

Offshore Banking Unit, Bangladesh

Notes to the Financial Statements

As at and for the year ended 31 December 2008

1 Background

The Hongkong and Shanghai Banking Corporation Limited (HSBC), Bangladesh Branches (the Bank) commenced its banking operations in Bangladesh on 3 December 1996 after obtaining its banking license from Bangladesh Bank on 17 April 1996. HSBC is incorporated in Hong Kong and its ultimate holding company HSBC Holdings plc (the Group) is incorporated in England.

The Bank has established an Islamic Banking Branch (Amanah branch) from 26 February 2004, on Islamic Shariah Principles based banking which is governed by the HSBC Shariah Supervisory Committee in Dubai, after obtaining its license from Bangladesh Bank on 31 August 2003.

HSBC also operates an Offshore Banking Unit (OBU) after obtaining its license from Bangladesh Bank on 9 July 1998.

2 Principal activities

HSBC offers a comprehensive range of financial services in Bangladesh including commercial banking, consumer banking, payments and cash management, trade services, treasury, and custody and clearing.

Commercial Banking: Commercial banking is a traditional strength of HSBC because of our international reach and a wide range of financial services and products. HSBC has an offshore banking unit (OBU) licence and therefore also provides foreign currency financing to qualifying customers.

Corporate and Institutional Banking: Corporate and institutional banking provides dedicated relationship management services to HSBC's clients in major corporate and financial institutions. The Bank's focus is on fostering long-term relationship based on its international connections and extensive knowledge of Asia and Asian business.

Global Markets: HSBC's Global Markets business ranks among the largest in the world and provides foreign exchange and money market services to the Central Bank, international and local corporations, institutional investors, and financial institutions as well as other market participants.

Trade & Supply Chain (formerly "Trade Services"): Trade finance and related services are a long-standing core business of HSBC based on the depth and spread of its corporate customer base, commitment to service, highly automated trade processing systems and extensive geographic reach.

The Bank established three Business Development Offices in Comilla, Mongla and Adamjee export processing zone focused on handling of export-import documents. As a result the bank now has presence in five export processing zone's in Bangladesh, including Chittagong export processing zone and Dhaka export processing zone.

Payments and Cash Management: HSBC is one of the leading service providers of payments and related services to financial institutions, corporate and personal customers in Bangladesh. Underpinned by our extensive network of offices and capabilities, payments and cash management assists companies through the provision of payments, collections, liquidity and account services. HSBCnet, a proprietary computer-based software package, provides customers with an instant link to HSBC's international computer network, allowing customers to perform transactions and obtain a diverse range of up-to-date information 24 hours a day, 365 days a year.

3 Basis of Preparation

These financial statements are prepared on the basis of a going concern and represent the financial performance and financial position of the OBU. The financial statements of the OBU are prepared in accordance with the Bank Companies Act 1991, in particular, Banking Regulation and Policy Department (BRPD) Circular No 14 (25 June 2003), other Bangladesh Bank Circulars, and International Accounting Standards (IAS) and International Financial Reporting standards (IFRS) as adopted by the Institute of Chartered Accountants of Bangladesh (ICAB) into Bangladesh Accounting Standards

(BAS) and Bangladesh Financial Reporting Standards (BFRS) where relevant to the Bank to the extent that these do not contradict the applicable statutory provisions.

4 Significant accounting policies

Foreign currencies

Items included in the financial statements of the Bank are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The financial statements of the Bank are presented in USD which is the Bank's functional and presentation currency.

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange ruling at the balance sheet date.

Loans and advances to customers

Loans and advances to customers are stated in the balance sheet on a gross basis.

Deposits by customers and banks

Deposits by customers and banks are recognised when the Bank enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and initially measured at the consideration received.

Offsetting financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition, and include cash and balances at central banks, treasury bills and other eligible bills and balances with other banks and financial institutions.

Revenue Recognition

Interest income

Interest income for all loans and advances are recognised in the profit and loss account using the effective interest method. The effective interest method is a way of calculating the amortised cost of a financial asset and of allocating the interest income over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial asset or, where appropriate, a shorter period, to the net carrying amount of the financial asset.

When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but not future credit losses. The calculation includes all amounts paid or received by the Bank that are an integral part of the effective interest rate of a financial asset, including transaction costs and all other premiums or discounts.

Interest expense

Interest expenses for all deposits are recognised in the profit and loss account on an accruals basis.

Commission & fee income

The Bank earns commission and fee income from a diverse range of services provided to its customers. Commission and fee income is accounted for as follows:

- ▶ income earned on the execution of a significant act is recognised as revenue when the act is completed
- ▶ income earned from services provided is recognised as revenue as the services are provided
- ▶ income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate

Exchange income

Exchange income includes all gains and losses from foreign currency transactions.

Operating expenses

Operating expenses incurred for the operations of the OBU are incurred by the Bank and apportioned between the Bank and OBU on the basis of total operating income.

Income tax

Income tax on the profit or loss for the year comprises current tax and deferred tax. Income tax is recognised in the profit and loss account except to the extent that it relates to items recognised directly in shareholders' equity, in which case it is recognised in shareholders' equity.

Current tax is the tax expected to be payable on the taxable profit for the year, calculated using tax rates as prescribed in the Income Tax Ordinance (ITO) 1984 and relevant Special Regulatory Orders (SRO) and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised. Deferred tax is calculated using the tax rates as prescribed in the Income Tax Ordinance (ITO) 1984 and relevant Special Regulatory Orders (SRO).

5 Balance with other Banks and Financial Institutions

	2008	2007
	USD	USD
Inside Bangladesh	-	-
Outside Bangladesh:		
HSBC, Hong Kong	-	110,300,000
HSBC Bank, USA	8,586,893	12,409,027
(For detail see Annexure - B)	<u>8,586,893</u>	<u>122,709,027</u>

6 Loans and advances

Loans

In Bangladesh		
Overdraft	3,653,266	2,460,470
Term loans	9,849,326	14,174,152
Import loans	58,839,488	48,768,870
	72,342,080	65,403,492
Outside Bangladesh	-	-
	<u>72,342,080</u>	<u>65,403,492</u>
Bills purchased and discounted:		
Inside Bangladesh		
Import bills	2,327,022	1,362,876
Export bills	155,497,745	41,165,743
	157,824,767	42,528,619
Outside Bangladesh	-	-
	<u>157,824,767</u>	<u>42,528,619</u>
	<u>230,166,847</u>	<u>107,932,111</u>

6.1 Maturity grouping of loans and advances including bills discounted and purchased

Payable on demand	14,733,329	12,063,737
Payable within one month	40,225,770	26,441,581
More than 1 month but less than three months	112,819,800	39,588,486
More than three months but less than one year	57,222,118	21,039,962
More than one year but less than five years	5,165,830	8,798,345
Over five years	-	-
	<u>230,166,847</u>	<u>107,932,111</u>

6.2 Maturity analysis of bills purchased and discounted

Within one month	34,509,555	16,740,024
More than one month but less than three months	80,541,287	18,514,039
More than three months but less than six months	36,475,190	7,274,556
More than six months	6,298,735	-
	<u>157,824,767</u>	<u>42,528,619</u>

6.3 Unclassified, classified, doubtful and bad loans

Unclassified	230,166,847	107,932,111
Substandard	-	-
Doubtful	-	-
Bad/Loss	-	-
	<u>230,166,847</u>	<u>107,932,111</u>

6.4 Sector-wise classification of loans and advances

Readymade garments and textile	96,429,575	84,864,917
Transport	316,844	711,622
Other manufacturing company	133,420,428	22,355,572
	<u>230,166,847</u>	<u>107,932,111</u>

6.5 Particulars of loans and advances

i) Loans considered good in respect of which the banking company is fully secured;	<u>230,166,847</u>	<u>107,932,111</u>
ii) Loans considered good against which the banking company holds no security other than the debtor's personal guarantee;	-	-
iii) Loans considered good secured by the personal undertakings of one or more parties in addition to the personal guarantee of the debtor;	-	-
iv) Loans adversely classified; provision not maintained thereagainst;	<u>230,166,847</u>	<u>107,932,111</u>
v) Loans due by directors or officers of the banking company or any of these either separately or jointly with any other persons;	<u>-</u>	<u>-</u>
vi) Loans due from companies or firms in which the directors of the banking company have interests as directors, partners or managing agents or in case of private companies as members;	<u>-</u>	<u>-</u>
vii) Maximum total amount of advance including temporary advance made at any time during the year to directors or managers or officers of the banking companies or any of them either separately or jointly with any other person;	<u>-</u>	<u>-</u>
viii) Maximum total amount of advances, including temporary advances granted during the year to the companies or firms in which the directors of the banking company have interest as directors, partners or managing agents or in case of private companies as members;	<u>-</u>	<u>-</u>
ix) Due from banking companies	<u>-</u>	<u>-</u>
x) Classified loans and advances		
a) Classified loans and advances on which no interest is credited to income;	<u>-</u>	<u>-</u>
b) Provision on classified loans and advances; (For movement see note 15.4)	<u>-</u>	<u>-</u>
c) Provision kept against loan classified as bad debts	<u>-</u>	<u>-</u>
d) Interest credited to the interest suspense account	<u>-</u>	<u>-</u>
xi) Cumulative amount of written off loans		
Opening balance	<u>-</u>	<u>-</u>
Amount written off during the year	<u>-</u>	<u>-</u>
The amount of written off loan for which law suit has been filed	<u>-</u>	<u>-</u>

6.6 Geographical Segmentation of Loans and Advances

Dhaka (Export Processing Zone)	230,166,847	107,932,111
	<u>230,166,847</u>	<u>107,932,111</u>

7 Other assets

Interest receivable from banks and other financial institutions	-	100,664
	<u>-</u>	<u>100,664</u>

8 Borrowings from other banks, financial institutions and agents

In Bangladesh

Pubali Bank Limited	136,455	1,054,548
AB Bank	-	125,000
Shahjalal Islami Bank Limited	75,000	-
	<u>211,455</u>	<u>1,179,548</u>

Outside Bangladesh

HSBC, Hong Kong	79,500,000	74,100,000
	<u>79,500,000</u>	<u>74,100,000</u>

8.1 Classification based on type of security

Secured	-	-
Unsecured	79,711,455	75,279,548
	<u>79,711,455</u>	<u>75,279,548</u>

8.2 Maturity grouping of borrowings from other banks, financial institutions and agents

Payable on demand	-	-
Payable within one month	-	812,036
More than one month but less than three months	61,111,137	60,208,065
More than three months but less than one year	18,600,318	14,259,447
More than one year but less than five years	-	-
	<u>79,711,455</u>	<u>75,279,548</u>

9 Deposits and other accounts

Payable on demand	6,912,105	3,264,300
Payable within one month	359,385	360,117
More than one month but less than three months	539,391	696,141
More than three months but less than one year	1,310,325	904,313
More than one year but less than five years	-	-
Over five years	-	-
	<u>9,121,206</u>	<u>5,224,871</u>

10 Other liabilities

Interest payable	262,174	179,028
Commission received in advance	65,524	40,149
HSBC Bangladesh Branches	146,708,622	143,684,320
Others	28,597	30,306
	<u>147,064,917</u>	<u>143,933,803</u>

11 Profit and loss account

Opening balance	6,303,580	2,635,896
Profit for the year	3,792,580	3,667,684
Profit remitted to Head office	(7,239,998)	-
Retained profit for the year	<u>2,856,162</u>	<u>6,303,580</u>

12 Contingent liabilities and commitments

Claim against the bank not acknowledge as debt	-	-
Acceptance and endorsement	31,480,454	22,258,735
	<u>31,480,454</u>	<u>22,258,735</u>

Letter of guarantees:

Money for which the bank is contingently liable in respect of guarantees given favoring:

Government	1,065,522	657,108
Bank and other financial institution	-	-
Other	-	-
	<u>1,065,522</u>	<u>657,108</u>
Irrevocable letters of credit	<u>20,670,375</u>	<u>21,011,790</u>
	<u>53,216,351</u>	<u>43,927,633</u>
13 Interest income		
Overdraft	109,315	117,953
Term loans	700,259	1,704,872
Import loans	2,646,956	3,010,002
Income from money market	677,968	58,795
Others	3,770,211	3,348,510
	<u>7,904,709</u>	<u>8,240,132</u>
14 Interest paid on deposits and borrowings		
Deposit by bank	2,277,072	2,646,444
Fixed deposits	20,380	31,613
	<u>2,297,452</u>	<u>2,678,057</u>
15 Commission, exchange and brokerage		
Letter of Credit issuing commission	3,058,243	2,687,250
Credit facilities	151,922	122,300
Commission on Letter of Guarantee	1,631	23,162
Dealing Profit/ (loss)	(576)	1,556
	<u>3,211,220</u>	<u>2,834,268</u>
16 Cash and cash equivalent		
Balance with other banks (Note 5)	<u>8,586,893</u>	<u>122,709,027</u>

17 Related Party Transaction

The OBU, not being incorporated in Bangladesh, operates in Bangladesh under the banking license issued by Bangladesh Bank and therefore the key management personnel of the Bank for the purposes of BAS 24 are defined as those persons having authority and responsibility for planning, directing and controlling the OBU, being members of the Board of Directors of the Group, Group Managing Directors, and close members of their families and companies they control, or significantly influence, or for which significant voting power is held.

17.1 Transactions with key management personnel

There were no transaction between the OBU and the key Management Personnel of the OBU in 2008 (2007: BDT nil).

17.2 Transactions, arrangements and agreements involving key management personnel

The OBU provides and receives certain banking and financial services to/from entities within the Group. As at year end the balances with these entities is disclosed in Note 5, Balance with other banks and financial institutions and Note 8, Borrowings from other banks, financial institutions and agents.

The disclosure of the year end balance is considered to be the most meaningful information to represent transactions during the year. The outstanding balances includes loans made to or deposits by the OBU and arose in the ordinary course of business and are on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties. Interest income received by the OBU from these entities during 2008 amounted to USD677,968 (2007:USD1,129,806) and interest expense paid to these entities during 2008 amounted to USD1,992,889 (2007:USD2,257,981), both of which is included in the net interest income disclosed in the profit and loss account.

17.3 Transactions with other related parties of the Bank

The OBU provides certain banking and financial services and administrative services to the Bank operating in Bangladesh under the banking license issued by Bangladesh Bank. As at year end the balance with the Bank is disclosed in Note 10, Other Liabilities.

The disclosure of the year end balance is considered to be the most meaningful information to represent transactions during the year. The outstanding balance includes loans made by the OBU to the Bank, expenses payable to the Bank by the OBU and income tax payable to the OBU by the Bank. These transactions arose in the ordinary course of business and are on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties, with the exception that during 2007 and up until 4th December 2008 loans made between the Bank and the OBU were made at an agreed zero percent interest rate. Net interest paid by the OBU to the Bank in 2008 amounted to USD195,776 (2007:USDnil) which is included in the net interest income disclosed in the profit and loss account.

Operating expenses incurred by the Bank for the operations of the Bank and OBU are apportioned to each entity on the basis of total operating income and reported in the profit and loss account. Income tax assessed for the Bank and the OBU are paid by the Bank and the element relating to the OBU is recharged back to the OBU as disclosed in Note 10, Other liabilities. The Bank does not charge the OBU any fees for the provision of administrative services.

18 Events after the balance sheet date

There were no material adjusting events after the balance sheet date.

19 General

19.1 Audit Committee: According to BRPD Circular No.12 (23 December 2002), all banks are advised to constitute an Audit Committee comprising of members of the Board. The Audit Committee will assist the board in fulfilling its oversight responsibilities including implementation of the objectives, strategies and overall business plans set by the board for effective functioning of the bank. The committee will review the financial reporting process, the system of internal control and management of financial risks, the audit process, and the bank's process for monitoring compliance with laws and regulations and its own code of business conduct.

The Bank, being a foreign bank, does not have a local Board of Directors from whom to select an Audit Committee, however, the Bank has received a dispensation from Bangladesh Bank on 19 December 2006 with regards to this requirement. The Bank has an Internal Audit department reporting directly to the CEO of the Bank. In addition to this the Bank is subject to audit by the internal auditors of HSBC and the internal auditors of the Group.

HSBC has an Audit Committee, comprising of three non-executive Directors of HSBC, which meets on a regular basis with the senior management of HSBC and its subsidiaries and associated companies, and with the internal and external auditors to consider and review the nature and scope of the reviews and the effectiveness of the systems of internal control and compliance as well as the financial statements of HSBC and its subsidiaries and associated companies.

The Group has an Audit Committee, comprising of five non-executive Directors of the Group, which meets on a regular basis with the senior management of the Group, and with the internal and external auditors to consider and review the nature and scope of the reviews and the effectiveness of the systems of internal control and compliance as well as the financial statements of the Group.

All audit reports issued by local internal and external auditor and all inspection/ audit reports issued by Bangladesh Bank are sent to the Audit Committees of HSBC in Hongkong and the Group in the UK.

19.2 Credit Rating: According to BRPD Circular No.6 (05 July 2006) it is mandatory from January 2007 for all banks to have themselves credit rated by a Credit Rating Agency. Credit Rating Agency of Bangladesh limited (CRAB) has issued the following ratings for the Bank:

Long-term	AAA
Short-term	ST-1

According to CRAB, financial institutions rated in this category are adjudged to be of highest quality, offer highest safety and have highest credit quality. This level of rating indicates exceptionally strong capacity for timely payment of financial commitments, highly unlikely to be adversely affected by foreseeable events. The short-term rating indicates highest certainty with regard to the Bank's capacity to meet its financial commitments. Safety is almost like risk free government short-term securities.

19.3 Assets and liabilities have been converted into Taka currency @ USD 1 = Tk 68.92 which represents the year-end middle rate of exchange as at 31 December 2008.

19.4 Previous year's figures have been rearranged, where necessary, to conform to current year's presentation.

19.5 Figures appearing in these Financial Statements have been rounded off to the nearest integer.



Sanjay Prakash
Chief Executive Officer, Bangladesh



Mustafa Alim Aolad
Head of Finance, Bangladesh

16 February 2009

Statement of Liquidity

Annexure - A

(Maturity analysis of assets and liabilities) As at 31 December 2008

Particulars	Maturity upto 1 month	Maturity within 1 to 3 months	Maturity within 3 to 12 months	Maturity within 1 to 5 years	Maturity over 5 years	Total Amount
	USD	USD	USD	USD	USD	USD
ASSETS						
Cash in hand	-	-	-	-	-	-
Balance with other banks and financial institutions	8,586,893	-	-	-	-	8,586,893
Money at call and short notice	-	-	-	-	-	-
Investment in Treasury Bills & others	-	-	-	-	-	-
Loans & advances to customers (Note 6.1)	54,959,099	112,819,800	57,222,118	5,165,830	-	230,166,847
Fixed assets	-	-	-	-	-	-
Other assets	-	-	-	-	-	-
Non-banking assets	-	-	-	-	-	-
Total Assets	63,545,992	112,819,800	57,222,118	5,165,830	-	238,753,740
LIABILITIES						
Borrowings from other banks & financial institutions (Note 8.2)	-	61,111,137	18,600,318	-	-	79,711,455
Deposits & other accounts	7,271,490	539,391	1,310,325	-	-	9,121,206
Other liabilities (including capital/ shareholders equity)	146,708,622	356,295	2,856,162	-	-	149,921,079
Total Liabilities	153,980,112	62,006,823	22,766,805	-	-	238,753,740
Net Liquidity Difference	(90,434,120)	50,812,977	34,455,313	5,165,830	-	