to Rs.1,305.336 million and Rs. 1,265.564 million respectively.

| | Rupees in '000 | December 31, 2006 | December 31, 2005 |
|---|---|---|---|
| **13.8** | Restriction/discrepancy in the title of property having a net book value of | 26,311 | 30,189 |
| **13.9** | Carrying amount of temporarily idle property and equipment | 61,432 | 221,498 |
| **13.10** | The gross carrying amount of fully depreciated/amortized assets that are still in use | | |
| | Furniture and fixtures | 153,845 | 153,955 |
| | Electrical, office and computer equipment | 556,360 | 556,353 |
| | Vehicles | 36,844 | 59,540 |
| | Intangible assets - software | 4,668 | 4,493 |
| **13.11** | The carrying amount of property and equipment that have retired from active use and are held for disposal | 123 | 669 |

## 13.12 Disposals of fixed assets

The details of disposals of assets whose original cost or book value exceeds rupees one million or two hundred and fifty thousand rupees respectively, whichever is lower, are given below:

| | Original cost/ revalued amount | Accumulated depreciation | Book value | Sale proceeds | Gain on sale | Mode of disposal | Particulars of purchaser |
|---|---|---|---|---|---|---|---|
| Rupees in '000 | | | | | | | |
| **Land** | | | | | | | |
| | 3,342 | - | 3,342 | 6,025 | 2,683 | Negotiation | Mr. Abdul Rauf Memon, Mirpurkhas |
| | 29 | - | 29 | 14,000 | 13,971 | Negotiation | Mr. Shaikh Mohammad Shoaib, Gujar Khan |
| | 8,368 | - | 8,368 | 21,600 | 13,232 | Negotiation | M/s Roomi Enterprises (Pvt) Ltd, Multan |
| | 679 | - | 679 | 679 | – | Negotiation | Mr. Abdul Hamid Shaikh, Multan |
| | 12,418 | - | 12,418 | 42,304 | 29,886 | | |
| **Building** | | | | | | | |
| | 72 | 12 | 60 | 4,822 | 4,762 | Negotiation | Mr. Abdul Hamid Shaikh, Multan |
| | 674 | 93 | 581 | 1,920 | 1,339 | Negotiation | Mr. Javed Ghani, Quetta |
| | 1,000 | 60 | 940 | 2,025 | 1,085 | Negotiation | Mr. Noor Mohammad, Karachi |
| | 1,746 | 165 | 1,581 | 8,767 | 7,186 | | |
| **Furniture & Fixtures** | | | | | | | |
| Items having book value of less than Rs.250,000 and cost of less than Rs.1,000,000 | 14,592 | 13,530 | 1,062 | 1,410 | 348 | Negotiation | Various |
| **Electrical, office and computer equipment** | | | | | | | |
| Items having book value of less than Rs.250,000 and cost of less than Rs.1,000,000 | 23,025 | 21,206 | 1,819 | 2,755 | 936 | Negotiation | Various |
| **Vehicles** | | | | | | | |
| | 2,590 | 2,590 | - | 714 | 714 | Auction | Mr. Fazal Muhammad, Karachi |
| | 2,461 | 2,461 | - | 246 | 246 | As per bank policy | Mr. Shaukat A. Kazmi, Lahore |
| | 2,200 | 2,200 | - | 494 | 494 | Auction | Mr. Muhammad Salahuddin, Karachi |
| | 1,308 | 1,308 | - | 540 | 540 | Auction | Mr. Afzal Saleem, Karachi |
| | 879 | 177 | 702 | 799 | 97 | Insurance Claim | E.F.U. General Insurance Karachi |
| | 849 | 509 | 340 | 441 | 101 | As per bank policy | Mr. Sheikh Tahir Azmat, Karachi |
| | 849 | 509 | 340 | 441 | 101 | As per bank policy | Mr. Khawja M. Almas, Karachi |
| | 849 | 509 | 340 | 340 | - | As per bank policy | Mr. Muhammadi Yaqoob, Karachi |
| | 609 | 122 | 487 | 487 | - | As per bank policy | Mr. Muhammad Rafique, Sukkur |
| | 609 | 244 | 365 | 390 | 25 | As per bank policy | Mr. I A Khairi, Karachi |
| | 609 | 244 | 365 | 390 | 25 | As per bank policy | Mr. Mohd Azam Usmani, Karachi |
| | 609 | 244 | 365 | 365 | - | As per bank policy | Mr. Tariq A Mehmood, Karachi |
| Items having book value of less than Rs.250,000 and cost of less than Rs.1,000,000 | 58,658 | 44,487 | 14,171 | 41,869 | 27,698 | Various | Various |
| | 73,079 | 55,604 | 17,475 | 47,516 | 30,041 | | |
| **December 31, 2006** | 124,860 | 90,505 | 34,355 | 102,752 | 68,397 | | |
| December 31, 2005 | 97,140 | 81,305 | 15,835 | 44,673 | 28,838 | | |

Information relating to sale of fixed assets (otherwise than through a regular auction) made to chief executive or a director or an executive or a shareholder holding not less that ten percent of the voting shares of the bank or any related party, as required by SBP's BSD circular no. 4 dated February 17, 2006, is given in Annexure "III" and is an integral part of these financial statements.

| | Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|---|
| **14. DEFERRED TAX ASSETS** | **Deferred debits arising in respect of** | | | |
| | Compensated leave absences | | 323,887 | 257,316 |
| | Provision against: | | | |
| | Investments | | 48,209 | 84,594 |
| | Other assets | | 208,277 | 156,972 |
| | Off balance sheet obligations | | 88,804 | 87,914 |
| | Post retirement medical benefits | | 368,540 | 328,047 |
| | Deficit on revaluation of investments | | 6,284 | - |
| | | | 1,044,001 | 914,843 |
| | **Deferred credits arising due to** | | | |
| | Surplus on revaluation of fixed assets | | (198,948) | (209,965) |
| | Accelerated tax depreciation / amortization | | (109,242) | - |
| | Excess of investment in finance lease over written down value of leased assets | | (97,643) | (24,785) |
| | | | (405,833) | (234,750) |
| | | | 638,168 | 680,093 |
| **15. OTHER ASSETS** | Income/Mark-up accrued on advances, investments and placements: | | | |
| | - in local currency | | 3,846,259 | 2,359,804 |
| | - in foreign currencies | | 9,947 | 9,311 |
| | Due on account of sale of investments | | 249,629 | 1,912 |
| | Advances, deposits, advance rent and other prepayments | | 950,019 | 328,618 |
| | Advance taxation (payments less provisions) | | 4,135,369 | 3,963,617 |
| | Non-banking assets acquired in satisfaction of claims | 15.1 | 189 | 189 |
| | Stationery and stamps on hand | | 49,252 | 56,853 |
| | Prepaid exchange risk fee | | - | 34 |
| | Due from the employees' retirement benefit schemes | 36.4 | 1,032,064 | 731,290 |
| | Unrealized gain on forward foreign exchange contracts | | 15,539 | 9,269 |
| | Receivable from SBP - customers encashments | | 28,048 | 103,146 |
| | Suspense account | | 423,204 | 92,883 |
| | Others | | 16,917 | 50,115 |
| | | | 10,756,436 | 7,707,041 |
| | Less: Provision held against other assets | | (595,075) | (479,088) |
| | Other assets (net of provision) | | 10,161,361 | 7,227,953 |
| 15.1 | Market value of Non-banking assets acquired in satisfaction of claims | | 135,117 | 45,039 |
| 15.2 | **Provision against other assets** | | | |
| | Opening balance | | 479,088 | 466,324 |
| | Charge for the year | | 208,652 | 39,828 |
| | Reversals | | (3,345) | (4,752) |
| | Net charge | | 205,307 | 35,076 |
| | Written off | | (89,320) | (22,312) |
| | Closing balance | | 595,075 | 479,088 |
| **16. BILLS PAYABLE** | In Pakistan | | 2,273,952 | 2,444,565 |
| | Outside Pakistan | | 4,055 | 4,055 |
| | | | 2,278,007 | 2,448,620 |

## 17. BORROWINGS

| Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|
| In Pakistan | | 18,033,050 | 9,536,455 |
| Outside Pakistan | | 377,375 | 157,330 |
| | | 18,410,425 | 9,693,785 |

**17.1 Particulars of borrowings with respect to Currencies**

| Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|
| In local currency | | 18,033,050 | 9,536,455 |
| In foreign currencies | | 377,375 | 157,330 |
| | | 18,410,425 | 9,693,785 |

**17.2 Details of borrowings Secured/Unsecured**

| Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|
| **Secured** | | | |
| Borrowings from financial institutions | | 14,500 | 5,000 |
| Borrowings from State Bank of Pakistan | | | |
| Under export refinance scheme | 17.3 | 5,555,134 | 3,999,675 |
| LTF - EOP | 17.4 | 3,907,552 | – |
| | | 9,462,686 | 3,999,675 |
| Repurchase agreement borrowings | 17.5 | 4,855,864 | 4,231,780 |
| **Unsecured** | | | |
| Call borrowings | 17.6 | 3,700,000 | 1,300,000 |
| Overdrawn nostro accounts | 17.7 | 377,375 | 157,330 |
| | | 4,077,375 | 1,457,330 |
| | | 18,410,425 | 9,693,785 |

**17.3** The bank has entered into various agreements for financing with the State Bank of Pakistan (SBP) for extending export finance to customers. As per the agreements, the bank has granted the SBP the right to recover the outstanding amount from the bank at the date of maturity of the finance by directly debiting the current account maintained by the bank with the SBP. These carry interest at rates ranging between 6.5% and 7.5% (2005: between 3.5% and 7.5%) per annum.

**17.4** This represents Long Term Financing against Export Oriented Projects (LTF-EOP) availed by the bank for further extending the same to its customers for export oriented projects, for a maximum period of 7.5 years. The loan repayments to SBP correspond the respective repayment from customers. The loan carries mark-up ranging from 4% to 5% per annum (2005: Nil).

**17.5** These represent funds borrowed from the local interbank market against government securities, carrying mark-up at rates, ranging between 8.00% and 8.85% (2005: 8.25% and 8.45%) per annum maturing on various dates, latest by January 19, 2007.

**17.6** These represent unsecured borrowings from the local interbank market, carrying mark-up at rates, ranging between 10.35% and 11.25% (2005: 8% and 9.10%) per annum maturing on various dates, latest by March 21, 2007.

**17.7** Included in overdrawn nostro accounts are balances, aggregating to Rs. 144.05 million (2005: Rs. 2.01 million), representing balances held with a related party outside Pakistan.

| Rupees in '000 | December 31, 2006 | December 31, 2005 |
|---|---|---|
| **18. DEPOSITS AND OTHER ACCOUNTS** | | |
| **Customers** | | |
| Fixed deposits | 53,304,136 | 31,633,508 |
| Savings deposits | 66,954,303 | 66,323,993 |
| Current accounts - Remunerative | 23,028,853 | 13,410,869 |
| - Non-remunerative | 56,422,618 | 49,710,944 |
| | 199,709,910 | 161,079,314 |
| **Financial Institutions** | | |
| Remunerative deposits | 6,321,414 | 330,954 |
| Non-remunerative deposits | – | – |
| | 6,321,414 | 330,954 |
| | 206,031,324 | 161,410,268 |
| **18.1 Particulars of deposits** | | |
| In local currency | 198,931,209 | 156,150,709 |
| In foreign currencies | 7,100,115 | 5,259,559 |
| | 206,031,324 | 161,410,268 |
| **19. SUB-ORDINATED LOANS** | | |
| Term Finance Certificates - Unsecured | 2,500,000 | – |

The bank has issued unsecured sub-ordinated Term Finance Certificates, which will contribute towards Tier II capital for minimum capital requirements (MCR) as per guidelines set by the SBP, under BSD Circular No. 12, dated August 24, 2004, to support the bank's growth. All the regulatory approvals were obtained in December 2006. Liability to the TFC holders shall be subordinated to and rank inferior to all other debts of the bank including deposits and is not redeemable before maturity without prior approval of the SBP. The rate of return is based on the Karachi Interbank Offer Rate (KIBOR) prevailing on the last working day before the beginning of each semi annual redemption period plus 1.9% (no floor, no cap). 0.24% of the principal shall be redeemed in the first 72 months and the remaining principal shall be redeemed in 4 equal semi-annual installments of 24.94% each of the Issue amount respectively, starting from the 78th month.

Other salient features of the issue are as follows:

| | |
|---|---|
| Total issue : | Rs. 2,500 million |
| Pre-initial public offer (Pre-IPO) : | Rs. 1,875 million |
| Initial public offer (IPO) : | Rs. 625 million |
| Rating : | A |
| Listing : | Karachi Stock Exchange (Guarantee) Ltd. |
| Repayment : | 8 Years (2007 – 2014) |
| Profit payment : | Semi annually in arrears (365 day basis) |

| Rupees in '000 | Note | December 31, 2006 | December 31, 2005 (Restated) |
|---|---|---|---|
| **20. OTHER LIABILITIES** | | | |
| Mark-up / Return / Interest payable in local currency | | 1,323,318 | 549,988 |
| Mark-up / Return / Interest payable in foreign currency | | 31,279 | 3,092 |
| Accrued expenses | | 324,389 | 252,636 |
| Branch adjustment account | | 131,623 | 838,568 |
| Provision for: | | | |
| gratuity | 36.4 | 112,570 | 112,325 |
| employees' medical benefits | 36.4 | 1,052,971 | 937,276 |
| employees' compensated absences | 36.8 | 925,392 | 735,189 |
| Unclaimed dividends | | 4,506 | – |
| Provision against off-balance sheet obligations | 20.1 | 253,727 | 251,181 |
| Security deposits against lease | | 142,948 | 122,562 |
| Unrealised loss on future contracts in respect of equity instruments | | - | 9,735 |
| Others | | 816,544 | 659,396 |
| | | 5,119,267 | 4,471,948 |

| Rupees in '000 | December 31, 2006 | December 31, 2005 |
|---|---|---|
| **20.1 Provision against off-balance sheet obligations** | | |
| Opening balance | 251,181 | 172,086 |
| Charge for the year | 4,108 | 87,626 |
| Reversals | (1,562) | (8,531) |
| Net charge | 2,546 | 79,095 |
| Closing balance | 253,727 | 251,181 |

The above provision has been made against letters of guarantee issued by the bank.

## 21. SHARE CAPITAL

### 21.1 Authorized Capital

| December 31, 2006 | December 31, 2005 | | December 31, 2006 | December 31, 2005 |
|---|---|---|---|---|
| No. of shares | | | Rupees in '000 | |
| 1,000,000,000 | 500,000,000 | Ordinary shares of Rs.10/- each | 10,000,000 | 5,000,000 |

### 21.2 Issued, subscribed and paid up

Fully paid up Ordinary shares of Rs. 10/- each

| December 31, 2006 | December 31, 2005 | | December 31, 2006 | December 31, 2005 |
|---|---|---|---|---|
| No. of shares | | Ordinary shares | Rupees in '000 | |
| 406,780,094 | 406,780,094 | Fully paid in cash | 4,067,801 | 4,067,801 |
| 24,535,471 | 24,535,471 | Issued as bonus shares | 245,355 | 245,355 |
| 431,315,565 | 431,315,565 | | 4,313,156 | 4,313,156 |
| 9,148,550 | 9,148,550 | 18,348,550 Ordinary shares of Rs. 10 each, determined pursuant to the Scheme of Amalgamation in accordance with the swap ratio, stipulated therein less 9,200,000 Ordinary shares of Rs. 10 each, held by ILL on the cut-off date (September 30, 2004) | 91,486 | 91,486 |
| 8,400,000 | 8,400,000 | 8,400,000 Ordinary shares of Rs. 10 each, determined pursuant to the Scheme of Amalgamation of First Allied Bank Modaraba with Allied Bank Limited in accordance with the share swap ratio stipulated therein | 84,000 | 84,000 |
| 448,864,115 | 448,864,115 | | 4,488,642 | 4,488,642 |

Ibrahim Fibres Limited and Ibrahim Agencies (Private) Limited, related parties of the bank, held 141,982,700 and 27,281,554 (December 31, 2005: 141,982,700 and 25,190,230) Ordinary shares of Rs.10 each, respectively, as at December 31, 2006.

## 22. SURPLUS/(DEFICIT) ON REVALUATION OF ASSETS - NET OF TAX

| Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|
| **Surplus/(deficit) arising on revaluation of:** | | | |
| - fixed assets | 22.1 | 1,540,001 | 1,579,059 |
| - securities | 22.2 | (81,895) | 56,483 |
| Surplus on revaluation of assets - net of tax | | 1,458,106 | 1,635,542 |

| | Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|---|
| 22.1 | **Surplus on revaluation of Fixed Assets** | | | |
| | Surplus on revaluation of fixed assets as at January 1 | | 1,789,024 | 953,073 |
| | Net increase arising on revaluations during the year | | - | 868,902 |
| | Surplus realized on disposal of revalued properties | | (20,149) | (1,392) |
| | Transferred to unappropriated profit in respect of incremental depreciation charged during the year - net of deferred tax | | (19,452) | (19,882) |
| | Related deferred tax liability | | (10,474) | (11,677) |
| | | 13.6 | (29,926) | (31,559) |
| | Surplus on revaluation of fixed assets as at December 31 | | 1,738,949 | 1,789,024 |
| | Less: Related deferred tax liability on: | | | |
| | Revaluation as at January 1 | | 209,965 | 169,664 |
| | Surplus arising on revaluation of building during the year | | - | 51,978 |
| | Disposal of revalued properties | | (543) | - |
| | Incremental depreciation charged during the year transferred to profit and loss account | | (10,474) | (11,677) |
| | | | 198,948 | 209,965 |
| | | | 1,540,001 | 1,579,059 |
| 22.2 | **Surplus / (Deficit) on revaluation of Available-for-sale securities** | | | |
| | **Federal Government Securities** | | | |
| | Market Treasury Bills | | (15,715) | 1,409 |
| | Pakistan Investment Bonds | | (2,240) | - |
| | **Term Finance Certificates - Listed** | | 7,298 | - |
| | **Shares / Certificates - Listed** | | (97,150) | 53,714 |
| | **Mutual Funds** | | 19,628 | 1,360 |
| | | 11.1 | (88,179) | 56,483 |
| | Less : Related deferred tax asset | | 6,284 | - |
| | | | (81,895) | 56,483 |

## 23. CONTINGENCIES AND COMMITMENTS

| | | December 31, 2006 | December 31, 2005 |
|---|---|---|---|
| 23.1 | **Direct credit substitutes** | | |
| | Guarantees in favour of: | | |
| | Banks and financial institutions | 1,761,869 | 1,355,300 |
| 23.2 | **Transaction-related contingent liabilities** | | |
| | Guarantees in favour of: | | |
| | Government | 1,986,614 | 627,404 |
| | Others | 4,761,103 | 3,464,202 |
| | | 6,747,717 | 4,091,606 |
| 23.3 | **Trade-related contingent liabilities** | 38,142,108 | 22,394,618 |
| 23.4 | **Claims against the bank not acknowledged as debt** | 2,738,318 | 5,622,737 |
| 23.5 | **Commitments to extend credit** | 8,090,550 | 6,480,152 |
| 23.6 | **Commitments in respect of forward foreign exchange contracts** | | |
| | Purchase | 6,983,267 | 3,173,997 |
| | Sale | 3,266,742 | 2,300,788 |
| | | 10,250,009 | 5,474,785 |

| | Rupees in '000 | December 31, 2006 | December 31, 2005 |
|---|---|---|---|
| 23.7 | **Commitments in respect of:** | | |
| | Civil works | 294,037 | 323,025 |
| | Acquisition of operating fixed assets | 1,149,408 | 258,327 |
| 23.8 | **Commitments in respect of future sale of equity instruments** | - | 290,136 |
| 23.9 | **Commitments in respect of lease financing** | 150,384 | 13,012 |
| 23.10 | **Commitments in respect of:** | | |
| | Forward lending | - | - |
| | Forward borrowing | 1,853,461 | - |
| | | 1,853,461 | - |

**23.11 Other Contingencies**

**23.11.1** The Income tax assessments of the bank have been finalized up to and including Tax Year 2005 and Tax Year 2004 for local operations and Azad Kashmir operations, respectively.

a) While finalizing income tax assessments up to the assessment year 2000-2001, the Income Tax Authorities made certain add backs with a tax impact of Rs. 278 million. As a result of appeals filed by the bank before the Appellate Authorities, these add-backs were deleted and set-aside with a tax impact of Rs. 64 million and Rs. 125 million respectively. The appeal effect orders with regard to the above matters are pending.

b) The assessments from Assessment Year 2001-2002 to Tax Year 2005 have been finalized with net additional tax liability of Rs. 4,684 million. As a result of the appeals filed by the bank before the Appellate Authorities, various additions having tax impact of Rs. 4,718 million and Rs. 2,424 million have been deleted and set-aside by the Appellate Authorities, respectively. The appeal effect orders with regard to the above matters are pending.

c) Income tax return for Tax Year 2006 is filed with tax liability of Rs. 1,601 million whereas provision has been made upto Rs. 1,331 million after considering the effect of carry forward losses of the above mentioned Assessment / Tax Years which would be made available in Tax Year 2006.

Pending the finalization of the above-referred appeals, no provision has been made by the bank in an aggregate sum of Rs. 5,232 million in these financial statements. This sum includes tax liability, aggregating to Rs. 4,782 million, already deleted by the Appellate Authorities for which appeal effect orders are pending. The management is hopeful that the outcome of these appeals will be in favor of the Bank.

**23.11.2** As a result of a compromise decree granted by the Honourable High Court of Sindh in August 2002, Fateh Textile Mills Limited pledged 16,376,106 shares of ABL with the bank as security consequent to the default by Fateh Textile Mills Limited on the terms of the decree. The bank published a notice on June 23, 2004 in accordance with the requirements of section 19(3) of the Financial Institutions (Recovery of Finances) Ordinance, 2001 and invited sealed bids from interested parties to purchase the pledged shares. The bidding process was scheduled for July 23 , 2004 and the bank had fixed a reserve price of Rs. 25 per share. On the bid date, the highest offer for these shares was received at a rate of Rs. 25.51 per share. The bid was approved and the successful bidder had deposited an amount of Rs. 417.75 million with the bank.

Fateh Textile Mills Limited had filed a suit against the bank in the High Court of Sindh challenging the sale of the above shares. The High Court had not granted a stay order on the process of sale of shares. However, the matter is still pending in the Court.

## 24. DERIVATIVE INSTRUMENTS

The bank at present does not offer structured derivative products such as Interest Rate Swaps, Forward Rate Agreements or FX Options. However, the bank's Treasury buys and sells derivative instruments such as:

- Forward Exchange Contracts
- Foreign Exchange Swaps
- Equity Futures

**Forward Exchange Contracts (with Importers and Exporters)**

Forward Exchange Contract (FEC) is a product which is offered to the obligor who transact internationally. These traders use this product to hedge themselves from unfavorable movements in a foreign currency, however, by agreeing to fix the exchange rate, they do not benefit from favorable movements in that currency.

An FEC is a contract between the Obligor and the bank in which both agree to exchange an amount of one currency for another currency at an agreed forward exchange rate for settlement more than two business days after the FEC is entered into (the day on which settlement occurs is called the value date). FEC is entered with those Obligors whose credit worthiness has already been assessed.

If the relevant exchange rate moves un-favourably, the bank will loose money, and Obligor will benefit from that movement because the bank must exchange currencies at the FEC rate. In order to mitigate this risk of adverse exchange rate movement, the bank hedges its exposure by taking forward position in inter-bank FX.

**Foreign Exchange Swaps**

A Foreign Exchange Swap (FX Swap) is used by the bank if it has a need to exchange one currency for another currency on one day and then re-exchange those currencies at a later date. Exchange rates and forward margins are determined in the "interbank" market and fluctuate according to supply and demand.

An FX Swap prevents the bank from gaining any benefit resulting from a favourable exchange rate movement in the relevant currency pair between the time bank enters into the transaction deal and when settlement occurs. Cancellation of the swap may also result in exposure to market movements. The key advantage of an FX swap is that it provides the bank with protection against unfavourable currency movements between the time it enters into the transaction and settlement. The term and amounts for FX Swap can also be tailored to suit the bank's particular needs.

**Equity Futures**

An equity futures contract is a standardized contract, traded on a futures counter of the stock exchange, to buy or sell a certain underlying scrip at a certain date in the future, at a specified price.

The bank uses equity futures as a hedging instrument to hedge its equity portfolio, in both held for trading and available for sale, against equity price risk. Only selected shares are allowed to be traded on futures exchange. Equity futures give flexibility to the bank either to take delivery on the future settlement date or to settle it by adjusting the notional value of the contract based on the current market rates. Maximum exposure limit to the equity futures is 10% of Tier I Capital of the bank.

The accounting policies used to recognize and disclose derivatives are given in note 7.15.2.

**25. MARK-UP / RETURN / INTEREST EARNED**

| Rupees in '000 | December 31, 2006 | December 31, 2005 |
|---|---|---|
| On loans and advances to customers | 12,199,617 | 5,998,381 |
| **On investments in:** | | |
| Available for sale securities | 1,716,804 | 402,390 |
| Held to maturity securities | 1,582,206 | 2,513,853 |
| | 3,299,010 | 2,916,243 |
| On deposits with financial institutions | 219,812 | 106,109 |
| On securities purchased under resale agreements | 824,084 | 228,075 |
| On certificates of investment | 226,961 | 338,757 |
| On letters of placement | 352,633 | 74,818 |
| On call money lending | 93,390 | 229,668 |
| | 17,215,507 | 9,892,051 |

**26. MARK-UP / RETURN / INTEREST EXPENSED**

| | December 31, 2006 | December 31, 2005 |
|---|---|---|
| Deposits | 6,125,387 | 1,696,420 |
| Securities sold under repurchase agreements | 313,740 | 215,869 |
| Other short term borrowings | 319,855 | 112,253 |
| Markup on TFCs | 21,387 | - |
| Others | 12,732 | 117 |
| | 6,793,101 | 2,024,659 |

| | Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|---|
| **27. FEE, COMMISSION AND BROKERAGE INCOME** | Core fees, commission and brokerage | | 1,152,093 | 820,031 |
| | Account maintenance charges | | 201,795 | 400,331 |
| | | | 1,353,888 | 1,220,362 |
| **28. GAIN ON SALE OF SECURITIES** | Federal Govt. Securities | | | |
| | Market Treasury Bills | | 24 | 1,117 |
| | Pakistan Investment Bonds | | 375 | - |
| | Shares - Listed | | 376,393 | 123,266 |
| | | | 376,792 | 124,383 |
| **29. OTHER INCOME** | Gain on sale of fixed assets | | 68,397 | 28,838 |
| | Miscellaneous | | 204,631 | 243,924 |
| | | | 273,028 | 272,762 |
| **30. ADMINISTRATIVE EXPENSES** | Salaries, allowances, etc. | | 3,083,342 | 2,610,605 |
| | Charge for defined benefit plan | | 226,909 | 39,341 |
| | Contribution to defined contribution plan - provident fund | | 118,499 | 107,956 |
| | Non-executive directors' fees, allowances and other expenses | | 361 | 194 |
| | Rent, taxes, insurance, electricity, etc. | | 498,321 | 378,017 |
| | Legal and professional charges | | 67,874 | 48,261 |
| | Communications | | 174,032 | 145,142 |
| | Repairs and maintenance | | 83,675 | 71,085 |
| | Stationery and printing | | 111,194 | 81,892 |
| | Advertisement and publicity | | 188,517 | 103,750 |
| | Auditors' remuneration | 30.1 | 8,805 | 9,576 |
| | Depreciation / Amortization | 13.2 & 13.3 | 238,881 | 241,604 |
| | Brokerage and commission | | 71,740 | 84,379 |
| | Security service charges | | 108,686 | 87,271 |
| | Travelling, conveyance and fuel expenses | | 114,805 | 86,887 |
| | Entertainment | | 40,334 | 28,691 |
| | Computer expenses | | 119,799 | 90,320 |
| | Subscription | | 18,621 | 23,823 |
| | Donations | 30.2 | 9,499 | 15,000 |
| | Others | | 6,684 | 5,738 |
| | | | 5,290,578 | 4,259,532 |

**30.1 Auditors' remuneration**

| | December 31, 2006 | | | December 31, 2005 | | |
|---|---|---|---|---|---|---|
| Rupees in '000 | Ford Rhodes Sidat Hyder & Co. | M. Yousuf Adil Saleem & Co. | Total | Ford Rhodes Sidat Hyder & Co. | M. Yousuf Adil Saleem & Co. | Total |
| Audit fee | 1,500 | 1,500 | 3,000 | 1,375 | 1,375 | 2,750 |
| Special certifications, half yearly and quarterly reviews and sundry miscellaneous services | 2,275 | 2,680 | 4,955 | 2,900 | 3,150 | 6,050 |
| Out-of-pocket expenses | 365 | 485 | 850 | 405 | 371 | 776 |
| | 4,140 | 4,665 | 8,805 | 4,680 | 4,896 | 9,576 |

30.2 None of the directors, executives and their spouses had any interest in the donations disbursed during the year. Donations paid in excess of Rs. 100,000 to a single party during the year are as follows:

| Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|
| Earthquake victims in Kashmir and NWFP | | - | 15,000 |
| Shaukat Khanum Memorial Cancer Hospital and Research Centre | | 3,700 | - |
| Tameer-e-Millat Foundation | | 2,500 | - |
| The Kidney Centre | | 1,000 | - |
| Sahara For Life Trust | | 500 | - |
| Golf Club Faisalabad | | 500 | - |
| Care Foundation | | 400 | - |
| Mr. Tahir Sadiq | | 249 | - |
| Agha Khan Hospital and Medical College Foundation | | 150 | - |
| OGS Trust | | 150 | - |

## 31. OTHER CHARGES

| | | | |
|---|---|---|---|
| Penalties imposed by SBP | | 7,078 | 18,999 |

## 32. TAXATION

| | | | |
|---|---|---|---|
| Current - for the year | | 2,215,092 | 1,331,468 |
| - for prior years | | - | 22,000 |
| | | 2,215,092 | 1,353,468 |
| Deferred | | 48,752 | 390,594 |
| | | 2,263,844 | 1,744,062 |

32.1 **Relationship between tax expense and accounting profit**

| | | | |
|---|---|---|---|
| Accounting profit for the current year | | 6,661,094 | 4,834,195 |
| Tax on income @ 35% (2005 : 37%) | | 2,331,383 | 1,788,652 |
| Effect of permanent differences | | 65,477 | 81,030 |
| Effect of exempt income | | (91,085) | (60,317) |
| Adjustments in respect of tax on reduced rates | | (36,804) | (14,767) |
| Effect of reduction in tax rates | | - | (43,508) |
| Tax charge for the prior year | | - | 22,000 |
| Others | | (5,127) | (29,028) |
| Tax charge for the current year | | 2,263,844 | 1,744,062 |

## 33. EARNINGS PER SHARE – BASIC AND DILUTED

| | | | |
|---|---|---|---|
| Profit for the year after taxation | | 4,397,250 | 3,090,133 |
| | | Number of Shares | |
| Weighted average number of Ordinary shares outstanding during the year | 33.1 | 448,864,115 | 448,864,115 |
| | | (Rupees) | |
| Earnings per share - basic and diluted | | 9.80 | 6.88 |

There is no dilution effect on basic earnings per share

33.1 The comparative figure of weighted average number of shares outstanding has been restated to include Ordinary shares issued by the bank during the year as a result of merger with FABM.

## 34. CASH AND CASH EQUIVALENTS

| Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|
| Cash and balances with treasury banks | 8 | 23,039,577 | 14,742,711 |
| Balances with other banks | 9 | 1,705,445 | 3,292,041 |
| Overdrawn nostro accounts | 17 | (377,375) | (157,330) |
| | | 24,367,647 | 17,877,422 |

## 35. STAFF STRENGTH

| Number | December 31, 2006 | December 31, 2005 |
|---|---|---|
| Permanent | 7,139 | 6,909 |
| Temporary/on contractual basis/trainee | 65 | 38 |
| Bank's own staff strength at the end of the year | 7,204 | 6,947 |
| Outsourced | 1,675 | 1,326 |
| Total Staff strength | 8,879 | 8,273 |

## 36. DEFINED BENEFIT PLANS

### 36.1 General description

The bank operates a funded gratuity scheme for all employees who opted for the new staff retirement benefit scheme introduced by the management with effect from July 1, 2002. For those employees who did not opt for the new scheme, the bank continues to operate a funded pension scheme.

The bank also operates a contributory benevolent fund (defined benefit scheme) and provides post retirement medical benefits to eligible retired employees.

### 36.2 Number of Employees under the schemes

The number of employees covered under the following defined benefit scheme/plans are:

| | |
|---|---|
| - Gratuity fund | 7,180 |
| - Pension fund | 4,000 |
| - Benevolent fund | 7,139 |
| - Employees' compensated absences | 7,139 |
| - Post retirement medical benefits | 7,139 |

### 36.3 Principal actuarial assumptions

The actuarial valuations were carried out on June 30, 2006 based on the Projected Unit Credit Method, using the following significant assumptions:

| | December 31, 2006 | December 31, 2005 | Sources of estimation |
|---|---|---|---|
| Discount rate: | | | |
| May 31, 2005 | - | 10.00% | |
| June 30, 2006 | 10.00% | - | Yield on investments in |
| December 31, 2006 | 10.00% | - | Government Bonds |
| Expected rate of return on plan assets: | | | |
| May 31, 2005 | - | 10.00% | |
| June 30, 2006 | 10.00% | - | Yield on investments in |
| December 31, 2006 | 10.00% | - | Government Bonds |
| Expected rate of salary increase | 8.00% | 6.50% | Rate of salary increase |

**36.4 Reconciliation of (receivable) / payable to defined benefit plan**

| Rupees in '000 | December 31, 2006 Pension fund | Gratuity fund | Benevolent fund | Post retirement medical |
|---|---|---|---|---|
| Present value of defined benefit obligations | 3,295,249 | 463,564 | 532,218 | 1,458,865 |
| Fair value of plan/scheme's assets | (5,155,897) | (393,999) | (610,811) | - |
| Net actuarial gains/(losses) not recognized | 907,356 | 43,005 | (78,951) | (405,894) |
| | (953,292) | 112,570 | (157,544) | 1,052,971 |
| Benefit of the surplus not available to the bank refer note 36.4.1 | - | - | 78,772 | - |
| | (953,292) | 112,570 | (78,772) | 1,052,971 |

| Rupees in '000 | December 31, 2005 Pension fund | Gratuity fund | Benevolent fund | Post retirement medical |
|---|---|---|---|---|
| Present value of defined benefit obligations | 3,244,547 | 376,520 | 559,397 | 1,292,221 |
| Fair value of plan/scheme's assets | (5,475,648) | (286,159) | (563,483) | - |
| Net actuarial gains/(losses) not recognized | 1,575,884 | 21,964 | (106,869) | (354,945) |
| | (655,217) | 112,325 | (110,955) | 937,276 |
| Benefit of the surplus not available to the bank refer note 36.4.1 | - | - | 34,882 | - |
| | (655,217) | 112,325 | (76,073) | 937,276 |

36.4.1 The latest actuarial valuation of Benevolent Fund, carried out as at June 30, 2006 highlighted a surplus of Rs 157.544 million. Out of this amount, a benefit of Rs 78.772 million can be availed by the bank in future years in the form of reduced contributions.

**36.5 Movement in (receivable) from/payable to defined benefit plan**

| Rupees in '000 | December 31, 2006 Pension fund | Gratuity fund | Benevolent fund | Post retirement medical |
|---|---|---|---|---|
| Opening balance | (655,217) | 112,325 | (76,073) | 937,276 |
| Charge/(reversal) for the year - note 36.6 | (298,075) | 84,084 | 30,219 | 188,045 |
| Contribution to fund made during the year | | | | |
| Bank's contribution | - | (83,839) | (32,918) | - |
| Benefits paid | - | - | - | (72,350) |
| | (953,292) | 112,570 | (78,772) | 1,052,971 |

| Rupees in '000 | December 31, 2005 Pension fund | Gratuity fund | Benevolent fund | Post retirement medical |
|---|---|---|---|---|
| Opening balance | (405,673) | 105,000 | (34,881) | 854,049 |
| Charge for the year - note 36.6 | (249,544) | 80,198 | (10,209) | 158,896 |
| Contribution to fund made during the year | | | | |
| Bank's contribution | - | (72,873) | (30,983) | - |
| Benefits paid | - | - | - | (75,669) |
| Closing balance | (655,217) | 112,325 | (76,073) | 937,276 |

**36.6 Charge for defined benefit plan**

| Rupees in '000 | December 31, 2006 Pension fund | Gratuity fund | Benevolent fund | Post retirement medical |
|---|---|---|---|---|
| Current service cost | - | 75,048 | 15,770 | 41,460 |
| Interest cost | 324,455 | 37,652 | 55,940 | 129,222 |
| Expected return on plan assets | (547,565) | (28,616) | (56,348) | - |
| Actuarial (gains)/losses | (74,965) | - | 3,885 | 17,363 |
| Contributions - employee | - | - | (32,918) | - |
| Benefit of the surplus not available to the bank | - | - | 43,890 | - |
| | (298,075) | 84,084 | 30,219 | 188,045 |

| Rupees in '000 | December 31, 2005 Pension fund | Gratuity fund | Benevolent fund | Post retirement medical |
|---|---|---|---|---|
| Current service cost | - | 73,555 | 13,769 | 30,811 |
| Interest cost | 319,295 | 23,588 | 43,646 | 112,209 |
| Expected return on plan assets | (501,366) | (16,945) | (40,378) | - |
| Actuarial (gains) / losses | (67,473) | - | 3,737 | 15,876 |
| Contributions - employee | - | - | (30,983) | - |
| | (249,544) | 80,198 | (10,209) | 158,896 |

| Rupees in '000 | December 31, 2006 | December 31, 2005 |
|---|---|---|
| **36.7 Actual return on plan assets** | | |
| - Gratuity fund | 38,285 | 37,507 |
| - Pension fund | 822,242 | 704,565 |
| - Benevolent fund | 71,892 | 65,529 |

**36.8 Employees' compensated absences**

The liability of the bank in respect of long-term employees' compensated absences is determined, based on actuarial valuation, carried out using the Projected Unit Credit Method. The liability of the bank as at December 31,2006, as per the latest actuarial valuation carried out as at September 30, 2006 which, after considering the estimated liability for the current year, amounted to Rs. 925.392 million (2005: Rs. 735.189 million). A charge of Rs. 222.635 million (2005: Rs. 60 million) has been provided during the current year, representing the management's best estimate.

## 37. DEFINED CONTRIBUTION PLAN

The bank operates a contributory provident fund scheme for employees who are covered under the new gratuity scheme. The employer and employee both contribute 8.33% of the basic salaries to the funded scheme every month. Number of employees covered under this plan are 6,598 (2005: 6,909) as on December 31, 2006. During the year, employees made a contribution of Rs. 118.499 (2005: Rs. 107.956) million to the fund. The bank has also made a contribution of equal amount to the fund.

## 38. COMPENSATION OF DIRECTORS AND EXECUTIVES

| | | President / Chief Executive | | Directors | | Executives | |
|---|---|---|---|---|---|---|---|
| Rupees in '000 | Note | December 31, 2006 | December 31, 2005 | December 31, 2006 | December 31, 2005 | December 31, 2006 | December 31, 2005 |
| Fees | 38.1 | - | - | 361 | 194 | - | - |
| Managerial remuneration | | 15,000 | 12,000 | 7,275 | 11,550 | 277,099 | 148,701 |
| Charge for defined benefit plan | | 842 | 69 | - | - | 74,310 | 26,103 |
| Contribution to defined contribution plan | | 1,275 | 1,020 | - | - | 21,555 | 10,353 |
| Rent and house maintenance | | - | - | 270 | 540 | 71,931 | 37,717 |
| Utilities | | 667 | 460 | 728 | 1,155 | 27,748 | 13,718 |
| Medical | | 24 | 2 | 728 | 1,155 | 19,668 | 3,868 |
| Bonus | | 7,500 | 3,500 | - | - | 251,158 | 236,555 |
| Conveyance and others | | 480 | 176 | - | - | 31,880 | 22,365 |
| | | 25,788 | 17,227 | 9,362 | 14,594 | 775,349 | 499,380 |
| Number of persons | | 1 | 1 | 10 | 7 | 330 | 343 |

**38.1** This represents remuneration paid to each director (total number of directors 10) for attending meetings of the Board of Directors, Audit Committee and other committees held during the year. Each director was paid Rs. 5,000 per meeting for each meeting attended during the year.

**38.2** The Chief Executive, Directors and certain executives are also provided with other facilities, including free use of the bank maintained cars.

## 39. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of traded investments is based on quoted market prices, except for securities classified by the bank as held to maturity. Fair value of unquoted equity investments is determined on the basis of break up value of these investments as per the latest available audited accounts.

Fair value of fixed term loans, other assets, other liabilities and fixed term deposits cannot be calculated with sufficient reliability due to the absence of current and active market for such assets and liabilities and reliable data regarding market rates for similar instruments. The provision for impairment of loans and advances has been calculated in accordance with the bank's accounting policy as stated in note 7.5.

The maturity and repricing profile and effective rates are stated in notes 43.3.1 and 43.2.3 respectively.

In the opinion of the management, the fair value of the remaining financial assets and liabilities are not significantly different from their carrying values since assets and liabilities are either short-term in nature or in the case of customer loans and deposits are frequently repriced.

## 40. SEGMENT DETAILS WITH RESPECT TO BUSINESS ACTIVITIES

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

| Rupees in '000 | Corporate Finance | Trading & Sales | Retail Banking | Commercial Banking | Payment & Settlement | Agency Services | Assets Management | Retail Brokerage | Others |
|---|---|---|---|---|---|---|---|---|---|
| **2006** | | | | | | | | | |
| Total Income | 169,366 | 2,063,283 | 8,326,310 | 13,521,560 | 784,622 | - | - | - | - |
| Total Expenses | (95,912) | (1,798,344) | (6,547,025) | (11,376,011) | (650,599) | - | - | - | - |
| Net Income (loss) | 73,454 | 264,939 | 1,779,285 | 2,145,549 | 134,023 | - | - | - | - |
| Segment Assets (Gross) | 156,669 | 20,537,908 | 59,942,453 | 179,602,511 | 257,132 | - | - | - | - |
| Segment Non Performing Loans | - | - | 2,658,173 | 7,820,416 | - | - | - | - | - |
| Segment Provision Required | - | - | 2,712,102 | 6,011,522 | - | - | - | - | - |
| Segment Liabilities | 72,062 | 8,892,264 | 151,543,249 | 71,173,039 | 2,404,682 | - | - | - | - |
| Segment Return on net Assets (ROA) (%)* | 59.41% | 1.44% | 3.62% | 1.46% | 63.17% | - | - | - | - |
| Segment Cost of Funds (%)* | 0.00% | 8.26% | 4.33% | 9.18% | 0.00% | - | - | - | - |
| **2005** | | | | | | | | | |
| Total Income | 78,367 | 1,126,570 | 6,430,550 | 6,069,770 | 477,008 | - | - | - | - |
| Total Expenses | (45,135) | (891,214) | (5,082,439) | (4,739,399) | (333,945) | - | - | - | - |
| Net Income (loss) | 33,232 | 235,356 | 1,348,111 | 1,330,371 | 143,063 | - | - | - | - |
| Segment Assets (Gross) | 81,054 | 9,584,968 | 50,277,329 | 141,779,339 | 331,678 | - | - | - | - |
| Segment Non Performing Loans | - | - | 4,277,854 | 8,421,484 | - | - | - | - | - |
| Segment Provision Required | - | - | 3,707,840 | 6,023,441 | - | - | - | - | - |
| Segment Liabilities | 18,039 | 5,732,000 | 127,570,541 | 41,929,921 | 2,522,939 | - | - | - | - |
| Segment Return on net Assets (ROA) (%)* | 45.79% | 1.74% | 1.94% | 1.80% | 46.68% | - | - | - | - |
| Segment Cost of Funds (%)* | 0.00% | 4.68% | 4.02% | 10.22% | 0.00% | - | - | - | - |

* The segment return on net assets and cost of funds are based on average assets and average liabilities for the year.

## 41. RELATED PARTY TRANSACTIONS

The bank has related party relationships with its subsidiary, companies with common directorship having equity under 20%, directors and employee benefit plans.

Banking transactions with related parties are executed substantially on the same terms, including mark-up rates and collateral, as those prevailing at the time for comparable transactions with unrelated parties and do not involve more than a normal risk (i.e., under the comparable uncontrolled price method).

Details of transactions with related parties except those under the terms of employment and balances with them as at the year end were as follows:

| | December 31, 2006 | | | December 31, 2005 | | |
|---|---|---|---|---|---|---|
| Rupees in '000 | Directors | Companies with common directorship having equity under 20% | Subsidiary | Directors | Companies with common directorship having equity under 20% | Subsidiary |
| **Nature of related party transactions** | | | | | | |
| **Deposits** | | | | | | |
| Deposits at the beginning of the year | 6,668 | 76,125 | 3,925 | 452 | 4,209 | 905 |
| Deposits received during the year | 17,432 | 765,872 | 270,262 | 12,967 | 889,895 | 3,141 |
| Deposits repaid during the year | (22,286) | (782,196) | (135,508) | (6,751) | (817,979) | (121) |
| Deposits at the end of the year | 1,814 | 59,801 | 138,679 | 6,668 | 76,125 | 3,925 |
| Mark-up expensed | 97 | 356 | 3,423 | - | - | - |

The balances, held with related parties, outstanding at the end of current year are included in notes 9.2, 9.3, 17.7 and 21.2 to these financial statements.

| Rupees in '000 | December 31, 2006 | December 31, 2005 |
|---|---|---|
| Net receivable from staff retirement benefit funds | 918,541 | 609,971 |
| (Reversal) / charge in respect of staff retirement benefit funds | (65,273) | (71,559) |

## 42. CAPITAL ADEQUACY

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

| Rupees in '000 | | December 31, 2006 | December 31, 2005 (Restated) |
|---|---|---|---|
| **Regulatory Capital Base** | | | |
| **Tier I Capital** | | | |
| Shareholders capital | | 4,488,642 | 4,488,642 |
| Reserves | | 6,133,209 | 5,693,484 |
| Unappropriated profits | | 5,607,796 | 2,731,979 |
| Less: Adjustments | | 144,383 | 62,488 |
| **Total Tier I Capital** | | 16,085,264 | 12,851,617 |
| **Tier II Capital** | | | |
| Subordinated debt (upto 50% of total Tier I Capital) | | 2,500,000 | - |
| General Provisions subject to 1.25% of Total Risk Weighted Assets | | 14,047 | 10,155 |
| Revaluation Reserve (upto 50%) | | 770,001 | 817,771 |
| **Total Tier II Capital** | | 3,284,048 | 827,926 |
| **Eligible Tier III Capital** | | - | - |
| **Total Regulatory Capital** | (a) | 19,369,312 | 13,679,543 |

**Risk-Weighted Exposures**

| Rupees in '000 | | December 31, 2006 Book Value | December 31, 2006 Risk Adjusted Value | December 31, 2005 Book Value | December 31, 2005 Risk Adjusted Value |
|---|---|---|---|---|---|
| **Credit Risk** | | | | | |
| Balance Sheet Items:- | | | | | |
| Cash and other liquid Assets | | 24,745,022 | 842,316 | 18,034,752 | 1,105,732 |
| Money at call | | 19,050,239 | 3,284,500 | 5,777,382 | 1,505,000 |
| Investments | | 46,953,241 | 6,942,075 | 44,926,652 | 4,779,037 |
| Loans and advances | | 144,033,634 | 116,455,007 | 111,206,774 | 89,979,354 |
| Fixed assets | | 6,445,111 | 6,445,111 | 4,720,662 | 4,720,662 |
| Deferred taxation | | 638,168 | 638,168 | 680,093 | 680,093 |
| Other assets | | 10,161,361 | 5,814,494 | 7,227,953 | 3,044,048 |
| | | 252,026,776 | 140,421,671 | 192,574,268 | 105,813,926 |
| Off Balance Sheet items | | | | | |
| Performance bonds etc. | | 8,255,859 | 1,908,421 | 5,195,725 | 1,126,290 |
| Stand By letters of credit | | 38,142,108 | 8,097,854 | 22,394,618 | 3,945,079 |
| Outstanding foreign exchange contracts | | | | | |
| - Purchase | | 6,983,267 | 69,104 | 3,173,997 | 32,743 |
| - Sale | | 3,266,742 | 13,750 | 2,300,788 | 12,448 |
| | | 56,647,976 | 10,089,129 | 33,065,128 | 5,116,560 |
| Credit risk-weighted exposures | | | 150,510,800 | | 110,930,486 |
| **Market Risk** | | | | | |
| General market risk | | | 237,113 | | 330,275 |
| Specific market Risk | | | 237,113 | | 910,550 |
| Foreign exchange Risk | | | 296,009 | | 250,538 |
| Market risk-weighted exposures | | | 770,235 | | 1,491,363 |
| **Total Risk-Weighted exposures** | (b) | | 151,281,035 | | 112,421,849 |
| **Capital Adequacy Ratio [(a) / (b) x 100]** | | | 12.80% | | 12.17% |

## 43. RISK MANAGEMENT

Risk Management is a continuous process which addresses all significant risks to which the bank is exposed. The process begins with the formulation of business objectives and strategies and encompasses the identification, assessment and measurement, monitoring and control of specific banking risks. The process is completed by the monitoring of current business objectives and strategies.

**Categories of Risk**

Our risk management processes distinguish among four kinds of specific banking risks: credit risk, market risk, liquidity risk and operational risk.

**Credit Risk** This risk is defined as the possibility of loss due to unexpected default or a deterioration of credit worthiness of a business partner.

Credit Risk includes Country Risk i.e., the risks that counterparty is unable to meet its foreign currency obligations as a result of adverse economic conditions or actions taken by governments in the relevant country.

**Market Risk** The risk of loss generated by adverse changes in the price of assets or contracts currently held by the bank (this risk is also known as price risk).

**Liquidity Risk** The risk that the bank is unable to meet its payment obligations when they fall due and to replace funds when they are withdrawn; the consequences of which may be the failure to meet obligations to repay depositors and fulfill commitments to lend.

**Operational Risk** The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

**Risk Responsibilities**

- The Board is accountable for the management of risk. This is discharged by defining the scope of risk management activities within the Risk Management Group, distributing responsibilities at Board level for their management and determining the manner in which risk authorities are set.
- The Board Risk Management Committee (BRMC) determines standards and policies for risk measurement and management. These standards and policies are proposed by Risk Management Committee (RMC), who is also accountable for providing independent assurance that risk is being managed, measured and controlled in conformity with RMG policies and standards.
- The President and Group Chiefs are accountable for the management of risk collectively through their membership of risk committees: Risk Management Committee and Asset and Liability Committee (ALCO).
- Independent supervision of risk management activities is provided by Audit Committee.
- Day-to-day operational responsibility for implementing the Bank's risk management policies and guidelines is delegated to the appropriate business units.

**Risk Management Group Organization**

Risk management functions have been segregated by business specialization, i.e., Credit Risk, Credit Administration, Risk Architecture, Portfolio Management Operational Risk and Market Risk. All these functions are operating in tandem to improve and maintain the health of the lending portfolio.

### 43.1 Credit Risk

Credit risk, the potential default of one or more debtors, is the largest source of risk for the bank. The bank is exposed to credit risk through its lending, trading and capital market activities. The bank's credit risk function is divided into Corporate and Financial Institutions Risk and Commercial and Retail Risk. The functions operate within an integrated framework of credit policies, guidelines and processes. The foundation of the bank's credit management framework is based on a systematic approval matrices introduced in 2005, which was followed with credit risk assessment methodology introduced in 2006 through a new Credit Application Package.

The bank manages 3 principal sources of credit risk:

i) Sovereign credit risk on its public sector advances
ii) Non-sovereign credit risk on its private sector advances
iii) Counterparty credit risk on interbank limits

**Sovereign Credit Risk**

When the bank lends to public sector borrowers, it prefers obtaining a full sovereign guarantee or the equivalent from the Government of Pakistan (GOP). However, certain public sector enterprises have a well defined cash flow stream and appropriate business model, based on which the lending is secured through collaterals other than GOP guarantee.

### Non-Sovereign Credit Risk

When the bank lends to private sector borrowers it does not benefit from sovereign guarantees or the equivalent. Consequently, each borrower's credit worthiness is analyzed on the newly introduced Credit Application Package that incorporates a formalized and structured approach for credit analysis and directs the focus of evaluation towards a balanced assessment of credit risk with identification of proper mitigants. These risks include Industry Risk, Business Risk, Financial Risk, Security Risk and Account Performance Risk. Financial analysis is further strengthened through use of separate financial spreadsheet templates that have been designed for manufacturing/ trading concerns, financial institutions and insurance companies.

### Counter Party Credit Risk on Interbank Limits

In the normal course of its business, the bank's Treasury utilizes products such as REPO and call lending to meet the needs of the borrowers and manage its exposure to fluctuations in market, interest and currency rates and to temporarily invest its liquidity prior to disbursement. All of these financial instruments involve, to varying degrees, the risk that the counter party in the transaction may be unable to meet its obligation to the bank.

Reflecting a preference for minimizing exposure to counterparty credit risk, the bank maintains eligibility criteria that link the exposure limits to counterparty credit ratings by external rating agencies. For example, the minimum rating for counterparties to be eligible for a banking relationship with the bank is BBB.

## Country Risk

The bank has in place a Country Risk Management Policy which has been approved by the Board. This policy focuses on international exposure undertaken by the bank. The bank utilizes country risk rating assessment reports published by Dun & Bradstreet Limited (an international credit rating agency) which use political, commercial, macroeconomic and external risk factors in assigning a country risk rating. The country risk limits used by the bank are linked to the Dun & Bradstreet ratings and FID is responsible for monitoring of country exposure limits.

## Credit Administration

Credit Administration is involved in minimizing losses that could arise due to security and documentation deficiencies. The Credit Administration Division constantly monitors the security and documentation risks inherent in the existing credit portfolio through six regional credit administration departments located all over the country.

## Portfolio Management

To ensure a prudent distribution of credit portfolio, the bank manages its lending activities within a framework of Borrower, Group and Sector exposure limits and risk profile benchmarks.

### Portfolio Risk Measurement Models

The bank has developed internal risk rating models to assign credit risk ratings to its Corporate and Institutional borrowers. These models are based on expert judgment, comprising of both quantitative and qualitative factors. The ratings are assigned at Portfolio Management Level and are given due weightage while extending credit to these asset classes.

### Stress Testing

The bank is also conducting stress testing of its existing portfolio, which includes all assets, i.e., advances as well as investments. This exercise is conducted on a semi-annual basis in line with regulatory requirements. This testing is conducted through assigning shocks to all assets of the bank and assessing its resulting affect on capital adequacy.

### Early Warning System

In order to ensure that monitoring of the regular lending portfolio focuses on problem recognition, an early warning system in the form of a 'Watch-List' category has being instituted to cover the gap between Regular and Substandard categories. Identification of an account on the said 'Watch-List' influences the lending branch to carry out an assessment of the borrower's ability to rectify the identified problem / weakness within a reasonable time-frame, consider tighter structuring of facilities, confirm that there are no critical deficiencies in the existing security position and, if possible, arrange for strengthening of the same through obtaining additional collateral. It should however, be noted that the Watch-List category of accounts is part of the Bank's Regular portfolio and does not require any provisioning.

In some cases, an account may even be downgraded directly from a Regular to Sub-Standard or worse on subjective basis based on the severity of the trigger involved.

**Management of Non Performing Loans**

The Bank has a Special Asset Management Group (SAM), which is responsible for management of non performing loans. SAM undertakes restructuring / rescheduling of problem loans, as well as litigation both civil and criminal for collection of debt.

For the non-performing loan portfolio, the bank makes a specific provision based on an assessment of the credit impairment of each loan. At the end of 2006, the average specific provisioning rate was 73.08% of the non-performing loan portfolio.

The accounting policies and methods used to determine specific and general provision are given in the note numbers 7 and 12 to these financial statements. The movement in specific and general provision held is given in note 12.5 to these financial statements.

**Portfolio Diversification**

During the year 2006 the banking sector advances in Pakistan grew by 18% whereas growth in the bank's advances was 27%. The growth pattern indicates that the bank has outpaced overall credit growth of banking sector, while concomitantly maintaining healthy Advances to Deposit Ratio and Capital Adequacy Ratio.

While expanding the advances portfolio, efficient portfolio diversification has been a key consideration. The diversification takes into account the volatility of various sectors by placing concentration limits on lending to these sectors thereby ensuring a diversified advances portfolio. Composition of the bank's advance's portfolio is significantly diversified. Textile, Cement, Financial Institutions, Agriculture and Transport / Communication are major contributors to the advances portfolio. These sectors are considered to be the biggest contributors towards country's GDP as well.

**43.1.1 Segmental Information**

**43.1.1.1 Segments by class of business**

| | December 31, 2006 | | | | | |
|---|---|---|---|---|---|---|
| | Advances (Gross) | | Deposits | | Contingencies and Commitments | |
| | Rupees in '000 | Percent | Rupees in '000 | Percent | Rupees in '000 | Percent |
| Financial institutions | 7,387,387 | 4.87% | 3,680,768 | 1.79% | 12,275,623 | 17.25% |
| Individuals | 5,367,775 | 3.54% | 73,450,765 | 35.65% | 909,368 | 1.28% |
| Textile | 36,230,311 | 23.88% | 4,067,376 | 1.97% | 2,050,040 | 2.88% |
| Sugar | 5,125,441 | 3.38% | 941,733 | 0.46% | 979,968 | 1.38% |
| Cement / clay / ceramics | 12,121,245 | 7.99% | 1,578,921 | 0.77% | 111,385 | 0.16% |
| Transport, storage and communication | 9,735,245 | 6.42% | 3,677,515 | 1.78% | 20,450 | 0.03% |
| Wholesale and retail trade | 5,771,268 | 3.80% | 11,973,448 | 5.81% | 3,278,690 | 4.61% |
| Agriculture | 13,138,154 | 8.66% | 9,617,896 | 4.67% | 184,524 | 0.26% |
| Real Estate, renting & other business activities | 10,919,991 | 7.20% | 8,001,616 | 3.88% | - | - |
| Food manufacturing | 5,562,228 | 3.67% | 3,064,610 | 1.49% | - | - |
| Iron steel | 3,551,261 | 2.34% | 12,241,712 | 5.94% | 465,192 | 0.65% |
| Oil and gas etc. | 7,005,959 | 4.62% | 7,880,756 | 3.83% | 2,980,189 | 4.19% |
| Electric generation | 5,471,261 | 3.61% | 9,437,962 | 4.58% | 8,547,092 | 12.01% |
| Others | 24,317,892 | 16.03% | 56,416,246 | 27.38% | 39,375,340 | 55.32% |
| | 151,705,418 | 100.00% | 206,031,324 | 100.00% | 71,177,861 | 100.00% |

**43.1.1.2 Segments by sector**

| | December 31, 2006 | | | | | |
|---|---|---|---|---|---|---|
| | Advances (Gross) | | Deposits | | Contingencies and Commitments | |
| | Rupees in '000 | Percent | Rupees in '000 | Percent | Rupees in '000 | Percent |
| Public/Government | 27,130,760 | 17.88% | 23,336,516 | 11.33% | 20,691,831 | 29.07% |
| Private | 124,574,658 | 82.12% | 182,694,808 | 88.67% | 50,486,030 | 70.93% |
| | 151,705,418 | 100.00% | 206,031,324 | 100.00% | 71,177,861 | 100.00% |

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

| Rupees in '000 | December 31, 2006 Classified Advances | December 31, 2006 Specific Provisions Held | December 31, 2005 Classified Advances | December 31, 2005 Specific Provisions Held |
|---|---|---|---|---|
| Individuals | 120,501 | 119,641 | 144,239 | 144,214 |
| Textile | 3,123,218 | 2,665,949 | 3,741,017 | 2,698,552 |
| Chemical | 236,486 | 79,814 | 568,331 | 427,895 |
| Transport, storage and communication | 300,866 | 218,916 | 354,169 | 245,334 |
| Wholesale and retail trade | 802,230 | 520,140 | 540,146 | 372,938 |
| Food manufacturing | 437,020 | 259,561 | 554,609 | 315,733 |
| Agriculture | 366,071 | 242,843 | 797,044 | 747,398 |
| Others | 5,092,197 | 3,550,873 | 5,999,783 | 3,696,678 |
| | 10,478,589 | 7,657,737 | 12,699,338 | 8,648,742 |

**43.1.1.4 Details of non-performing advances and specific provisions by sector**

| Rupees in '000 | December 31, 2006 Classified Advances | December 31, 2006 Specific Provisions Held | December 31, 2005 Classified Advances | December 31, 2005 Specific Provisions Held |
|---|---|---|---|---|
| Public/Government | 230,183 | 126,989 | 293,719 | 83,519 |
| Private | 10,248,406 | 7,530,748 | 12,405,619 | 8,565,223 |
| | 10,478,589 | 7,657,737 | 12,699,338 | 8,648,742 |

**43.1.1.5 Geographical Segment Analysis**

| Rupees in '000 | December 31, 2006 Profit before taxation | Total assets employed | Net assets employed | Contingencies and Commitments |
|---|---|---|---|---|
| Pakistan | 6,661,094 | 252,026,776 | 17,687,753 | 71,177,861 |

**43.2 Market Risk**

The bank is exposed to Foreign Exchange Risk, Interest Rate Risk and Equity position Risk.

Market Risk Function has been partially set up with current responsibility of performing basic market risk measurement, monitoring and control functions. However, to give it a formal structure, we expect to appoint a consultant within the first quarter of 2007, for assistance in establishment of Market Risk Management Framework.

**Risk Pertaining to the Trading Book**

**Trading Book**

A trading book consists of positions in financial instruments held either with trading intent or in order to hedge other elements of the trading book. To be eligible for trading book, financial instruments must be held with the intent of trading and free of any restrictive covenants on their tradability. In addition, positions need to be frequently and accurately valued and the portfolio should be actively managed.

The bank's trading book includes equity securities classified as 'Held for Trading'. These positions are actively managed by treasury as part of their capital market activities. Since trading book constitutes capital market equities therefore, they are mainly exposed to equity price risk.

**Risk Pertaining to Banking Book**

All the investments excluding trading book are considered as part of banking book. Banking book includes:

i) Available for sale securities
ii) Held to maturity securities
iii) Other strategic investments

Treasury investments parked in the banking book include:

i) Government securities
ii) Capital market investments
iii) Strategic investments
iv) Investments in bonds, debentures, etc.

Due to the diversified nature of investments in banking book, it is subject to interest rate and equity price risk.

**Interest Rate Risk – Banking Book**

Government securities (PIB & T-Bills) and other money market investments are subject to interest rate risk. To capture the risk associated with these securities extensive modeling is being done with respect to duration analysis. Stress testing and scenario models are also in place to capture the sensitivity of the portfolio to adverse movement in interest rates. For prudent risk management all money market investments are marked to market to assess changes in the market value of investments due to interest rate movements.

**Equity Position Risk – Banking Book**

The bank's portfolio of equity securities categorized under 'Available for Sale' and 'Strategic Investments' are parked in the banking book. These investments expose the bank to equity price risk.

**Stress Testing**

The bank also conducts Stress Testing of the bank's investment portfolio to ascertain the impact of various adverse scenarios on the capital adequacy and sustainability of the bank. The exercise assumes various stress conditions, with respect to Market Risk (Rise or Fall in Interest Rates, leading to interest rate risk), Equity Price Risk resulting from Stock Market movements, FX Rate Risk leading from adverse movements in exchange rates and Liquidity Risk (ability to meet short-term obligations if there is a run on deposits). This is in line with the Central Bank's regulatory requirements.

**Duration GAP Analysis**

A Duration Gap Analysis is also conducted to ascertain the duration gap between the bank's assets and liabilities, to ascertain the effect of interest rate shifts on the market value of equity.

**Market Risk Capital Charge**

The bank uses standardized measurement method for calculation of market risk capital charge. The results are as under:

| Rupees in '000 | Risk Weighted Exposures | Capital Charge |
|---|---|---|
| General market risk - Equity Exposures | 237,113 | 18,969 |
| Specific market risk - Equity Exposures | 237,113 | 18,969 |
| Foreign Exchange risk | 296,009 | 23,681 |
| Total | 770,235 | 61,619 |

43.2.1 **Foreign Exchange Risk**

Foreign Exchange Risk is the risk of loss arising from fluctuations of exchange rates. Our FX Risk is first controlled through substantially matched funding policy. On the mismatched exposures, we utilize appropriate derivative instruments such as Forwards and Swaps.

The majority of net foreign currency exposure is in US Dollars. The bank is carefully monitoring the net foreign currency exposure and the effect of exchange rate fluctuations by conducting sensitivity analysis and stress testing, as well as utilizing the currency forwards and swaps to hedge the related exposure.

| | December 31, 2006 | | | |
|---|---|---|---|---|
| Rupees in '000 | Financial assets | Financial liabilities | Off-balance sheet items | Net foreign currency exposure |
| Pakistan Rupee | 234,550,090 | 223,065,585 | (3,716,525) | 7,767,980 |
| United States Dollar | 3,555,379 | 5,598,173 | 2,271,948 | 229,154 |
| Great Britain Pound | 167,090 | 1,110,894 | 945,406 | 1,602 |
| Japanese Yen | 17,799 | 1,312 | (16,778) | (291) |
| Euro | 283,131 | 747,869 | 502,612 | 37,874 |
| Other Currencies | 64,853 | 50,520 | 13,337 | 27,670 |
| | 4,088,252 | 7,508,768 | 3,716,525 | 296,009 |
| | 238,638,342 | 230,574,353 | - | 8,063,989 |

43.2.2 **Equity Position Risk**

The Board with the recommendations of ALCO approves exposure limits applicable to investments in Trading Book. Equity securities are perpetual assets and are classified under either Held for Trading Portfolio or Available for Sale Portfolio.

**Concentration Risk**

ALCO is responsible for making investment decisions in the capital market and setting limits that are a component of the risk management framework. Portfolio, Sector and Scrip wise limits are as signed by the ALCO to guard against concentration risk and these limits are reviewed and revised periodically. Treasury ensures compliance of concentration limits set by ALCO. Limit monitoring is done on a daily basis. Limit breaches if any are promptly reported to ALCO with proper reason and justification.

**Price Risk**

Trading and investing in equity securities give rise to price risk. ALCO and Treasury's Capital Market Unit both ensure that through prudent trading strategy and use of equity futures, the equity price risk is mitigated, albeit to a certain extent.

### 43.2.3 Mismatch of Interest Rate Sensitive Assets and Liabilities

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | December 31, 2006 | | | | | | | | | | | |
| | | | | | Exposed to Yield / Interest risk | | | | | | | |
| Rupees in '000 | Effective Yield / Interest rate | Total | Upto 1 Month | Over 1 to 3 Months | Over 3 to 6 Months | Over 6 Months to 1 Year | Over 1 to 2 Years | Over 2 to 3 Years | Over 3 to 5 Years | Over 5 to 10 Years | Above 10 Years | Non-interest bearing financial instruments |
| **On-balance sheet financial instruments** | | | | | | | | | | | | |
| **Assets** | | | | | | | | | | | | |
| Cash and balances with treasury banks | 3.39% - 4.39% | 23,039,577 | 996,792 | - | - | - | - | - | - | - | - | 22,042,785 |
| Balances with other banks | 3.65% | 1,705,445 | 460,827 | - | - | - | - | - | - | - | - | 1,244,618 |
| Lending to financial institutions | 9.34% | 19,050,239 | 15,946,799 | 3,103,440 | - | - | - | - | - | - | - | - |
| Investments | 7.66% | 46,953,241 | 7,002,035 | 5,270,477 | 4,353,928 | 14,951,671 | 2,030,842 | 1,595,826 | 2,130,731 | 6,302,526 | - | 3,315,205 |
| Advances | 9.99% | 144,033,634 | 130,671,046 | 208,495 | 281,163 | 660,825 | 2,215,854 | 1,658,380 | 1,662,453 | 1,791,518 | 2,063,048 | 2,820,852 |
| Other assets | | 3,856,206 | - | - | - | - | - | - | - | - | - | 3,856,206 |
| | | 238,638,342 | 155,077,499 | 8,582,412 | 4,635,091 | 15,612,496 | 4,246,696 | 3,254,206 | 3,793,184 | 8,094,044 | 2,063,048 | 33,279,666 |
| **Liabilities** | | | | | | | | | | | | |
| Bills payable | | 2,278,007 | - | - | - | - | - | - | - | - | - | 2,278,007 |
| Borrowings | 7.36% | 18,410,425 | 12,180,747 | 2,536,011 | 172,790 | 431,451 | 1,449,671 | 1,009,586 | 571,268 | 58,901 | - | - |
| Deposits and other accounts | 4.01% | 206,031,324 | 126,388,320 | 14,504,789 | 4,543,025 | 4,172,572 | - | - | - | - | - | 56,422,618 |
| Sub-ordinated loans | 12.49% | 2,500,000 | - | - | 2,500,000 | - | - | - | - | - | - | - |
| Liabilities against assets subject to finance lease | | - | - | - | - | - | - | - | - | - | - | - |
| Other liabilities | | 1,354,597 | - | - | - | - | - | - | - | - | - | 1,354,597 |
| | | 230,574,353 | 138,569,067 | 17,040,800 | 7,215,815 | 4,604,023 | 1,449,671 | 1,009,586 | 571,268 | 58,901 | - | 60,055,222 |
| **On-balance sheet gap** | | 8,063,989 | 16,508,432 | (8,458,388) | (2,580,724) | 11,008,473 | 2,797,025 | 2,244,620 | 3,221,916 | 8,035,143 | 2,063,048 | (26,775,556) |
| **Off-balance sheet financial instruments** | | | | | | | | | | | | |
| Forward lending | 11.78% - 15.60% | 8,240,934 | 230,745 | 280,305 | 2,750,234 | 3,279,650 | 1,700,000 | - | - | - | - | - |
| Forward borrowing | 8.65% | (1,853,461) | (1,853,461) | - | - | - | - | - | - | - | - | - |
| **Off-balance sheet gap** | | 6,387,473 | (1,622,716) | 280,305 | 2,750,234 | 3,279,650 | 1,700,000 | - | - | - | - | - |
| **Total Yield / Interest Risk Sensitivity Gap** | | 14,451,462 | 14,885,716 | (8,178,083) | 169,510 | 14,288,123 | 4,497,025 | 2,244,620 | 3,221,916 | 8,035,143 | 2,063,048 | (26,775,556) |
| **Cumulative Yield / Interest Risk Sensitivity Gap** | | | 14,885,716 | 6,707,633 | 6,877,143 | 21,165,266 | 25,662,291 | 27,906,911 | 31,128,827 | 39,163,970 | 41,227,018 | 14,451,462 |

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

| | |
|---|---|
| Total financial assets as per note 43.2.3 | 238,638,342 |
| Add Non Financial Assets | |
| Operating fixed assets | 6,445,111 |
| Deferred tax asset | 638,168 |
| Other assets | 6,305,155 |
| Total assets as per balance sheet | 252,026,776 |
| | |
| Total liabilities as per note 43.2.3 | 230,574,353 |
| Add Non Financial Liabilities | |
| Other liabilities | 3,764,670 |
| Total liabilities as per balance sheet | 234,339,023 |

**43.3 Liquidity Risk**

Liquidity risk is the risk that the bank is unable to fund its current obligations and operations in the most cost efficient manner. Asset Liability Committee (ALCO) is the forum to oversee liquidity management. The overall bank's principle is that the ALCO has the responsibility for ensuring that bank's policy for liquidity management is adhered to on a continual basis.

Other than customer's deposits, the bank's funding source is the inter-bank money market. Change in the government monetary policy and market expectations of interest rate are all important factors that can adversely affect our key funding source. Efficient and accurate planning plays a critical role in liquidity management. Our MIS provides information on expected cash inflows/out flows which allow the bank to take timely decisions based on the future requirements.

Comprehensive gap analysis, stress testing and scenario analysis is done on periodic basis to capture any adverse effect of market movements on liquidity position. Based on the results produced by analytical models, ALCO devise the liquidity management strategy to maintain sufficient liquidity to deal with any related catastrophe.

**43.3.1 Maturities of Assets and Liabilities**

The table below summarizes the maturities of assets and liabilities in accordance with liquidity assumptions used by the bank to monitor liquidity risk. Assets and liabilities are assumed to mature on their contractual maturities or on the expected date of realization/settlement/replacement as required by the assumptions.

| | | | | | December 31, 2006 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Rupees in '000** | **Total** | **Upto 1 Month** | **Over 1 to 3 Months** | **Over 3 to 6 Months** | **Over 6 Months to 1 Year** | **Over 1 to 2 Years** | **Over 2 to 3 Years** | **Over 3 to 5 Years** | **Over 5 to 10 Years** | **Above 10 Years** |
| **Assets** | | | | | | | | | | |
| Cash and balances with treasury banks | 23,039,577 | 23,039,577 | - | - | - | - | - | - | - | - |
| Balances with other banks | 1,705,445 | 1,705,445 | - | - | - | - | - | - | - | - |
| Lending to financial institutions | 19,050,239 | 15,946,799 | 3,103,440 | - | - | - | - | - | - | - |
| Investments | 46,953,241 | 1,643,754 | 5,552,558 | 4,540,490 | 15,311,179 | 4,209,204 | 2,305,857 | 3,908,816 | 8,157,492 | 1,323,891 |
| Advances | 144,033,634 | 13,793,820 | 9,140,413 | 28,420,534 | 40,998,448 | 13,537,452 | 10,418,660 | 13,728,001 | 9,503,655 | 4,492,651 |
| Operating fixed assets | 6,445,111 | 23,212 | 46,425 | 69,638 | 139,274 | 745,031 | 194,400 | 278,097 | 351,770 | 4,597,264 |
| Deferred tax assets | 638,168 | 134,553 | 9,254 | 13,434 | 24,969 | 46,100 | 46,382 | 92,702 | 115,122 | 155,652 |
| Other assets | 10,161,361 | 2,069,248 | 2,554,593 | 2,546,304 | 2,991,216 | - | - | - | - | - |
| | 252,026,776 | 58,356,408 | 20,406,683 | 35,590,400 | 59,465,086 | 18,537,787 | 12,965,299 | 18,007,616 | 18,128,039 | 10,569,458 |
| **Liabilities** | | | | | | | | | | |
| Bills payable | 2,278,007 | 2,278,007 | - | - | - | - | - | - | - | - |
| Borrowings | 18,410,425 | 6,625,613 | 2,536,011 | 5,727,924 | 431,451 | 1,449,671 | 1,009,586 | 571,268 | 58,901 | - |
| Deposits and other accounts | 206,031,324 | 42,367,111 | 41,178,574 | 19,376,104 | 21,194,510 | 14,142,578 | 24,517,204 | 15,084,408 | 14,352,654 | 13,818,181 |
| Sub-ordinated loans | 2,500,000 | - | - | 500 | 500 | 1,000 | 1,000 | 2,000 | 2,495,000 | - |
| Other liabilities | 5,119,267 | 2,172,202 | 1,591,725 | 576,925 | 576,609 | 34,258 | 35,593 | 56,909 | 37,523 | 37,523 |
| | 234,339,023 | 53,442,933 | 45,306,310 | 25,681,453 | 22,203,070 | 15,627,507 | 25,563,383 | 15,714,585 | 16,944,078 | 13,855,704 |
| **Net assets / (liabilities)** | 17,687,753 | 4,913,475 | (24,899,627) | 9,908,947 | 37,262,016 | 2,910,280 | (12,598,084) | 2,293,031 | 1,183,961 | (3,286,246) |

| | |
|---|---|
| Share capital | 4,488,642 |
| Reserves | 6,133,209 |
| Unappropriated profit | 5,607,796 |
| Surplus on revaluation of assets - net of tax | 1,458,106 |
| | 17,687,753 |

**43.3.1.1** When an asset or liability does not have any contractual maturity date, the period in which these are assumed to mature has been taken as the expected date of maturity.

**43.4 Operational Risk**

The bank, like all financial institutions, is exposed to many types of operational risks, including the potential losses arising from internal activities or external events caused by breakdowns in information, communication, physical safeguards, business continuity, supervision, transaction processing, settlement systems and procedures and the execution of legal, fiduciary and agency responsibilities.

The bank maintains a system of internal controls designed to keep operational risk at appropriate levels, in view of the bank's financial strength and the characteristics of the activities and market in which it operates. These internal controls are periodically updated to conform to industry best practice.

In 2006, the bank has initiated the process of implementing internationally accepted Internal Control-Integrated Framework published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), with a view to consolidate and enhance the existing internal control processes.

## 44. LIQUIDATION OF ALLIED MANAGEMENT SERVICES (PRIVATE) LIMITED

The Board of Directors in its meeting held on October 30, 2006 has approved the liquidation of Allied Management Services (Private) Limited, (AMSL) a wholly owned subsidiary of the bank, consequent to the merger of First Allied Bank Modaraba (managed by AMSL) into the bank.

## 45. RECLASSIFICATION

Following corresponding figure has been reclassified for the purpose of better presentation.

| Rupees in '000 | From | To | December 31, 2005 |
|---|---|---|---|
| | Deposits | Other liabilities | 442,956 |

## 46. NON ADJUSTING EVENT AFTER THE BALANCE SHEET DATE

The Board of Directors in its meeting held on February 26, 2007 has proposed a cash dividend in respect of 2006 of Rs. 2.5 per share (2005: cash dividend Rs. 2.5 per share). In addition, the directors have also announced a bonus issue of 20%. These appropriations will be approved in the forthcoming Annual General Meeting. The financial statements for the year ended December 31, 2006 do not include the effect of these appropriations which will be accounted for in the financial statements for the year ending December 31, 2007.

## 47. GENERAL

**47.1** These accounts have been prepared in accordance with the revised forms of annual financial statements of the banks issued by the State Bank of Pakistan through its BSD Circular No. 04 dated February 17, 2006.

**47.2** Figures have been rounded off to the nearest thousand rupees.

## 48. DATE OF AUTHORIZATION FOR ISSUE

These financial statements were authorized for issue on February 26, 2007 by the Board of Directors of the bank.

| | | |
|---|---|---|
| **Chief Financial Officer** | **President and Chief Executive** | **Director** |
| **Director** | **Chairman** | |

Notice of 61st Annual

# Notice of 61st Annual General Meeting

NOTICE IS HEREBY GIVEN THAT THE 61st ANNUAL GENERAL MEETING OF ALLIED BANK LIMITED WILL BE HELD AT HOTEL AVARI LAHORE ON THURSDAY, 29th MARCH, 2007 AT 11:00 A.M. TO TRANSACT THE FOLLOWING BUSINESS:

## ORDINARY BUSINESS

1. To confirm the minutes of the last Extraordinary General Meeting held on 17th August, 2006.
2. To receive, consider, approve and adopt the Annual Audited Accounts of the Bank for the year ended December 31, 2006 together with Directors' and Auditors' Report thereon.
3. To approve 25% cash dividend (Rs: 2.50 per share) as recommended by the Board of Directors.
4. To appoint the Auditors of the Company for the year 2007 and fix their remunerations. The present auditors M/s M.Yousuf Adil Saleem and Co. Chartered Accountants and M/s Ford Rhodes Sidat Hyder and Co. Chartered Accountants being eligible offer themselves for reappointment.

## SPECIAL BUSINESS

5. To consider, and approve the issue of Bonus Shares to the debit of Share Premium Account in proportion of 20 shares for every hundred shares held (20%).

## OTHER BUSINESS

6. To transact any other business with the permission of the Chair.

Note: Statement under section 160 of the Companies Ordinance, 1984 is appended below.

By Order of the Board

Date: March 8, 2007
Place: Lahore

Zia Ijaz
Company Secretary

Registered Office:
8-Kashmir / Egerton Road,
Lahore.

## STATEMENT UNDER SECTION 160 OF THE COMPANIES ORDINANCE, 1984

### ITEM NO. 5 OF THE NOTICE

**Issuance of Bonus Shares**

To approve capitalization of a sum of Rs. 897,728,230 (Rupees Eight hundred and ninety seven million seven hundred and twenty eight thousand two hundred and thirty) out of Share Premium Account for the issuance of bonus shares (B-3) in the proportion of 20 shares for every 100 shares and approve the following resolution by way of Special Resolution

**Resolved that:**

a) "A sum of Rs. 897,728,230 out of shares premium account be capitalized and applied to the issue of 89,772,823 Ordinary shares of Rs.10/- each and allotted as fully paid-up Bonus Shares to the members of the Bank whose names appear on the Register of Members of the Bank as at close of business on March 22, 2007 in the proportion of 20 shares for every 100 Ordinary Shares held."

b) "The bonus shares entitlement in fraction be consolidated into whole shares and sold by the Company Secretary in the Stock Market and proceeds of sale when realized be given to a charitable institution."

c) "President and CEO and the Company Secretary of the Bank be and are hereby authorized and empowered to give effect to this resolution and to do or cause to be done all acts, deeds and things that may be necessary or required for issuance, allotment and distribution of Bonus Shares (B-3)."

The Directors of the Company have no interest in the property or profits of the Bank other than that as holders of ordinary shares in the capital of the Bank and dividends, if any, declared by the Bank according to their share holding.

### NOTES

i) All members are entitled to attend and vote at the Meeting.

ii) A member entitled to attend and vote is entitled to appoint a proxy under his / her own hand or through his / her duly authorized attorney to attend and vote instead of himself / herself and the proxy must be a member of Allied Bank Limited.

iii) The instrument of proxy and the power of attorney or other authority (if any) under which it is signed, or a notarially certified copy of that power of attorney or authority to be effective must be deposited at the registered office of Allied Bank Limited not less than 48 hours before the time for holding the Meeting.

iv) Share Transfer Books of Allied Bank Limited will remain closed from 23rd March, 2007 to 29th March, 2007 (both days inclusive). Transfers received at M/s Technology Trade (Pvt.) Limited, Dagia House, 241-C, Block-2, PECHS, Karachi, the Registrar and Share Transfer Office of the Bank at the close of business on 22nd March, 2007 will be treated as being in time for the purpose of entitlement of cash dividend and bonus shares to the transferees.

v) Members are requested to notify immediately changes, if any, in their registered address to our Share Registrar M/S Technology Trade (Pvt) Limited, 241-C, Block-2, PECHS, Karachi.

vi) CDC Account Holders will have to follow the under mentioned guidelines as laid down by the Securities and Exchange Commission of Pakistan.

### A. FOR ATTENDING THE MEETING

i) In case of individuals, the account holder or sub account holder and / or the person whose securities are in group account and their registration details are uploaded as per the Regulations, shall authenticate his / her identity by showing his / her original Computerized National Identity Card (CNIC) or original passport at the time of attending the Meeting.

ii) In case of corporate entity, the Board of Directors' resolution / power of attorney with specimen signature of the nominee shall be produced (if it has not been provided earlier) at the time of the Meeting.

### B. FOR APPOINTING PROXIES

i) In case of individuals, the account holder or sub account holder and / or the person whose securities are in group account and their registration details are uploaded as per the Regulations, shall submit the proxy form as per the above requirement.

ii) The proxy form shall be witnessed by two persons whose names, addresses and CNIC numbers shall be mentioned on the form.

iii) Attested copies of CNIC or the passport of the beneficial owners and the proxy shall be furnished with the proxy form.

iv) The proxy shall produce his / her original NIC or original passport at the time of the Meeting.

v) In case of corporate entity, the Board of Directors' resolution / power of attorney with specimen signature shall be submitted (if it has not been provided earlier) along with proxy form of the Company.

# Organizational Structure

Organizational Structure

Board of Directors

- Audit Committee
  - Audit and Inspection (AIG)
- President
  - Corporate and Investment Banking (CIBG)
  - Commercial and Retail Banking (CRBG)
  - Consumer and Personal Banking (CPBG)
  - Treasury
  - Risk Management (RMG)
  - Finance
  - Operations
  - Information Technology (IT)
  - Human Resources (HRG)
  - Special Assets Management (SAM)
  - Compliance and Control (CCG)
  - Corporate Affairs (CAG)
  - Business Transformation Team (BTT)

# PATTERN OF SHAREHOLDING

PATTERN OF SHAREHOLDING

| No. of Shareholders | Shareholdings From | To | Total Shares Held |
|---|---|---|---|
| 8618 | 1 | 100 | 331,165 |
| 9427 | 101 | 500 | 1,848,801 |
| 1131 | 501 | 1000 | 847,244 |
| 1526 | 1001 | 5000 | 3,492,490 |
| 288 | 5001 | 10000 | 2,108,314 |
| 117 | 10001 | 15000 | 1,414,344 |
| 40 | 15001 | 20000 | 695,714 |
| 16 | 20001 | 25000 | 360,962 |
| 11 | 25001 | 30000 | 301,819 |
| 5 | 30001 | 35000 | 160,610 |
| 8 | 35001 | 40000 | 302,685 |
| 7 | 40001 | 45000 | 312,015 |
| 5 | 55001 | 60000 | 288,149 |
| 3 | 65001 | 70000 | 201,913 |
| 2 | 70001 | 75000 | 142,664 |
| 3 | 75001 | 80000 | 230,112 |
| 1 | 90001 | 95000 | 92,800 |
| 3 | 95001 | 100000 | 291,948 |
| 2 | 105001 | 110000 | 215,311 |
| 2 | 115001 | 120000 | 236,308 |
| 1 | 125001 | 130000 | 129,182 |
| 1 | 135001 | 140000 | 135,500 |
| 1 | 155001 | 16000 | 159,600 |
| 1 | 170001 | 175000 | 173,600 |
| 1 | 200001 | 205000 | 200,500 |
| 1 | 210001 | 215000 | 212,400 |
| 1 | 225001 | 230000 | 226,600 |
| 1 | 235001 | 240000 | 235,439 |
| 1 | 240001 | 245000 | 243,000 |
| 1 | 270001 | 275000 | 273,000 |
| 1 | 300001 | 305000 | 302,209 |
| 1 | 310001 | 315000 | 310,900 |
| 1 | 355001 | 360000 | 357,185 |
| 1 | 370001 | 375000 | 371,700 |
| 2 | 505001 | 510000 | 1,011,966 |
| 1 | 640001 | 645000 | 640,300 |
| 1 | 720001 | 725000 | 723,100 |
| 1 | 970001 | 975000 | 971,600 |
| 1 | 1040001 | 1045000 | 1,044,602 |
| 1 | 1240001 | 1245000 | 1,244,308 |
| 1 | 1800001 | 1805000 | 1,800,817 |
| 1 | 2030501 | 2040000 | 2,038,200 |
| 1 | 2180001 | 2185000 | 2,183,163 |
| 1 | 2455001 | 2460000 | 2,457,301 |
| 1 | 2870001 | 2875000 | 2,874,100 |
| 1 | 4225001 | 4230000 | 4,228,611 |
| 3 | 5360001 | 5365000 | 16,084,325 |
| 1 | 5670001 | 5675000 | 5,671,896 |
| 1 | 6270001 | 6275000 | 6,273,946 |
| 1 | 10720001 | 10725000 | 10,720,154 |
| 1 | 16245001 | 16250000 | 16,250,000 |
| 1 | 16375001 | 16380000 | 16,376,106 |
| 1 | 39510001 | 39515000 | 39,513,437 |
| 1 | 78195001 | 78200000 | 78,200,000 |
| 1 | 79365001 | 79370000 | 79,367,300 |
| 1 | 141980001 | 141985000 | 141,982,700 |
| 21,254 | | | 448,864,115 |

## DETAILED PATTERN OF SHAREHOLDING

| | | | No. of Shareholders | Shares Held | Percentage |
|---|---|---|---|---|---|
| **1.** | **Directors, Chief Executive Officer, and their spouse and minor children** | | | | |
| | a) | Mohammed Naeem Mukhtar | 1 | 80,411,902 | 17.915 |
| | b) | Mohammed Waseem Mukhtar | 1 | 79,444,308 | 17.699 |
| | c) | Sheikh Mukhtar Ahmed | 1 | 357,185 | 0.080 |
| | d) | Bina Sheikh | 1 | 35,733 | 0.008 |
| | e) | Iqbal Begum | 1 | 302,209 | 0.067 |
| | f) | Ghazala Naeem | 1 | 235,439 | 0.052 |
| | g) | Abdul Aziz Khan | 1 | 35,041 | 0.008 |
| | h) | Jalees Ahmed | 1 | 5,451 | 0.001 |
| | i) | Tasneem M. Noorani | 1 | 2,500 | 0.001 |
| | j) | Mubashir A. Akhtar | 1 | 2,500 | 0.001 |
| | k) | Kamal Monnoo | 1 | 2,500 | 0.001 |
| | | | 11 | 160,834,768 | 35.832 |
| **2.** | **Associated Companies, undertaking and related parties.** | | | | |
| | a) | Ibrahim Agencies (Pvt.) Limited. | 1 | 27,281,554 | 6.078 |
| | b) | Ibrahim Fibres Limited. | 1 | 141,982,700 | 31.632 |
| | | | 2 | 169,264,254 | 37.709 |
| **3.** | **NIT and ICP** | | | | |
| | a) | National Bank of Pakistan, Trustee Dept. | 1 | 2,457,301 | 0.547 |
| | b) | Investment Corporation of Pakistan | 1 | 6,613 | 0.001 |
| | | | 2 | 2,463,914 | 0.549 |
| **4.** | **Banks, DFIs, Financial Institutions, NBFCs** | | | | |
| | a) | State Bank of Pakistan | 1 | 45,185,333 | 10.067 |
| | b) | Askari Commercial Bank Limited | 1 | 16,376,106 | 3.648 |
| | c) | Prime Commercial Bank Limited | 1 | 1,383 | 0.000 |
| | d) | PICIC Commercial Bank Limited | 1 | 371,700 | 0.083 |
| | f) | Trust Leasing Corporation Limited | 1 | 80 | 0.000 |
| | g) | United Bank Limited | 1 | 13,990 | 0.003 |
| | h) | Escorts Investment Bank Limited | 1 | 227,600 | 0.051 |
| | i) | MCB Bank Limited | 1 | 506,000 | 0.113 |
| | j) | Pakistan Kuwait Investment Co. (Pvt) Limited | 1 | 14,500 | 0.003 |
| | k) | Habib Metropolitan Bank Limited | 1 | 39,500 | 0.009 |
| | l) | National Bank of Pakistan | 1 | 40,858 | 0.009 |
| | m) | First Dawood Investment Bank Limited | 1 | 1,932 | 0.000 |
| | n) | Faysal Bank Limited | 1 | 24 | 0.000 |
| | 0) | Bank Alfalah Limited | 1 | 159,600 | 0.036 |
| | | | 14 | 62,938,606 | 14.022 |
| **5.** | **Insurance Companies** | | | | |
| | a) | Pakistan Re-insurance Co. Limited | 1 | 75,812 | 0.017 |
| | b) | State Life Insurance Corp. of Pakistan | 1 | 116,308 | 0.026 |
| | c) | Silver Star Insurance Co. Limited | 1 | 429 | 0.000 |
| | d) | Orient Insurance Co. Limited | 1 | 160 | 0.000 |
| | e) | Gulf Insurance Co. Limited | 1 | 285 | 0.000 |
| | f) | EFU Life Assurance Limited | 1 | 62,219 | 0.014 |
| | g) | Saudi Pak Insurance Company Limited | 1 | 3,600 | 0.001 |
| | h) | Century Insurance Co. Limited | 1 | 12,400 | 0.003 |
| | i) | The Crescent Star Insurance Company Limited | 1 | 75 | 0.000 |
| | | | 9 | 271,288 | 0.060 |

## DETAILED PATTERN OF SHAREHOLDING

| | | No. of Shareholders | Shares Held | Percentage |
|---|---|---|---|---|
| **6.** | **Modarabas and Mutual Funds** | | | |
| | a) Pakistan Stock Market Fund | 1 | 971,600 | 0.216 |
| | b) Trustee Unit Trust Of Pakistan | 1 | 173,600 | 0.039 |
| | c) Pakistan Capital Market Fund | 1 | 273,000 | 0.061 |
| | d) AMZ Plus Stock Fund. | 1 | 92,800 | 0.021 |
| | e) Pakistan Premier Fund. | 1 | 723,100 | 0.161 |
| | f) PICIC Investment Fund | 1 | 2,038,200 | 0.454 |
| | g) NAMCO Balanced Fund | 1 | 1,200 | 0.000 |
| | h) PICIC Growth Fund | 1 | 2,874,100 | 0.640 |
| | i) AKD Index Tracker Fund | 1 | 135,500 | 0.030 |
| | j) Trustee Askari Income Fund | 1 | 500 | 0.000 |
| | k) First Tawakkal Modaraba | 1 | 139 | 0.000 |
| | l) Modaraba Al-Mali. | 1 | 48 | 0.000 |
| | m) KASB Liquid Fund | 1 | 9,100 | 0.002 |
| | n) Pakistan Income Fund | 1 | 78,300 | 0.017 |
| | o) First Fidelity Leasing Modaraba | 1 | 12 | 0.000 |
| | p) First Prudential Modaraba | 1 | 19,000 | 0.004 |
| | q) Al-Zamin Leasing Modaraba | 1 | 1,000 | 0.000 |
| | | 17 | 7,391,199 | 1.647 |
| **7.** | **Public Sector Companies and Corporations** (other than those covered in Insurance Companies and Banks) | Nil | Nil | Nil |
| **8.** | **Shareholders holding 10% (and above)** (Excluding Directors and associated companies) | Nil | Nil | Nil |
| **9.** | **Foreign Investors** | | | |
| | Habib Bank AG Zurich, Switzerland | 1 | 1,800 | 0.000 |
| | Habib Bank AG Zurich, London | 1 | 100,000 | 0.022 |
| | Ashiq Ali Kanji | 1 | 7,823 | 0.002 |
| | Amanullah Hashmi | 1 | 19 | 0.000 |
| | Masood Kazmi | 1 | 2,000 | 0.000 |
| | Consuelo G Abdullah | 1 | 2,400 | 0.001 |
| | State Street Bank and Trust Co. | 1 | 23,500 | 0.005 |
| | Suleman Ahmed Saeed Al-Hoqani | 1 | 80 | 0.000 |
| | | 8 | 137,622 | 0.031 |
| **10.** | **Shares held by the Executives of the Bank** | 127 | 312,079 | 0.070 |
| **11.** | **General Public - Individuals** | 21,061 | 37,296,424 | 8.309 |
| **12.** | **Federal Government of Pakistan** | 1 | 6,273,946 | 1.398 |
| **13.** | **Securities & Exchange Commission of Pakistan** | 1 | 15 | 0.000 |
| **14.** | **Others** | 1 | 1,680,000 | 0.374 |
| | | 3 | 7,953,961 | 1.772 |
| | **Grand Total** | 21,254 | 448,864,115 | 100 |

**Note:** Bank's directors Mr. Mubashir A. Akhtar, Mr. Tasneem A. Noorani & Mr. Kamal Monoo have purchased 2500 shares each. Sheikh Jalees Ahmed Director has purchased 5000 shares. One Executive purchased 17,500 shares during the year 2006 and one sold 8,000 shares. Apart from these there had been no trades in the shares of the Bank, carried out by its other directors, CEO, CFO, Company Secretary and their spouses and minor children except for FABM shares held by them and were converted into ABL shares.

# Performance Highlights


Rs. in Millions

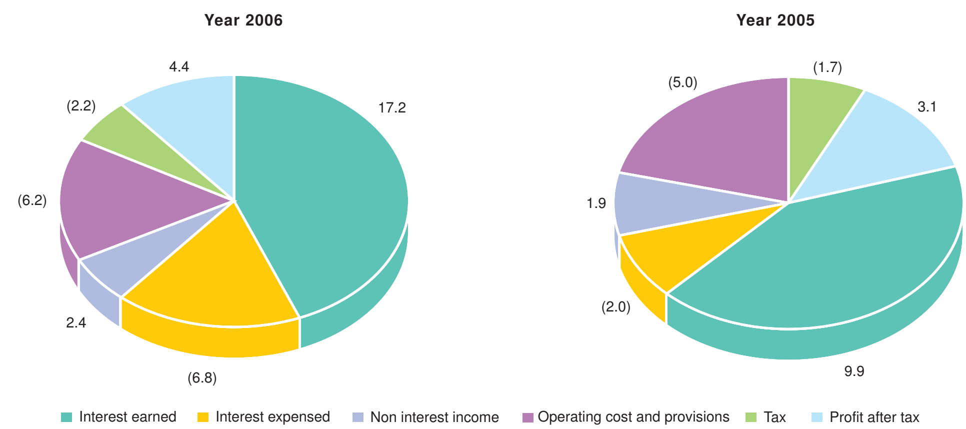
| December 31 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|---|
| | | | | | Restated | |
| **ASSETS** | | | | | | |
| Cash and balances with treasury and other banks | 11,394 | 11,472 | 11,205 | 12,320 | 18,035 | 24,745 |
| Lending to financial institutions | 8,643 | 10,839 | 15,361 | 16,175 | 5,777 | 19,050 |
| Investments - Gross | 16,085 | 34,001 | 41,126 | 57,657 | 45,269 | 47,156 |
| Advances - Gross | 59,870 | 54,032 | 49,987 | 69,949 | 119,866 | 151,705 |
| Operating fixed assets | 3,006 | 2,835 | 2,596 | 2,552 | 4,721 | 6,445 |
| Other assets | 10,831 | 8,760 | 7,306 | 7,500 | 7,907 | 10,801 |
| **Total assets - Gross** | **109,829** | **121,939** | **127,581** | **166,153** | **201,575** | **259,902** |
| Provisions against non performing advances | (5,631) | (9,065) | (9,673) | (10,890) | (8,659) | (7,672) |
| Provisions against diminution in the value of investments | (630) | (409) | (392) | (337) | (342) | (203) |
| **Total assets - net of provision** | **103,568** | **112,465** | **117,516** | **154,926** | **192,574** | **252,027** |
| **LIABILITIES** | | | | | | |
| Customer deposits | 94,492 | 103,883 | 114,218 | 126,392 | 161,410 | 206,031 |
| Inter bank borrowings | 7,743 | 7,483 | 2,665 | 12,538 | 9,694 | 18,410 |
| Bills payable | 1,227 | 1,400 | 1,773 | 2,534 | 2,449 | 2,278 |
| Other liabilities | 3,316 | 3,205 | 2,834 | 3,206 | 4,471 | 7,620 |
| **Total liabilities** | **106,778** | **115,971** | **121,490** | **144,670** | **178,024** | **234,339** |
| **NET ASSETS / LIABILITIES** | **(3,210)** | **(3,506)** | **(3,974)** | **10,256** | **14,550** | **17,688** |
| Share capital | 1,063 | 1,063 | 1,063 | 4,405 | 4,489 | 4,489 |
| Share premium | – | – | – | 10,640 | 4,316 | 4,316 |
| Reserves | 481 | 481 | 558 | 717 | 1,377 | 1,817 |
| Unappropriated profit / (loss) | (5,962) | (6,811) | (6,490) | (6,314) | 2,732 | 5,608 |
| **Equity - Tier I** | **(4,418)** | **(5,267)** | **(4,869)** | **9,448** | **12,914** | **16,230** |
| **Surplus on revaluation of assets - net of tax** | **1,208** | **1,761** | **895** | **808** | **1,636** | **1,458** |
| **PROFITABILITY** | | | | | | |
| Markup / Return / Interest earned | 8,285 | 7,497 | 4,985 | 5,245 | 9,892 | 17,216 |
| Markup / Return / Interest expensed | 5,032 | 3,727 | 1,155 | 794 | 2,025 | 6,793 |
| Net Markup / Interest income | 3,253 | 3,770 | 3,830 | 4,451 | 7,867 | 10,423 |
| Fee, Commission, Brokerage and Exchange income | 844 | 723 | 617 | 1,520 | 1,470 | 1,636 |
| Dividend income and Capital gain | (8) | 477 | 1,198 | 65 | 196 | 540 |
| Other income | 219 | 272 | 328 | 155 | 273 | 273 |
| Operating expenses | 3,471 | 3,537 | 3,681 | 3,964 | 4,263 | 5,289 |
| Profit before provisions | 837 | 1,705 | 2,292 | 2,227 | 5,543 | 7,583 |
| Donations | – | – | – | – | 15 | 9 |
| Provisions - (expense) / reversal | (517) | (3,222) | (870) | (1,594) | (694) | (913) |
| Additional charge for employee benefit and other obligations | (1,159) | (70) | (468) | (151) | – | – |
| Profit / (Loss) before taxation | (839) | (1,587) | 954 | 482 | 4,834 | 6,661 |
| Taxation | (283) | 518 | (568) | (290) | (1,744) | (2,264) |
| Profit / (Loss) after taxation | (1,122) | (1,069) | 386 | 192 | 3,090 | 4,397 |

| December 31 | | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|---|---|
| | | | | | | Restated | |
| **FINANCIAL RATIOS** | | | | | | | |
| Return on equity (RoE) | % | – | – | – | 8 | 28 | 30 |
| Return on assets (RoA) | % | -1.07 | -0.99 | 0.34 | 0.14 | 1.78 | 1.98 |
| Profit before tax ratio | % | -10 | -21 | 19 | 9 | 49 | 39 |
| Gross spread ratio | % | 39 | 50 | 77 | 85 | 80 | 61 |
| Return on capital employed (ROCE) | % | – | – | – | 8 | 28 | 28 |
| Advances to deposits ratio (ADR) - Gross | % | 63 | 52 | 44 | 55 | 74 | 74 |
| Advances to deposits ratio (ADR) - Net | % | 57 | 43 | 35 | 47 | 69 | 70 |
| Income to expense ratio | Times | 1.2 | 1.5 | 1.6 | 1.6 | 2.3 | 2.4 |
| Cost to revenue ratio | % | 80.6 | 67.5 | 61.6 | 64.0 | 43.5 | 41.1 |
| Growth in gross income | % | 48 | 22 | 14 | 4 | 58 | 31 |
| Growth in net profit after tax | % | 77 | 5 | 136 | -50 | 1,511 | 42 |
| Debt to equity ratio | % | – | – | – | – | – | 15.4 |
| Total assets to shareholders' funds | Times | (23) | (21) | (24) | 16 | 15 | 16 |
| Intermediation cost ratio | % | 3.6 | 3.6 | 3.4 | 3.3 | 3.0 | 2.9 |
| NPL ratio | % | 28.2 | 33.8 | 35.7 | 22.0 | 10.6 | 6.9 |
| Net infection ratio | % | 21.04 | 21.19 | 21.10 | 8.34 | 3.64 | 1.96 |
| Capital adequacy ratio (CAR) | % | -13.94 | -16.54 | -12.33 | 16.64 | 12.17 | 12.80 |
| **SHARE INFORMATION** | | | | | | | |
| Cash dividend per share | Rs. | – | – | – | – | 2.50 | 2.50 |
| Bonus issue per share | Rs. | – | – | – | – | – | 2.00 |
| Dividend yield | % | – | – | – | – | 2.9 | 4.8 |
| Dividend payout ratio | % | – | – | – | – | 36 | 46 |
| Earnings per share (EPS) | Rs. | (10.55) | (10.06) | 3.63 | 0.81 | 6.88 | 9.80 |
| Price earnings ratio * (PE x) | Times | – | – | – | – | 12.6 | 9.5 |
| Market value per share - at the end of the year * | Rs. | – | – | – | – | 86.5 | 93.5 |
| Market value per share - lowest / highest during the year | Rs. | – | – | – | – | 41.00 / 87.45 | 78.50 / 111.65 |
| Book value per share - Tier-1 | Rs. | (41.6) | (49.5) | (45.8) | 21.4 | 28.8 | 36.2 |
| Book value per share - Total | Rs. | (30.2) | (33.0) | (37.4) | 23.3 | 32.4 | 39.4 |
| **OTHER INFORMATION** | | | | | | | |
| Non performing loans (NPLs) | Rs. in millions | 16,877 | 18,242 | 17,833 | 15,383 | 12,699 | 10,479 |
| Imports and Exports business | Rs. in millions | 62,532 | 54,153 | 56,868 | 72,765 | 96,072 | 113,571 |
| Number of employees | Nos. | 7,082 | 6,946 | 6,859 | 6,768 | 6,909 | 7,139 |
| Number of branches | Nos. | 856 | 814 | 752 | 735 | 741 | 742 |

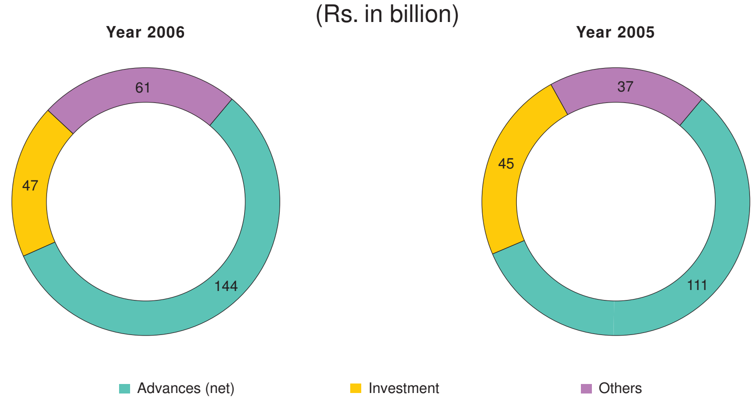
* The Bank was listed on all three stock exchanges during the last year, therefore, information pertaining to prior years is not given.

# Performance Highlights

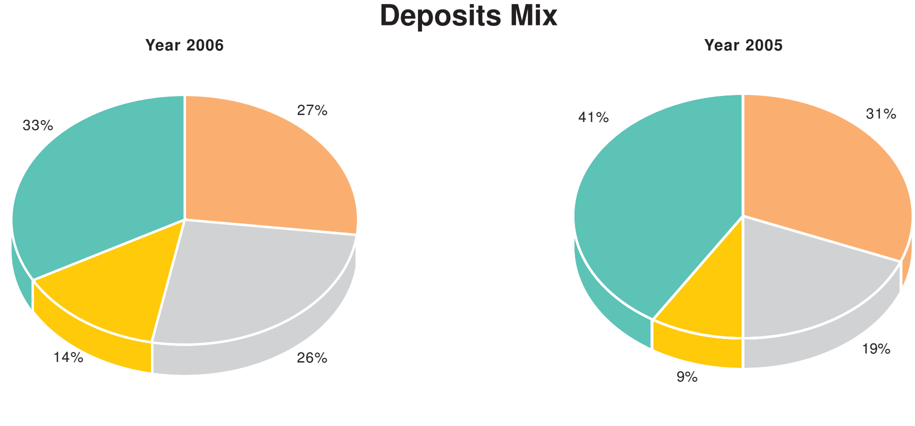
## Profit and Loss Summary
(Rs. in billion)




## Total Assets
(Rs. in billion)

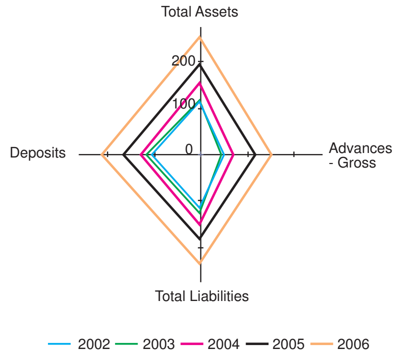



## Deposits Mix

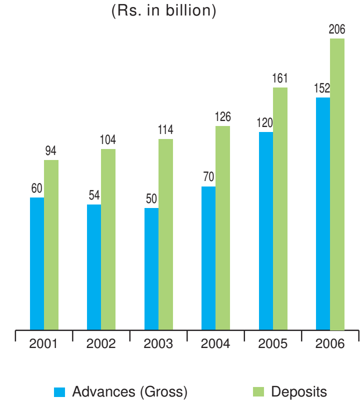


# Highlights

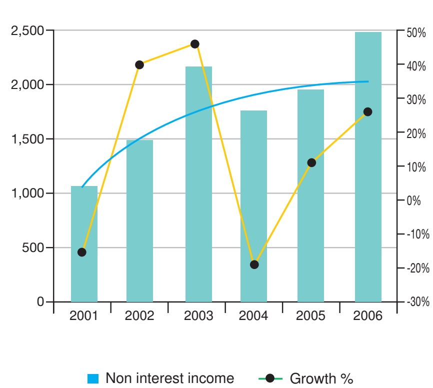
**Deposits, Advances, Assets and Liabilities**
(Rs. in billion)



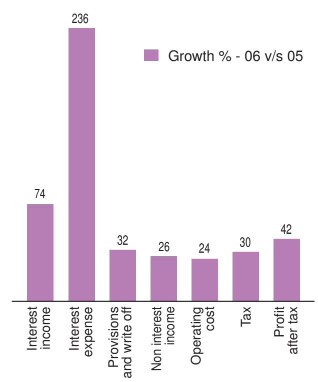

**Deposits and Advances**
(Rs. in billion)




**Non Interest Income**
(Rs. in million)




**Profit and Loss**




**KSE 100 Index and ABL Share Price (Rs.)**
Movement during year 2006

# PROFIT AND LOSS ACCOUNT
# FOR THE YEAR ENDED DECEMBER 31, 2006

PROFIT AND LOSS ACCOUNT

| | Rupees in '000 | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|---|
| | Mark up/Return/Interest earned | 25 | 17,215,507 | 9,892,051 |
| | Mark up/Return/Interest expensed | 26 | 6,793,101 | 2,024,659 |
| | Net Mark up/Interest income | | 10,422,406 | 7,867,392 |
| | Provision against non performing loans and advances – net | 12.5 | 583,305 | 399,608 |
| | (Reversal)/Provision for diminution in the value of investments – net | 11.3 | (14,623) | 20,411 |
| | Bad debts written off directly | 12.6.1 | 136,189 | 160,059 |
| | | | 704,871 | 580,078 |
| | Net Mark up/Interest income after provisions | | 9,717,535 | 7,287,314 |
| **NON MARK UP/ INTEREST INCOME** | Fee, commission and brokerage income | 27 | 1,353,888 | 1,220,362 |
| | Dividend income | | 193,255 | 46,146 |
| | Income from dealing in foreign currencies | | 282,285 | 250,224 |
| | Gain on sale of securities | 28 | 376,792 | 124,383 |
| | Unrealized (loss)/gain on revaluation of investments classified as held for trading – net | 11.5 | (30,180) | 25,706 |
| | Other income | 29 | 273,028 | 272,762 |
| | Total non markup/Interest income | | 2,449,068 | 1,939,583 |
| | | | 12,166,603 | 9,226,897 |
| **NON MARK UP/ INTEREST EXPENSES** | Administrative expenses | 30 | 5,290,578 | 4,259,532 |
| | Provision against other assets – net | 15.2 | 205,307 | 35,076 |
| | Provision against off balance sheet obligations – net | 20.1 | 2,546 | 79,095 |
| | Other charges | 31 | 7,078 | 18,999 |
| | Total non markup/interest expenses | | 5,505,509 | 4,392,702 |
| | Extra ordinary/unusual items | | – | – |
| | **PROFIT BEFORE TAXATION** | | 6,661,094 | 4,834,195 |
| | Taxation – Current | 32 | 2,215,092 | 1,331,468 |
| | – Prior years | 32 | – | 22,000 |
| | – Deferred | 32 | 48,752 | 390,594 |
| | | | 2,263,844 | 1,744,062 |
| | **PROFIT AFTER TAXATION** | | 4,397,250 | 3,090,133 |
| | Unappropriated profit/(Accumulated losses) brought forward | | 2,731,979 | (6,387,872) |
| | Transfer from surplus on revaluation of fixed assets – net of tax | 22.1 | 19,452 | 19,882 |
| | | | 2,751,431 | (6,367,990) |
| | Accumulated losses set off against share premium account | | – | 6,323,707 |
| | **PROFIT AVAILABLE FOR APPROPRIATION** | | 7,148,681 | 3,045,850 |
| | **Basic earnings per share (in Rupees)** | 33 | 9.80 | 6.88 |
| | **Diluted earnings per share (in Rupees)** | 33 | 9.80 | 6.88 |

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

**Chief Financial Officer** **President and Chief Executive** **Director**

**Director** **Chairman**

# Regionwise Branch Network

Regionwise Branch Network

**Central Group**

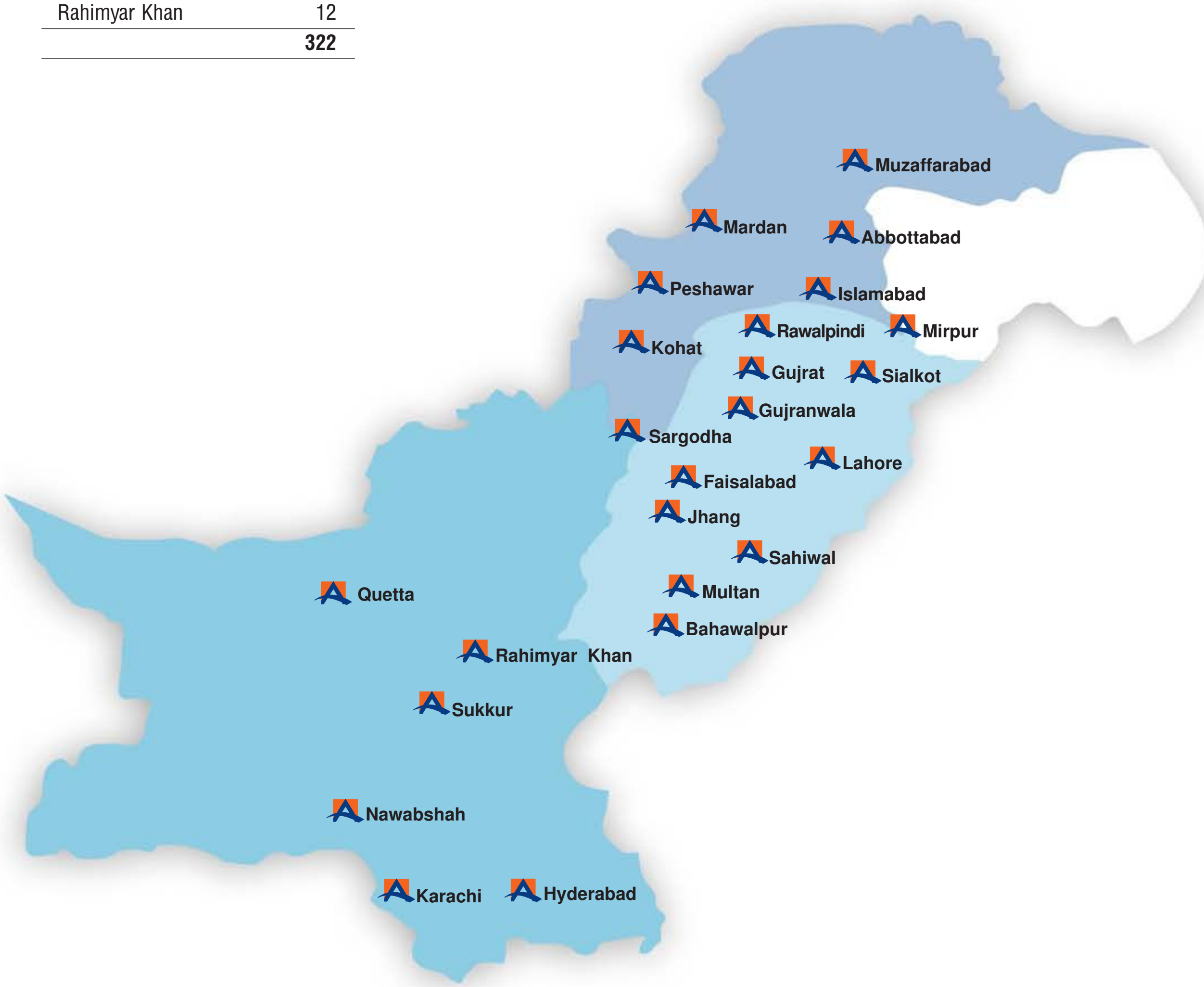
| *Regions* | *Branches* |
|---|---|
| Gujrat | 21 |
| Sialkot | 23 |
| Gujranwala | 34 |
| Sargodha | 35 |
| Lahore - City | 33 |
| Lahore - Gulberg | 34 |
| Faisalabad | 35 |
| Jhang | 18 |
| Sahiwal | 25 |
| Multan | 30 |
| Bahawalpur | 22 |
| Rahimyar Khan | 12 |
| | **322** |

**North Group**

| *Regions* | *Branches* |
|---|---|
| Muzaffarabad | 18 |
| Mardan | 32 |
| Abbottabad | 20 |
| Peshawar | 40 |
| Islamabad | 30 |
| Rawalpindi | 41 |
| Kohat | 17 |
| Mirpur | 33 |
| | **231** |

**South Group**

| *Regions* | *Branches* |
|---|---|
| Quetta | 32 |
| Sukkur | 21 |
| Nawabshah | 17 |
| Hyderabad | 24 |
| Karachi - City | 31 |
| Karachi - Nazimabad | 32 |
| Karachi - Saddar and Society | 32 |
| | **189** |



# STATEMENT OF CHANGES IN EQUITY
# FOR THE YEAR ENDED DECEMBER 31, 2006

STATEMENT OF CHANGES IN EQUITY

| Rupees in '000 | Share Capital | Share Premium | Statutory Reserve | Special Reserve | Merger Reserve | General Reserve | (Accumulated loss)/ Un-appropriated Profit | Total |
|---|---|---|---|---|---|---|---|---|
| **Balance as at January 01, 2005 – ABL** | 4,404,642 | 10,640,031 | 574,703 | 67,995 | 67,864 | 6,000 | (6,313,635) | 9,447,600 |
| **Balance as at January 01, 2005 – FABM** | 350,000 | – | 80,727 | – | – | – | (74,237) | 356,490 |
| Transferred from surplus on revaluation of fixed assets to accumulated loss – net of tax | – | – | – | – | – | – | 19,882 | 19,882 |
| Profit after taxation for the year ended December 31, 2005 – ABL | – | – | – | – | – | – | 3,033,372 | 3,033,372 |
| Profit after taxation for the year ended December 31, 2005 – FABM | – | – | – | – | – | – | 56,761 | 56,761 |
| Total recognized income and expense for the year | – | – | – | – | – | – | 3,110,015 | 3,110,015 |
| Transfer to statutory reserve – ABL | – | – | 303,337 | – | – | – | (303,337) | – |
| Transfer to statutory reserve – FABM | – | – | 10,534 | – | – | – | (10,534) | – |
| Accumulated losses set off against share premium account – ABL | – | (6,323,707) | – | – | – | – | 6,323,707 | – |
| **Balance as at December 31, 2005 ABL – Restated*** | 4,404,642 | 4,316,324 | 878,040 | 67,995 | 67,864 | 6,000 | 2,759,989 | 12,500,854 |
| **Balance as at December 31, 2005 – FABM** | 350,000 | – | 91,261 | – | – | – | (28,010) | 413,251 |
| Elimination of Capital (modaraba certificates) of Creation of merger reserve as a result of merger of ABL and FABM | (350,000) | – | – | – | 266,000 | – | – | (84,000) |
| Further issue of share capital of ABL to the certificate holders of FABM as a result of merger | 84,000 | – | – | – | – | – | – | 84,000 |
| **Amalgamated balances as at December 31, 2005 – Restated** | 4,488,642 | 4,316,324 | 969,301 | 67,995 | 333,864 | 6,000 | 2,731,979 | 12,914,105 |
| Effect of change in accounting policy* | | | | | | | | |
| Final cash dividend for the year ended December 31, 2005 declared subsequent to year end (Rs. 2.5 per Ordinary share) | – | – | – | – | – | – | (1,101,160) | (1,101,160) |
| Transferred from surplus on revaluation of fixed assets to unappropriated profit – net of tax | – | – | – | – | – | – | 19,452 | 19,452 |
| Profit after taxation for the year ended December 31, 2006 | – | – | – | – | – | – | 4,397,250 | 4,397,250 |
| Total recognized income and expense for the year | – | – | – | – | – | – | 4,416,702 | 4,416,702 |
| Transfer to statutory reserve | – | – | 439,725 | – | – | – | (439,725) | – |
| **Balance as at December 31, 2006** | 4,488,642 | 4,316,324 | 1,409,026 | 67,995 | 333,864 | 6,000 | 5,607,796 | 16,229,647 |

* Refer note 6 for change in accounting policy and the resulting impact on unappropriated profit.

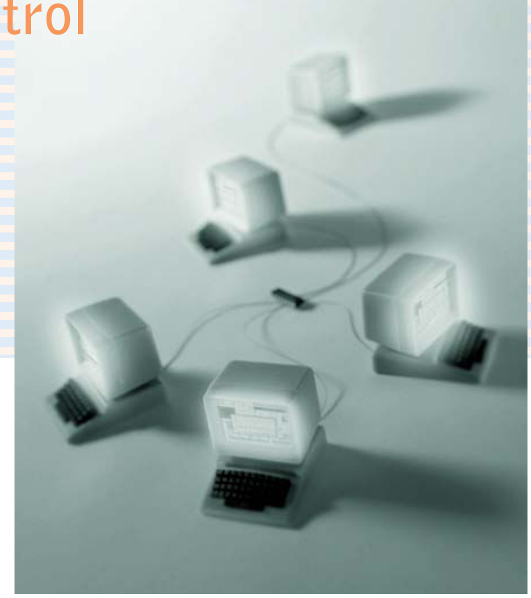
The annexed notes 1 to 48 form an integral part of these financial statements.

**Chief Financial Officer** **President and Chief Executive** **Director**

**Director** **Chairman**

Statement of Internal Control

# Statement of Internal Control



## Statement of Management Responsibilities

It is the responsibility of Bank's management to:

- Establish and maintain an adequate and effective system of internal controls and procedures for an efficient working environment for obtaining desired objectives.
- Evaluate the effectiveness of the Bank's internal control system that encompasses material matters by identifying control objective, reviewing significant policies and procedures and establishing relevant control procedures.

The control activities are being closely monitored across the Bank through Audit Group, working independent of line management. In addition, Compliance and Control Group monitors control activities on an on going basis. Both Groups cover all banking activities in general and key risks areas in particular. The Audit Committee of the Board reviews special audit reports periodically where significant violations to the local regulations, prescribed policies and procedures have occurred. The Audit Committee ensures their implementations through concerned Group to mitigate identified risks to safeguard the interest of the Bank.

The Bank's internal control system has been designed to provide reasonable assurance to the Bank's management and Board of Directors. All internal control systems, no matter how well designed, have inherent limitations that they may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate. However, control activities are on going process that includes identification, evaluation and management of significant risks faced by the Bank.

In an effort to incorporate the Internal Control Guidelines as spelled out by the State Bank of Pakistan in BSD Circular No. 7 of 2004, the Bank is already in the process of carrying out a detailed exercise through a well established firm of Chartered Accountants including documentation and benchmarking of existing processes and controls relating to financial reporting on internationally accepted standards. This project will help in further improving the quality of internal controls across the Bank and in ensuring compliance with the SBP requirement for external auditors' attestation on Internal Control over financial reporting, to be provided in the Financial Report for 2007.

The Board of Directors is ultimately responsible for the internal control system and the Board endorses the above management evaluation.

**Khalid A. Sherwani**
President

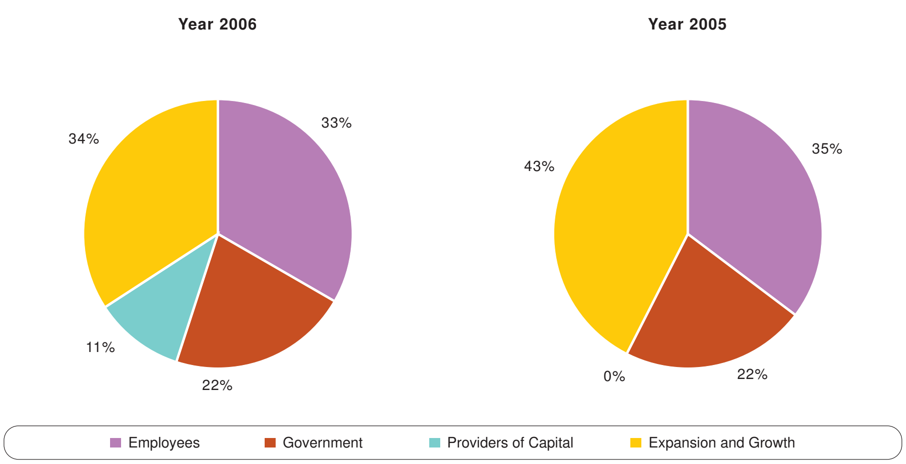
# Statement of Value Addition

Statement of Value Addition

(Rupees in Thousand)

| Value Added | 2006 | Percentage | 2005 (Restated) | Percentage |
|---|---|---|---|---|
| Income from banking services | 12,803,077 | | 9,778,137 | |
| Cost of services | (1,629,664) | | (1,278,831) | |
| Value added by banking services | 11,173,413 | | 8,499,306 | |
| Non banking income | 68,397 | | 28,838 | |
| Provision against non performing assets | (912,724) | | (694,249) | |
| | **10,329,086** | | **7,833,895** | |
| **Value Allocated** | | | | |
| **to employees** | | | | |
| Salaries, allowances and other benefits | 3,429,111 | 33.20% | 2,758,096 | 35.21% |
| **to Government** | | | | |
| Income tax | 2,263,844 | 21.92% | 1,744,062 | 22.26% |
| **to providers of capital** | | | | |
| as dividends (for 2005) | 1,101,160 | 10.66% | – | 0.00% |
| **to expansion and growth** | | | | |
| Depreciation / Amortization | 238,881 | 2.31% | 241,604 | 3.08% |
| Retained in business | 3,296,090 | 31.91% | 3,090,133 | 39.45% |
| | 3,534,971 | 34.22% | 3,331,737 | 42.53% |
| | **10,329,086** | **100%** | **7,833,895** | **100%** |

## Value Allocation




television
24 hr
sensation!
Teller

# Vision

To become a dynamic and efficient bank providing integrated solutions in order to be the first choice bank for the customers

# Mission

- To provide value added services to our customers
- To provide high tech innovative solutions to meet customers' requirements
- To create sustainable value through growth, efficiency and diversity for all stakeholders
- To provide a challenging work environment and reward dedicated team members according to their abilities and performance
- To play a proactive role in contributing towards the society

# Core Values

- Integrity
- Excellence in Service
- High Performance
- Innovation and Growth

## Cashing in on our strengths

**Allied Bank now has 350 ATMs in 125 Cities - the biggest ATM network in the country**