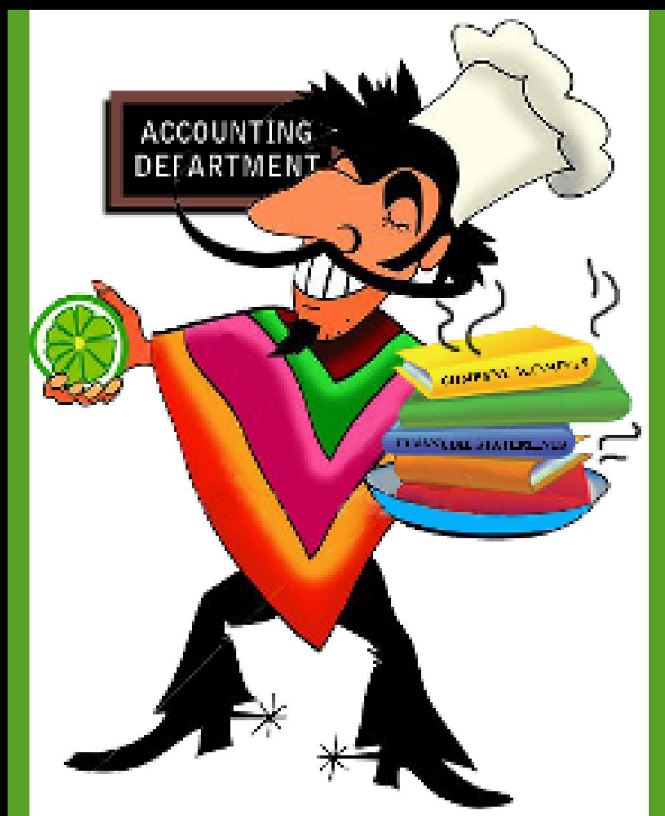
THE PAKISTAN
ACCOUNTANT

Magazine of The Institute of Chartered Accountants of Pakistan



Would Satyam Happen in Pakistan?

JANUARY - MARCH 2009

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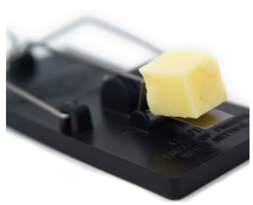

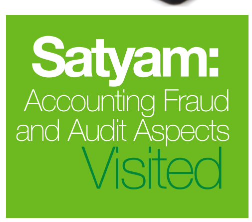

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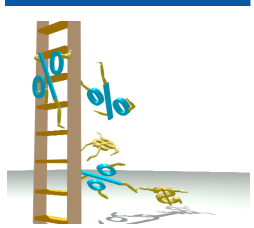

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EDITOR'S LETTER

Would Satyam Happen in Pakistan

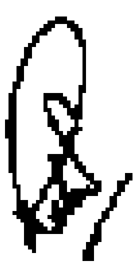
The "prudent man" concept, as expressed in *Cooley on Torts*, describes a professional's obligation for reasonable care as follows:

"In all [these] employments where peculiar skill is prerequisite, if one offers his service, he is understood as possessing the degree of skill commonly possessed by others in the same employment, and if his pretensions are unfounded, he commits a species of fraud upon every man who employs him in reliance on his public profession. But no man, whether skilled or unskilled, undertakes that the task he assumes shall be performed successfully, and without fault or error: he undertakes for good faith and integrity, but not for infallibility, and he is liable to his employer for negligence, bad faith, or dishonesty, but not for losses consequent upon pure errors of judgment."

Among all the other issues that the Satyam scandal has brought to the forefront that of the auditor's role has gained prime significance. The balance between the requirements gap on the one hand, and the feasibility gap on the other, is precarious. The distinction between errors of judgment and ordinary negligence presents a troublesome scenario because auditors are not liable when they believe that their opinion is correct, but is likely to be disputed, but auditors may be held liable for ordinary negligence, that is, the failure to exercise due professional care.

Thus, each time a scandal of Satyam's magnitude occurs it causes an outburst of public outrage whereby the auditors' actual standard of performance versus the performance required of them by society comes under scrutiny. The public perceives the auditor as an insurer or guarantor of financial statements who is supposed to detect fraud and give early warnings about the possibility of a business's failure. In the wake of Satyam, auditors must understand that the public's increasing, some may say unrealistic, demands for accountability refuse to recognize the limitations of an audit. As guardians of public trust auditors are put on a pedestal on which the future of the profession hinges.

On the flip side the aim of regulation and corporate governance is to prevent managers from abusing their power in running corporations. A large number of publicly listed companies in Pakistan and India are family-owned businesses. Corporate power rests largely in the hands of promoters and independent directors, and disregard for ethics and corporate governance will further tarnish the image of these businesses in the eyes of already wary foreign institutional investors. This is compounded by the FII's reliance on the financial statements where misrepresentations are left unchallenged. The only solution to this problem can be achieved by strengthening the accounting framework, disclosure practices and transparency.



Abdul Rahim Suriya

PRESIDENT'S PAGE

On July 7, 2009, Mr. Ramalinga Raju, Chairman of Satyam Computer Services Limited, resigned after making a revelation in his letter, addressed to the board of directors of India's fourth largest software service provider, that he had indulged in cooking of the company's books over a period of several years. Raju made these revelations after his unsuccessful attempt to sell two companies to Satyam a month earlier in a final attempt to plug Rs.50.4 billion ($ 1 billion) of 'fictitious' cash presented on the company's balance sheet.

Many analysts have called July 7 a *black day* for India's software industry, as well as for corporate India as a whole, as it is considered the biggest set back for both.

Satyam is undoubtedly one of the largest accounting frauds in the history of South Asia. Happening at a time when the entire world is in the midst of one of the worst recessions in the last 100 years or so, it raises some serious questions about the state of Corporate Governance in India. More specifically, it has brought to the fore the enhanced risks in family owned enterprises, even though they may be listed on stock exchanges and subjected to rigorous regulatory oversight. While the investigations into the causes of this scam are still continuing, the role of independent directors and auditors is also in the spotlight.

For accounting profession, the more relevant issue is the role played by the external auditors of Satyam, which in this case was a major accounting firm. While the final verdict can only come after the investigation and litigation process is completed, which will obviously take years, there could obviously be three possibilities:

a) whether the auditors were negligent in performing their work;

b) whether the auditors had the knowledge of the fraud and colluded ; or

c) whether the auditors, despite performing their work to the best of their abilities, and in line with the auditing standards, were not able to uncover this fraud due to fraud having been well designed and concealed by management.

In our own context, the pertinent question is whether Pakistan is also at risk of such accounting frauds happening without being detected by the board of directors as well as the auditors. While there can be no system in the world that can be 100 percent secure against the risk of frauds, the most important firewall against such frauds happening is the state of Corporate Governance, and within this, the integrity of its key components, including board of directors and auditors. As the Chairman of Corporate Governance Group of South Asian Federation of Accountants, I had the privilege of reviewing the comparative state of Corporate Governance in South Asian Countries, and on this basis, I am of the view that on an overall basis, the state of Corporate Governance in Pakistan is not very different from that of India, and we do need significant improvements in many aspects of the same. One area, where I feel more confident of this risk being low is the state of audit profession. In my personal opinion, based on my knowledge and experience of the profession in Pakistan over the last 28 years, I can confidently say that the possibility of such a large accounting fraud being perpetrated by management and not being detected by a major audit firm over a period of several years would be remote.

Syed Asad Ali Shah

Join the Discourse

This month's topic:
Don't Blame it on Me, Blame it on the System!

In his Davos dispatch on the web magazine Slate*, *Newsweek* columnist Daniel Gross wrote this:

"At least with regard to finance and business, the consensus [at Davos] seems to be clear: *Success* is the work of Great Men and Great Women, while *failure* can be pinned on the system."

In the context of the global financial crisis, would you agree that we live in a world where success is privatized by attributing it to individuals, but failure is socialized by blaming it on the system?

Comments

Systems are basically a tool for implementation of policies and not a policy-making tool themselves. The role of humans in any system cannot be ignored because they are the real policy-makers and implementers of any system. Blaming a system is just like blaming your pen for writing any sub-standard material. Although it is a reality that the pace of dependency on technology is very high, but the responsibility for success and failure will remain on individuals. You can delegate authority but you cannot delegate responsibility. As Putts Law states:

Technology is dominated by two types of people: those who understand what they do not manage, and those who manage what they do not understand.

Zafar Abbas Badami
Karachi

Systems are also developed by individuals and blaming systems means blaming another individual. Proactive people understand that they are responsible for the present conditions and environment around them, but unfortunately there are fewer numbers of such people in the world today.

Khalil Hashmi
Lahore

We can not hide behind the system when we see a failure. Certain basic questions need to be answered first, for example what is the system, who is supposed to make it, or change it, or take corrective action. My answer to these questions is that we are responsible for what the system does.

In fact, I say we are the system, a process or software can not be said to be complete without human involvement at some point. It's clear that the current scenario can not be said to have been caused by the failure of the system, but rather by the failure of the decision makers who either took wrong decisions, or failed to take action when it was needed.

Irfan Ahmed Meer
Karachi

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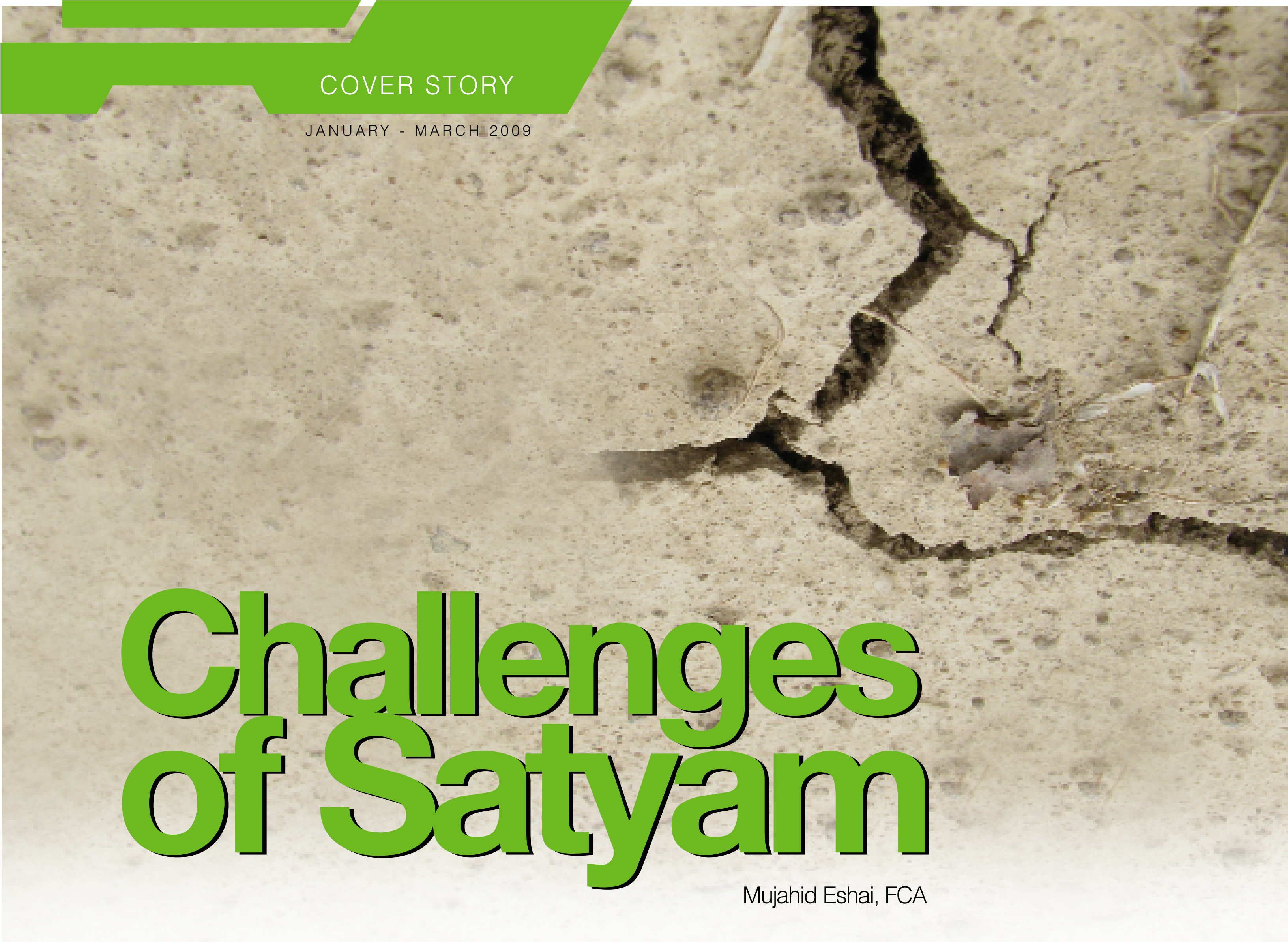


Challenges of Satyam

Mujahid Eshai, FCA

Financial scandals like Satyam happen all over the world at regular intervals. The year 2008 is replete with them and the Enron and World Com fiascos are not so distant in history to be forgotten. The Ponzi scheme had its origin in the Great Depression of 1920s. The world today is informed in detail about what transpired and the scandals, after due establishment of facts, become part of recorded history.

Case studies based on these incidents are taught at business schools and are debated and discussed at length. Consequently, legislation is enacted or amended to stop such occurrences in future, as much as possible.

However, the human mind being as fertile as it is, there is nothing to stop it from concocting yet another mind boggling scheme sooner. Tricksters and financial conmen abound. Perhaps, greed turning into reckless greed causes people to indulge in illegal and unethical activities. But the fact remains that truth is sought and obtained and those violating the legal, ethical and societal norms are taken to task. The law does not seek to protect such persons nor are the legislators and regulators prepared to sweep everything under the carpet.

Satyam Scandal: Chronology

Before getting into the details of the scandal let us look at how the events unfolded in the words of James Fontanella - Khan of *The Financial Times* published on January 07, 2009:

Dec 16: Satyam announces the $1.6bn acquisition of two companies controlled by the family of Ramalinga Raju, chairman of the IT outsourcer. However, Satyam aborts the deal seven hours later due to a revolt by investors who oppose the takeover. Satyam shares plunge 55 per cent in New York.

Dec 17: Mr. Raju says Satyam is considering a share buyback in a move to regain investors' confidence after its stock plunged. Citigroup, JP Morgan and Merrill Lynch downgrade Satyam and slash their share price estimates by up to half. Satyam shares end the day down 30.2 per cent in Mumbai.

Dec 23: The World Bank bars Satyam from doing business with it for eight years in one of the most severe penalties by a client against a large Indian outsourcing company. On the day the stock drops a further 13.6 per cent, its lowest in more than four and a half years.

Dec 24: Mangalam Srinivasan, an independent director at Satyam, resigns following the World Bank's critical statements and the botched attempt to buy two companies controlled by Mr. Raju's family.

Dec 25: Satyam asks the World Bank to withdraw the "inappropriate" statements about the Indian outsourcer and to issue an apology for the harm done to the company.

Dec 27: Satyam postpones a board meeting set for December 29, where it was expected to announce a management shake-up, to January 10. The move aims to give the group more time to mull options beyond just a possible share buyback. Satyam appoints Merrill Lynch to review "strategic options to enhance shareholder value."

Dec 29: Three more directors quit the company as the independence of the board members is questioned.

Jan 2: Satyam says its founder's stake fell by a third to 5.13 per cent.

Jan 5: Satyam shares tumble 9 per cent after the London-based World Council for Corporate Governance, which awarded Satyam a Golden Peacock last year, said it was seeking legal advice to understand the mechanics of the aborted takeovers as part of its effort to reassess whether Satyam still deserved the award.

Jan 7: Mr. Raju resigns after he admits falsifying Satyam books.

Facts and Opinion

Satyam was India's fourth largest outsourcing services provider with at least 100 of the Fortune 500 contributing to its gross revenue. It had one of the Big Four as their auditors since 2000. Suddenly, one wintry day on January 7, when the whole world was reeling from the financial crisis caused by the sub-prime lending in the U.S. housing sector, Satyam chairman and founder Ramalinga Raju resigned after stating in a letter to the Securities and Exchange Board of India (SEBI) that about $1 billion, or 94 percent of the cash and bank balances on the company's books at end September, 2008, did not exist. The company's shares plunged nearly 80 percent. It very soon also came to the fore that Satyam had incurred a $253m liability on funds personally arranged by its chairman and founder, and had overstated quarterly revenues for the period ending 30 September 2008 by 28% and overstated earnings by $125m. Satyam American depositary receipts fell $8.42, or 90 percent, to 93 cents before the opening of the New York Stock Exchange, which then halted trading in the stock.

India's markets regulator C.B. Bhave said the Satyam disclosure was of 'horrifying magnitude'. The SEBI ordered a probe into trading in Satyam shares, according to the regulator's website. Two partners of PricewaterhouseCoopers, the auditors, who had been responsible for the audit of Satyam since their appointment in 2000 were arrested towards the end of January. Both have denied allegations that they were involved in criminal activity while working on the audit. A PricewaterhouseCoopers statement said that there is 'not an iota of material to link them with the accusations levelled against them'. The Satyam scandal is spurring concern that India's corporate governance is inadequate. Emile Woolf, forensic and litigation consultant, writing in the Accountancy Magazine February 2009 issue says: "As for governance based on non-executive vigilance, this too is powerless when there is little grasp of the technical complexity in a company's operational engine."

The Economist in its issue dated January 15, 2009, states, "But when a liar confesses, can you believe him? Many suspect that even now only 50% of the truth is out. Cash, after all, is hard to fake. Satyam's books were audited by PricewaterhouseCoopers. According to the *Economic Times*, an Indian newspaper, the auditor says it verified Satyam's fixed deposits with the banks that held them. So perhaps the money did exist, but has since been spirited out of the company. Such tricks are not unusual in India, even if the scale of the Satyam fraud is extraordinary. Indian promoters (who include business families and other corporate insiders) still hold almost half of the shares on the National Stock Exchange (NSE). But many family firms are evolving into widely held corporations. The danger is that as the stake held by insiders falls, they have an incentive to rip off other shareholders by siphoning off money."

Rajeev Srinivasan, a financial analyst, writing on Rediff.Com, an Indian website offering online news entertainment and other information options to the Indian diaspora says, “I did not see through the biggest scam in the Indian market in years. I have to admit that I misjudged the promoters of Satyam when I defended them and the company recently. But then, I am in good company -- the independent board members of Satyam (including the dean of the Indian School of Business, a Harvard Business School professor, and an erstwhile star at Intel), the institutional investor community, the SEBI, retail investors, and the external auditor -- none of them, including professional investors with detailed information and models available to them, detected the malfeasance.

“How did they manage to conceal a fraud of such magnitude even from the auditors?” asked Greg Kuhnert a London-based fund manager at Investec Asset Management Ltd., which manages about $10 billion and sold its 0.15 percent stake in Satyam in December. Francine McKenna, an ex-PWC director and a fierce critic of the Big Four accounting firms (PricewaterhouseCoopers, KPMG, Deloitte and Ernst & Young) as reported in the daily Guardian of January 15, 2009, believes the Satyam issue raises fundamental questions of oversight. She says: "It's hard to know the extent to which there was complicity between the auditors and senior management or whether it was plain incompetence. PWC (Satyam's auditors) doesn't have the enforcement capability. It's left with little choice other than to cut off the gangrenous arm and throw some of its Indian partners under the bus." Michelle Perry's ethics analysis entitled “Fit to Judge?” in the February 2009 Accountancy Magazine issue states as follows: “And upon reflection of PricewaterhouseCooper's statement that its audit of Satyam were conducted 'in accordance with applicable auditing standards and were supported by appropriate audit evidence' it becomes apparent that the rules played no role in stopping senior financial executives from producing fictitious numbers.”

Rajeev Srinivasan, a financial analyst, writing on Rediff.Com, an Indian website offering online news entertainment and other information options to the Indian diaspora says, “I did not see through the biggest scam in the Indian market in years. I have to admit that I misjudged the promoters of Satyam when I defended them and the company recently. But then, I am in good company -- the independent board members of Satyam (including the dean of the Indian School of Business, a Harvard Business School professor, and an erstwhile star at Intel), the institutional investor community, the SEBI, retail investors, and the external auditor -- none of them, including professional investors with detailed information and models available to them, detected the malfeasance.” He goes on to say: “Why do people get into fraudulent behaviour? Perhaps, it just became a habit. There was a statement in the Satyam letter to the SEBI that gives a clue -- it talks about 'riding the tiger, not knowing how to get off without being eaten.' Apparently once the books began to be falsified, the company embarked on a slippery slope wherein it could not right matters without things falling apart. I suspect that in the intensely competitive IT services market, Satyam as the smallest of the big four players was under pressure to show extraordinary results in order to survive. Was there anything more complicated? Was there unaccounted for money being funnelled in and out of Satyam? It is a known fact that rural Andhra Pradesh has rich landowners who have significant untaxed agricultural income: maybe there were informal arrangements whereby they funded and expected high returns from Satyam.”

Satyam in Pakistan

Can a similar situation like Satyam happen in Pakistan? Anybody asking this question must reckon that there are only angels living in Pakistan, or we have very short memories. Satyam has happened many times over in this land of the pure. How can people forget the Crescent Standard Bank Scandal, the Taj Company fiasco, Schon Group of Companies, the Samad Dadhabhoy and the Double Shah Ponzi scheme, to name just a few. Of course, we must also not forget the financial scams relating to the cooperatives societies, Mehran and Indus Banks and NDFC debacles.

Then, there are obvious candidates in the waiting which, if it were in any other country of the world, would have had upended a long time ago rather than being a constant drain on the national budget and the taxpayer's money. The recent moves of the SECP and the State Bank to bail out the financial and industrial sector vis-à-vis the application of IAS 39 was obviously so unique a move that no one anywhere in the world attempted to adopt this route to save their institutions. They let them go under or provided huge fiscal help. Of course, we provided the CFS Mark I and II facilities to bail out our stock brokers. But obviously, we did not follow either route for the corporate and financial sector because it is our culture not to let them go under and as far as providing fiscal help was concerned there was nothing available in the kitty. Bankruptcies and liquidations do not happen in Pakistan. Our businesses and business persons just fade away into oblivion leaving hundreds of thousands ruing their fate.

Some of the issues raised by financial analysts and observers regarding Satyam and other scandals could apply to businesses in Pakistan:

- Stake held by family insiders falls, they have an incentive to rip off other shareholders by siphoning off money.
- Significant untaxed agricultural income and expected high returns.
- Rules play no role in stopping senior financial executives from producing fictitious numbers.
- Personal investments generally, and particularly in the real estate sector, by siphoning off money from the public institution.
- Under pressure to show extraordinary results in order to survive.
- Laws relating to transactions with related companies, businesses and individuals

The list may be extended but not modified. The fact remains that there is a thriving black economy in the country that provides avenues that promise higher returns than the market rate. There are enough businesses out there to take this money and use it to fill in the gaps. Then there is a concerted belief that rules and regulations must be broken to achieve success. Yet we must also be seen as the paragons of transparency, integrity and law and order.

Professional accountants and auditors cannot rest assured that the IASs and IFRSs are being followed. In my opinion, the time has come for auditors, in particular, to go beyond the exercise of verifying the accuracy, disclosure and presentation issues. They perhaps will have to go beyond this to examine the state of corporate governance in an organization, the decision making processes, the role of executive, non-executive and independent directors, and particularly the assessment of the business ethics followed by a business. The latter issue will result in a lot of debate and disagreement. There may also be areas of conflict. There will be questions of competence. But then the profession will have to grow and acquire what it may lack, as the auditors' independent opinion is still the only means of ensuring credibility of a set of financial statements for the investor at large.

Conclusion

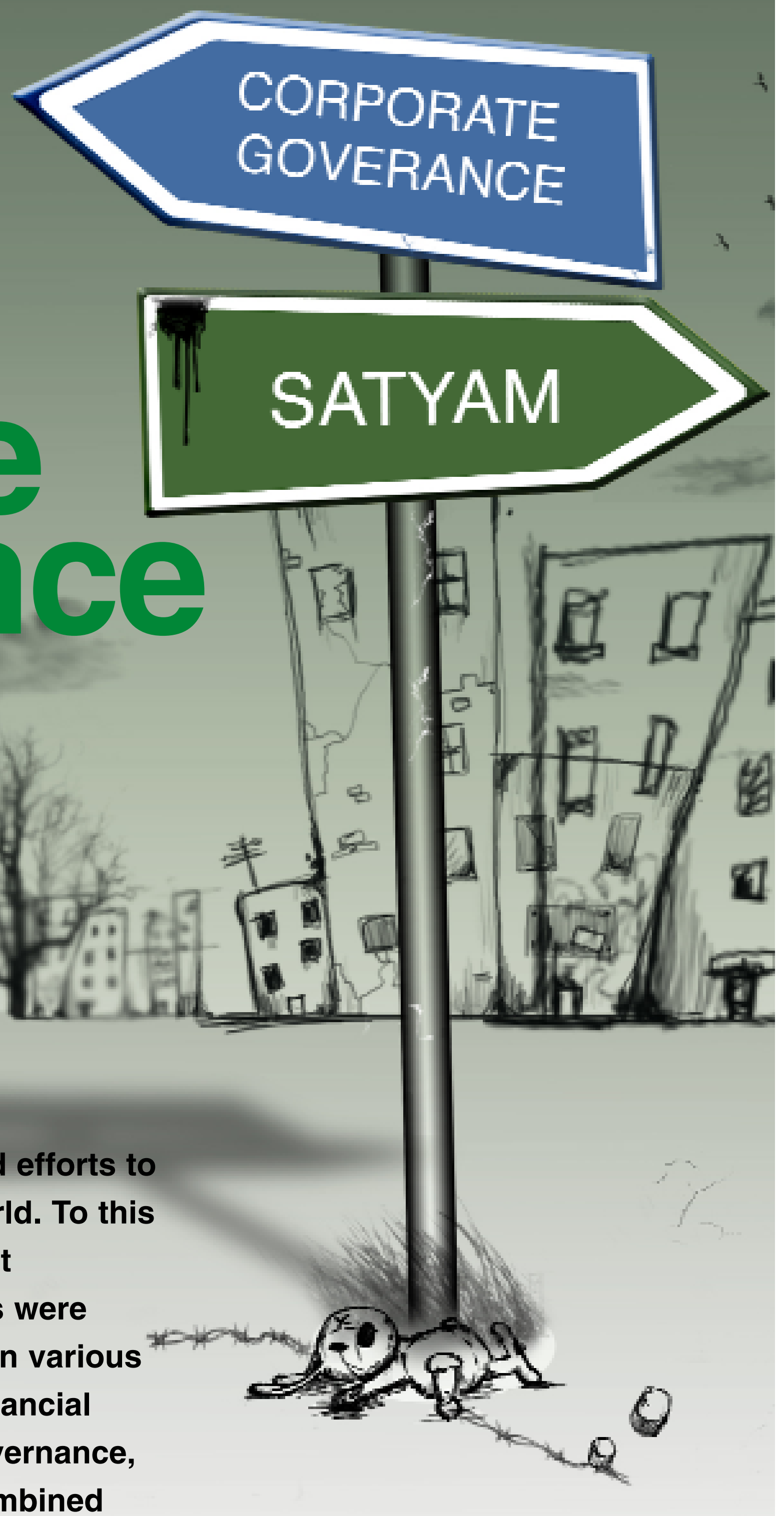
The fact is, if we as a profession start looking for ways out, direct or indirect, to aid and abet bad or unethical business practices, particularly resulting in off the books transactions, then we should not be seen as the advocates of transparency, integrity, honesty and law and order. It is indeed time for reflection and critical self analysis. It is a time for change. Should auditors think in terms of working in close liaison with anti-corruption and fraud agencies to develop controls to check corporate corruption and research what role they should play in detecting corruption? Should the old debate about a completely independent oversight mechanism for the auditing or assurance business be commenced again? Should auditors be involved with the auditing of business ethics? These issues are global issues and not merely confined to Pakistan. But we, in Pakistan, need to move fast indeed and take a lead on some, if not all, of these matters as what is happening in our economy is not reflected in the volume of goods and services being produced or consumed. Corporate governance and practice have now become a major issue.

In conclusion I will once again quote from Emile Woolf (*We're all in a Ponzi Partnership*, Accountancy Magazine, February 2009):

“To the extent that a rise in market prices of financial and real estate assets exceed the ability of the economy to provide commensurate level of goods and services, any apparent increase in wealth is illusory.”

The search for Truth (Satyam) continues.

The Satyam Scandal and Role of Corporate Governance



Khalid Rahman, FCA

During the last decade, there were widespread efforts to improve corporate governance across the world. To this end, a series of preemptive measures aimed at enhancing the efficacy of control mechanisms were instituted. Besides other enabling legislation in various countries, these included the International Financial Reporting Standards, Codes of Corporate Governance, including the US Sarbanes-Oxley Act, and Combined Code of Corporate Governance in the UK.

Despite these efforts, there were a number of corporate failures the world over, casting doubt over efforts to contain them. The latest among them was exposed on January 7, 2009, when Ramalinga Raju, Chairman of Satyam Computer Services Limited - at one time India's fourth-largest outsourcing IT organization, serving over a third of Fortune 500 companies with operations in 66 countries and a workforce of 53,000 - announced that US$ 1.5 billion were missing from their accounts. The scandal highlighted the inadequacy of corporate governance in India and cast a looming shadow over the once-shining image of Indian industry overseas.

How the scandal was unearthed?

It all started in early December 2008, when Satyam attempted to acquire two companies controlled by Raju's sons - Maytas Properties and Maytas Infra - for US$ 1.6 billion in order to replace the company's fictitious assets with real ones. The deal was rejected when the shareholders claimed the move was nepotistic and entailed a gross misuse of funds. The failed acquisition resulted in panic selling, causing losses worth millions to investors in India. Satyam's share price plummeted 55 percent and 78 percent on the New York and Mumbai stock exchanges, respectively. As a result, some members of Satyam's Board of Directors (BoD) resigned on December 29, 2008.

Whatever the reasons behind the scam, it clearly revealed the failure of good corporate governance by Satyam's BoD and inadequate application of audit procedures on the part of the organization's external auditors.

The exact nature and causes of Satyam's downfall will only come to light once investigations are completed. However, the following factors may have contributed to its downfall:

a) Ineffective Corporate Governance

News of the scam urged the world to ask whether the independent directors on the Satyam's board acted responsibly. As such, the abortive deal to acquire construction companies was totally unrelated to Satyam's business and reflected unnecessary diversification, especially at a time when the construction business was witnessing a lull.

Such an unexpected resolution passed by the BoD gives rise to the possibility that the chairman and managing director, the founder and co-founder of the company, respectively, may have used their influence to compel other directors to approve the decision to acquire Maytas Properties and Maytas Infra. It is also possible that the interest of the chairman and managing director in the transaction may not have been disclosed in the board meeting where the proposal was floated for approval.

Further, Satyam's BoD did not form an investment committee. Instead, there was an Investor Grievance Committee (IGC) whose function was to focus on shareholder grievances and strengthen investor relations. The IGC did not meet the requirements of the investment committee which, as per best practice, works as a sub-committee of the BoD, comprising non-executive directors responsible for approving all major long-term company investments.

b) IFRS and Indian GAAP

Currently, Indian GAAP is followed for the preparation of financial statements. Convergence with IFRS has gained momentum in recent years all over the world as capital markets became increasingly global in nature. Even the Institute of Chartered Accountants in India has expressed its preference for IFRS for public-interest entities on or after April 1, 2011. This is due to the fact that Indian GAAP does not provide specific guidance nor disclosure requirements in a number of areas.

c) Inability of Auditors to Detect Fraud

Satyam's auditors are said to have failed to detect the fraud for several years. Still, it appears rather incredulous that they overlooked the absence of a huge sum of US$ 1.04 billion from their cash and bank balances. It also remains uncertain whether third party confirmation, one of the most common audit procedures to verify bank balances, was carried out. The occurrence and non-detection of a fraud of this magnitude points towards the possibility that the standard mix of audit procedures was not followed by the auditors, who tended to rely completely and imprudently on the design and implementation of the entity's internal controls. As expected, the scam has put the reputation of one of the world's leading audit firms at grave risk, urging the Institute of Chartered Accountants of India to seek an explanation regarding their negligent conduct.

The Satyam management has indicated that the auditors were aware of the fraud. However, according to the *Times of India's* March 18, 2009 edition, the auditors maintain their partners were clearly misled by the Satyam management. This may be indicative of the external auditors' over-reliance on management representation in place of carrying out independent audit procedures.

d) Keeping Pace

Many analysts believe that an insatiable greed for profit coupled with the desire to retain the market share of India's US$50 billion outsourcing industry could be the motive behind fudging Satyam's accounts.

Corporate Governance: From an International Viewpoint

Good corporate governance is an essential prerequisite for the integrity and credibility of companies operating in the economy. It promotes transparency, fairness and accountability with respect to shareholders in particular and other stakeholders in general.

Key elements of good corporate governance principles include honesty, trust and integrity, openness, performance orientation, responsibility and accountability, mutual respect and commitment to the organization. Corporate governance also includes the relationship among the many stakeholders involved and the goals according to which the corporation is governed. The principal stakeholders are the shareholders, management and the BoD.

There has been renewed interest in corporate governance practices since 2001, particularly due to the Enron and WorldCom debacles. In 2002, the US Federal Government passed the Sarbanes-Oxley Act, with the aim to uphold investors' confidence in corporate governance. Even so, the recent financial meltdown has raised a number of questions regarding the effectiveness of these efforts for financial risk management and good corporate governance.

Can Satyam-like Scandals Happen in Pakistan?

Due to inherent limitations of businesses as well as audit procedures, it is difficult to say whether a scam such as Satyam's can be completely avoided in any part of the world. Even in the presence of detailed legislation and reporting frameworks, the possibility of fraud remains, unless the people tasked with governance and auditors perform their duties with professionalism, transparency and due vigilance.

Corporate Governance in Pakistan

The Code of Corporate Governance (CCG) was issued by the Securities and Exchange Commission of Pakistan in 2002, compliance with which is mandatory for all listed companies. The CCG lays down comprehensive guidelines regarding important aspects of corporate governance. These include composition, responsibilities, powers and functions of the BoD, tenure of office and qualification of directors, BoD meetings, issues to be placed before the BoD for decision making, related party transactions, qualification, appointment and approval of CFO and Company Secretary, Directors' Report, corporate and financial reporting framework, Audit Committee, internal and external audit.

Unlike India, Pakistan has adopted International Financial Reporting Standards. Statutory auditors are required to perform their audits according to International Standards on Auditing and report whether financial statements have been prepared in accordance with International Financial Reporting Standards and the local reporting framework

International Financial Reporting Standards and International Standards on Auditing

Unlike India, Pakistan has adopted International Financial Reporting Standards. Statutory auditors are required to perform their audits according to International Standards on Auditing and report whether financial statements have been prepared in accordance with International Financial Reporting Standards and the local reporting framework.

Moreover, continued professional development and requirements to follow Code of Ethics in the profession as well as businesses have resulted in strict adherence to professional behaviour and due care by the accountants in the performance of their duties.

Why Wouldn't Satyam Happen in PPL?

Pakistan Petroleum Limited (PPL), one of the largest exploration and production companies in Pakistan, places a lot of emphasis on good corporate governance practices. PPL was listed in 2004. However, the company was voluntarily complying with the CCG prior to its listing. The procedures and practices followed by PPL in connection to good corporate governance are:

The mission and vision statement, overall corporate strategy and all significant policies are developed and approved by PPL's BoD. The company has a well-defined organizational structure with clear reporting lines and division of responsibilities. The company has constituted a Board Audit Committee, Board Human Resource Committee and Board Operations and Finance Committee (BOFC).

Each major investment initiative is only undertaken after the recommendation of the BOFC and approval by the BoD. It is important to mention that in line with the requirements of the Companies Ordinance 1984, each director of the company has to disclose his/her interest in any project or proposal considered by the BoD. PPL also complies with the requirements of IAS-24 and the Companies Ordinance relating to comprehensive disclosure of related party transactions.

PPL's commitment to comply with best practices of the CCG is evidenced by:

a) Effective Role of the Audit Committee

The Audit Committee, comprising four non-executive directors, performs its responsibilities effectively, thereby contributing to good corporate governance in the company. The Terms of Reference of the Audit Committee are consistent with those stated in the CCG. It is noteworthy that the head of PPL's Internal Audit Function has direct access to the Board Audit Committee. External auditors also meet the Board Audit Committee at least once every year in the absence of the Head of Internal Audit and CFO, strictly in accordance with CCG requirements.

b) Strong Internal Control Systems

PPL has an effective internal control system to safeguard the integrity of its financial and other operations, transparent accounting system and reporting structure. These include:

- Well documented Standard Operating Procedure manuals for all important functions by reputed independent consultants, which are rigorously followed by all operating departments.
- The Internal Audit Function carries out an audit of every department in the company as part its yearly plan and issues independent reports which are reviewed by the Board Audit Committee. PPL's Internal Audit Function is relatively large with a professional staff of around 20 and adequate resources and technical expertise, including qualified accountants, to carry out its functions effectively.
- ISO certifications have been earned by various PPL fields and operating departments.
- Extensive use of information technology plays a significant role in decision making throughout the company. PPL is the first E&P company in Pakistan to implement SAP, a leading worldwide ERP solution.

c) Full Compliance with the Code, IFRS and Applicable Laws

PPL is fully compliant with IFRS's requirements as well as those of the Companies Ordinance 1984 and other applicable laws in letter and spirit. A statement of compliance with the CCG is also circulated along with the Annual Report which is reviewed and verified by external auditors. Consistent compliance with standards and applicable laws promotes transparency in corporate reporting, resulting in disseminating relevant and reliable information to shareholders for informed investment decision making.

Such measures have contributed to the outstanding success of PPL through effective risk management. Indeed, if other companies in Pakistan follow the same principles, fraud and ultimate corporate failure similar to Satyam's can be minimized, if not completely eliminated.

Conclusion

It is the directors' fiduciary responsibility to protect the interest of shareholders. The responsibility for compliance with best management practices rests with the company management. The Internal Audit Function is also imperative as it can play a significant role in ensuring compliance with best practices as outlined in the CCG.

Chartered accountants as auditors and responsible professionals have a duty to ensure that interests of all stakeholders are protected on a priority basis. This position of responsibility is given on the basis of trust developed by our predecessors over many years. However, catastrophes such as the Satyam fraud or the Enron scandal are atrophying this trust. Therefore, it is imperative that all ethical guidelines are followed to ensure the trust placed on the profession is upheld and honoured.

Khalid Rahman is a fellow member of the Institute of Chartered Accountants of England and Wales and Institute of Chartered Accountants of Pakistan since 1982.

Khalid Rahman has rich and varied professional experience spanning 32 years in senior management positions in the accounting profession as well as the oil and gas and banking industries in Pakistan and abroad, particularly Europe and the Far East.

Can Satyam Like Fraud Happen in Pakistan

M. Farid Alam, FCA

Keeping in view the events that took place across the border with reference to the accounting and auditing flaws at Satyam Computer Services, it is pertinent to understand the related role of shareholder activism. In this article we will discuss the role of 'shareholder activism' in Pakistan, with specific reference to the Satyam case. Furthermore, we will also discuss how shareholder activism was not able to protect investors' interest in Satyam, and if the same situation were to arise in Pakistan would shareholder activism be able to protect investors' interest?

Shareholder activism has not yet taken off in Pakistan. The reason for this does not lie in absence of cases like Satyam (although the amount involved and global investor base was enormous) but rather in the lack of interest taken by large corporate investors/mutual funds representatives on the boards of companies in preventing and detecting and reporting shabby or foul play practices.

The Case of Satyam

On 7 January, 2009 the Chairman of Satyam, Mr. Ramalinga Raju made some extraordinary revelations. He stated that accounts of Satyam were overstated to the tune of INR 50.4 billion (~US$1billion) related to cash and bank balances. The startling revelation has led analysts in India to dub the Satyam scandal as India's own Enron. The revelations were taken very seriously not only because of the large amount involved but also because of the fact that Satyam in Hindi means truth and there was nothing but truth in its financial statements presented to all the stakeholders year after year.

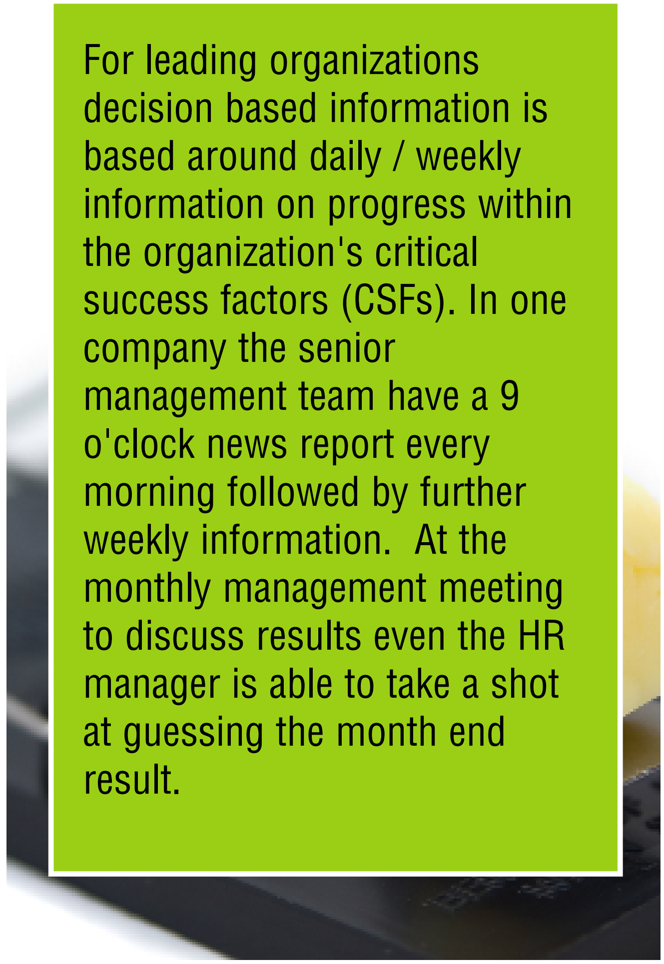
Regarding the Satyam scandal, the seed of mistrust between the Chairman and the shareholders was sown a few weeks prior to these stark revelations. Satyam had made its intentions of purchasing two companies from the then Chairman's son for well over US$1 billion. The two firms to be purchased were Maytas Properties and Maytas Infra.

The decision to purchase these companies was overturned due to shareholder pressure. This was the first instance of 'shareholder activism' playing some part in Satyam's recent history and forcing Mr. Raju to make the revelations of the accounts overstatement, since he had exhausted all available options to sweep the fraudulent activities under the carpet. Had the Satyam-Maytas deal gone through, Mr. Raju would have conveniently incorporated the purchased assets on the books of Satyam and to a substantial degree would have balanced the books. The shareholders of Satyam saw possible foul play and made those feelings clear, leading to the abandonment of the Satyam-Maytas deal.

Shareholder Activism- Satyam

The revelations made by the Chairman suggested that cash was overstated by INR5,040 crores, debtors were overstated by an amount of INR4,900 crores and that liabilities were understated by INR1,230 crores. These misstatements pertained to failure on the part of the auditors to pinpoint discrepancies, particularly those related to cash balances. In this regard, the local affiliate of the international firm charged with auditing Satyam's accounts has stated that its reliance on management information may have rendered its audit unreliable. In this case, shareholder activism does not seem to have had a great role to play since catching these discrepancies falls within the auditor's ambit, with ordinary shareholders having to trust audited accounts.

Hence shareholder activism was not completely missing. Shareholders did raise their voice against the proposed deal to purchase two companies from the ex-Chairman's



For leading organizations decision based information is based around daily / weekly information on progress within the organization's critical success factors (CSFs). In one company the senior management team have a 9 o'clock news report every morning followed by further weekly information. At the monthly management meeting to discuss results even the HR manager is able to take a shot at guessing the month end result.

family - which eventually led to the revelations about accounting misstatement. Indeed, Mr. Raju has admitted that the proposed Satyam-Maytas deal was the final attempt to plug the hole in the balance sheet.

Nevertheless, it appears that this act of shareholder activism came too late, and was only triggered by a questionable deal concerning a related party. During the time Satyam was reporting excellent profits; shareholders were content to reap the benefits and only raised their voices when it was already too late. An analysis of the Satyam case suggests that shareholders only became active after seeing signs of mismanagement and remained inactive during periods of high profitability and Satyam had a remarkable history of declaring higher profitability year after year.

Shareholder Activism- Global Perspective

'Shareholder Activism', as understood globally, is considered a tool of corporate transparency at the behest of the shareholders of a corporate entity. The roots of shareholder activism can be traced to the United States, where it is believed that the infamous stock market crash of the late 1920s was caused in significant part by companies' lack of transparency. Post the market crash, the Securities and Exchange Commission (SEC) was formed through The Securities Act of 1933 and 1934. The purpose was to create public disclosure and enforcement mechanisms to guard shareholders and encourage the dissemination of reliable corporate information.

In recent times 'shareholder activism' has largely been linked to two particular traits, namely; *Socially-Oriented shareholder activism* and *Corporate Governance* activism. Socially-orientated activism generally deals with shareholders' concerns about social responsibility issues. These issues are wide ranging and stem from religious/political beliefs of the shareholder community. The notion of ethics and integrity being maintained in all corporate activity at the demand of the shareholders is integral to the idea of socially-responsible shareholder activism.

Corporate Governance activism is the trait most likely missing in the Satyam case as well as other high profile accounting cases like Enron. Even in the context of discussing shareholder activism in Pakistan, it is the Corporate Governance side of shareholder activism which should be considered for discussion.

Shareholder activism- Pakistan Perspective

Keeping in mind the Satyam case, key questions warranting an answer from stakeholders are:

- Whether a case like Satyam could happen in Pakistan and if the answer is in affirmative,
- Can shareholder activism prevent or detect it from happening in a timely manner?

With respect to shareholder activism, the following need to be examined before these questions can be answered.

Free Float

The free float of the listed shares remains low as sponsors keep their shareholdings well above the simple majority. The free float of the market is around 20%. In this backdrop the minority shareholders do not get any representation on the board. Even if one or two seats do come their way their power to participate/prevail upon in the policy discussion remains weak, thus limiting their powers to have any significant bearing in the context of preventing or detecting any foul play.

On the flip side this practice and psyche of sponsors of keeping higher shareholding of listed companies within the group acts as a measure of risk sharing. However, in the case of Satyam it may be noted that the sponsors were not holding sizeable shareholding in the company.

Individual Shareholder

There is also a tendency among Pakistani investors to keep a short term view of the market. Generally, 'small investors' do not keep a long-term and dividend orientated view of their equity investments. With quick gains desired, their focus is least likely on the company itself, as a result of which minimal shareholder activity is seen in Pakistan. The psyche of the individual shareholder is not to hold any particular scrip for an extended period, rather they prefer switching from one scrip to another on the premise that active trading will earn them larger capital gains. In this regard, small shareholders in Pakistan do not really see themselves as part owners of the company whose share they hold.

Institutional Shareholder

It is disheartening to note that nominee directors of corporate and mutual fund industry have not taken over the role of whistleblower on detecting any foul play. Their presence on the board is mainly ceremonious and restricted to attending board meetings and at the most protecting their company's interest in achieving a block deal with the sponsors at a price which has historically been way above the market price for the particular stock because of low float in the scrip.

In my view their inactivity and disinterest causes more harm than good since their presence (on the boards of prestigious organizations they represent) lends credence to the misdeeds of the sponsors.

Minority Shareholder Legislation

In Pakistan there exists a minimum limit for seeking solution from court against cases of mismanagement under the Companies Ordinance, 1984. For that to happen at least twenty percent of the shareholders will have to take the initiative. Luckily, however, there is really no restriction to refer a case to the regulator and that too in a most cost efficient manner.

The investment horizon for minority shareholders is usually less than one year as they prefer churning their portfolios for earning better returns. So, holding minority shareholders responsible for detecting fraud may be asking too much from them even if they suspect unfair and malafide practices in their investee company.

These are the main reasons why shareholders don't really care when the going is good.

Would shareholder activism actually unearth and bring the fraudulent activities to limelight? It appears that shareholder activism does not seem to work when the going is good and only becomes active when something is blatantly wrong. That said, it appears that enforcement division of SECP and the auditing discipline are the only vehicles capable of arresting fraudulent activity in Pakistan's context since shareholder activism is generally subdued and confined to AGMs only where response is pretty lukewarm.

In Pakistan, many fraudulent acts have been unearthed by whistleblowers, bringing the story to limelight and appropriate actions have been taken by the regulators. Some pertinent cases making news, where management was involved in deceiving shareholders through various manipulative ways, are cited below.

Shareholder Activism - Some Corporate Fraud Cases in Pakistan

Year	Name of Company	Fraudulent activities	Whistleblower
2006	Ahmed Spinning Mills Ltd.	Sale of shares of United Sugar Mills Limited	SECP
2008	Norrie Textile Mills Ltd.	Huge difference in eligible securities in CDC and paid-up capital	CDC
2005	Islamic Investment Bank Ltd.	Misappropriation of bank guarantee	Client/SECP
2008	Haseeb Waqas Sugar Mills Ltd.	Related party transactions	Auditors
2007	CallMate Telips	Inaccurate revenue recognition policy	Auditors
2008	Bank of Punjab (BOP)	Non compliance in lending	Internal auditors

Case I: Ahmed Spinning Mills Limited in the case of sale of shares of United Sugar Mills Limited

The case was brought to light by the SECP itself. Ahmed Spinning Mills Limited sold shares of United Sugar Mills Limited to Clearshore Limited, a UK based company, at PKR16 per share. The shares were then sold to JDW Sugar Mills Limited at PKR333.33 per share. Clearshore was able to make PKR213 million from the said transaction in a short span of one year. This irregular transaction was detected by the officers of the Commission. Later, it was revealed that the management of Ahmed Spinning owned Clearshore. The Commission directed JDW to deposit the amount to the Commission as it belonged to shareholders of Ahmed Spinning, which was upheld by the Honorable Court.

Case II: Norrie Textile Mills Limited

On intimation by the Central Depository Company (CDC), the SECP noted the existence of share fraud in the accounts of M/s Norrie Textile Mills. The eligible securities in Central Depository System (CDS) and paid-up capital report stated in accounts disclosed huge differences; Paid-up capital of PKR48.6 million was reported in the quarterly accounts for the period ended March 31, 2008, while eligible securities of PKR598.6 million were registered in CDS. These differences coupled with unusual trading pattern transpired that counterfeit shares of the company were in circulation in the market. The decision by the regulator of this case is still pending.

Case III: Islamic Investment Bank Ltd. (IIBL)

A financial scam of PKR634.4 million, moved forward by the Client/SECP, was unearthed implicating 20 high-profile executives including the president and directors of Islamic Investment Bank Ltd (IIBL) and a former registrar of the Supreme Court. The 22 high-profile figures were found involved in embezzling a bank guarantee of PKR634,393,898 given by Fecto Belarus Tractors to the Supreme Court. Former registrar of the Supreme Court was accused to have misappropriated the money in connivance with the president and directors of the Islamic Investment Bank Ltd.

Case IV: Haseeb Waqas Sugar Mills Limited

The auditors brought to the notice of the SECP that the directors were in breach of Section 208 of the Ordinance and ongoing default from 2004 to 2007 in respect of the investments made in the associated concerns. After going through the facts, the Commission established that the directors had contravened the provisions of Section 208 and had invested funds without prior authorization of the shareholders, for which one of the directors was fined and other directors were instructed to remain vigilant in the future. The Commission also directed to bring the extracts of all transactions with associated undertakings to the notice of the shareholders.

Case V: CallMate Telips

Rifts surfaced between CallMate and its auditor regarding CallMate's revenue recognition policy. The auditor declined to book the revenues on the basis of sale of cards (a practice which was being followed for the last four years) without having to wait for usage of these cards. The auditor noted that it is a common practice worldwide and in Pakistan that the revenues are booked on the basis of sale of prepaid cards and not on their usage, as according to a survey 25% of the prepaid cards are never used.

Case VI: Bank of Punjab (BOP)

Within the financial sector, the scandal at Bank of Punjab is relatively recent. Despite internal auditors' warnings that some loans exceeded limits and the borrower did not satisfy all requirements, bank management failed to take action. As a result, BOP's CY07 accounts carried an auditor's qualification which subsequently led to a change in bank's management. The particular loan in question is still outstanding, and has been restructured. Shareholder activism has been largely silent on this issue despite BOP share price collapsing from more than PKR100/share to just above PKR10/share.

Conclusion

Hence, it may be argued that Satyam like cases can and will continue to happen around the globe, and in Pakistan, unless proactive role is played by all stakeholders including shareholders and regulators.

Satyam: Accounting Fraud and Audit Aspects Visited

Khawaja Amjad Saeed, FCA

Satyam's Accounting Scam and Related Aspects

The Confession

An eye opening confession came from Chairman, Satyam Computer Services Limited, Hyderabad, India in a letter consisting of 1080 words addressed to the Board of Directors of the above company on January 07, 2009. Facts brought to the notice of Board of Directors are reproduced below:

1) The balance sheet carries as of September 30, 2008 the following:

   a) Inflated (non-existent) cash and bank balance of Rs. 5,040 crore (as against Rs. 5,361 crore reflected in the books)
   b) An accrued interest of Rs. 376 crore which is non-existent.
   c) An understated liability of Rs. 1,230 crore on account of funds arranged by me.
   d) An overstated debtors position of Rs. 490 crore (as against Rs. 2,651 crore reflected in the books)

2) For the September quarter (Q2) was reported a revenue of Rs. 2,700 crore and as an operating margin of Rs. 649 crore (24% of revenues) as against the actual revenues of Rs. 2,112 crore and an actual margin of Rs. 61 crore (3% of revenue). This has resulted in artificial cash and bank balances going up Rs. 588 crore in Q2 alone".

In the above letter, the founder of the above company suggested as under:

> "You may have restatement of accounts'' prepared by the auditors in the light of the facts that I have placed before you".

Copies of the above letter were marked to Chairman, Securities & Exchange Board of India (Sebi) and stock exchanges of India.

Unlike several previous global financial frauds, Satyam is a unique and self-confessed financial fraud.

The founder of Satyam confessed inflating for the past several years with fictitious assets and non-existent cash. He said that about $ 1.04 billion (94% of cash) listed in assets at the end of company's second quarter in September 2008 was fictitious.

Objective of Financial Scandal

The aim was duping investors through manipulating information. This has tarnished the image of India and has sent shock waves globally regarding conduct of affairs in corporate sector in India. This needs to be reversed and true image of excellent conduct of corporate affairs needs to be developed and later capitalized.This Piece focuses its attention primarily on accounting and auditng aspects.

Accounting Fraud

The accounting fraud in Satyam Computer Services Limited is generally believed to be much bigger than Rs. 10,000 crore. This figure appears to be much higher than the one disclosed by the company's founder, Ramalinga Raju.

The investigating agencies have retrieved over 7,000 fake invoices and forged documents showing fixed deposits and bank balances. Initial investigations have revealed that the scam is over Rs. 9,600 crore. It may be noted that on January 07, 2009, Mr. Raju had disclosed the scam to be Rs. 7,800 crore.

Heavy reliance on computer technology helped the company generate nearly 7,000 fake invoices aggregating to a total of Rs. 4,500 crore. This amount was fed through computer in Satyam's books of accounts. Accordingly, the above inflated figures were reflected in the financial statements prepared by management under the supervision of Mr. Raju. Moreover, fake fixed deposit receipts for Rs. 3,300 crore were also created through forged documents.

CBI is investigating the biggest accounting fraud in India's corporate history. They have been joined by a 23 member team comprising officials from CBI, Income Tax Department, Registrar of Companies, Sebi, Serious Fraud Investigation Office (SFIO), Institute of Chartered Accountants of India, Institute of Cost and Works Accountants of India and some legal experts to conduct the investigation. The biggest misfortune is that the Satyam scam has dented India's image abroad which was gaining popularity as India Inc.

Indian Government's Views

The Government of India stands worried due to financial scam of Satyam. The honourable Prime Minister of India held several meetings with various stakeholders including regulators, prominent industrialists etc. Mr. Kamal Nath, Indian Minister of Commerce of India said that: "The government should only look at the regulatory part of it".

Corporate Governance

Corporate governance is expected to ensure checks and balances relating to management of a corporate entity. Satyam has been claiming to have implemented corporate governance in good spirit. Accordingly, the World Council of Corporate Governance awarded Satyam its "Golden Peacock Award for Corporate Governance" in 2008.

This raises fundamental question of rethinking and redesigning the criteria for the above award to ensure effective corporate governance. There is a further need to revisit Sarbanes - Oxley legislation to help avoid fraud like the one that took place in Satyam.

Audit Aspects

Questions Raised

The investigating agencies have raised many questions. Some of these questions have been as under:

a) How come year after year accredited auditors could not smell something fishy?

(b) If indeed they have not been able to do so, how effective have they been in auditing?

(c) What were the statutory auditors and the independent directors of Satyam Computer Services Limited doing while this massive fraud was taking place?

(d) Strong action must be initiated by the regulatory authorities against the statutory auditors and independent directors.

Audit Style

It is generally believed that all the top firms of the world have high quality standards for conducting audit. Sample testing procedures are followed. If the same fail to meet the expected results extended checks are performed. According to Bloomberg, based on information available, the local unit of PwC said in a statement that Satyam accounts were supported by "appropriate audit evidence".

Institute of Chartered Accountants of India (ICAI)

The Institute of Chartered Accountants of India is a well respected six decades old professional accounting institute and is headquartered in New Delhi. It is the second largest accounting body in the world with 145,000 members. Being a member of the International Federation of Accountants (IFAC), it is in the process of introducing International Financial Reporting Standards (IFRS) in India. PwC uses IFRS and its client Satyam is said to be one of India's first companies to maintain accounts in this form.

ICAI President, Ved Jain told the media that, " We are examining it on high priority and strict action will be taken against auditors, if found guilty." He further said that, "If found guilty of professional misconduct, the Auditors stand to lose their Practising License."

New Auditors

The new Board of Directors of Satyam Computer Services Limited has mandated two global auditing firms namely; KPMG and Deloitte to restate accounts of the above company. It is interesting to note that even the original company's auditor Price Waterhouse has stated that its auditing of Satyam's book should not be considered reliable as they were based on statements and information provided by the management. It may be noted that under the Company Law of various countries, including that of India, the prime responsibility for the preparation of accounts and financial statements rests on management. It is expected that the management ought to prepare financial statements to exhibit true and fair view of the state of affairs of the company on which external auditors will express their opinion. However, investigations are going on and we have to wait for the results.

Policy Recommendations

Legal and Moral Aspects

The 19th century English case namely, Kingston Cotton Mills Company Ltd. (1896) may be revisited. Lord Justice Lopes stated: “The auditor is a watch dog and not a bloodhound”.

The responsibility for preparation of financial statements essentially vests upon management. An auditor expresses an opinion about the fairness or otherwise relating to duly certified financial statements. The management needs to be reminded about this time and again. In this respect, sound internationally accredited values system to strengthen moral aspects be popularized, disseminated and operationalized. Divine Value System from Quran is quoted below:

“Allah commands justice, the doing of good, and liberality to kith and kin, and He forbids all shameful deeds, and injustice and rebellion: He instructs you, that you may receive admonition.” (16:90)*

Regulators

There is a need to revisit legislative aspects of regulatory agencies and also man them with highly competent and qualified personnel. The regulators must follow both approaches:

Preventive approach: This may involve the enactment of special legislation which should make accounting misstatement a crime and be given stringent penalty.

Palliative approach: This would involve measures to take Satyam like case by introducing new process and additional verification methods. This is needed to inspire investor confidence.

IFRSs

IFRSs should be strictly implemented. The implementation should be made mandatory across the board by the management through strict legislative measures which governments through guidance of professional accounting bodies ought to take. The role of recently established Oversight Board by IFAC be strengthened and made result oriented.

Audit Evidence

No cash be allowed to be kept on hand on the closing date of accounts. It should be deposited in bank. Accordingly there will be no need to verify cash on hand by auditors. Difficulty arises when a client has several branches / offices spread over geographical basis. Accordingly, it becomes difficult for an auditor to visit all branches / offices and physically count the cash.

Verification of bank balances be made directly from banks in a strictly confidential manner, with approval of client. Special efforts be made for double check in case of significantly material amounts to avoid collusion between the client and the bank even in the case of direct receipt of bank certificates.

Significant amounts of debtors be verified through circularization of accounts and their subsequent collection.

In services sector, including BPO, invoices be checked against actual services rendered rather than relying on invoices alone. This can possibly reduce the chances of raising fake invoices. Forensic audit will uncover actual amount of fake invoices raised in Satyam during the current ongoing investigation.

Verification procedure through audit evidence needs to be revisited, redefined and strengthened. One may benefit from any weakness or lapse ascertained during investigations of Satyam's accounting records and financial statements.

Joint Auditors

In large clients, the appointment of joint auditors may be considered mandatory for mutual check.

Management Responsibility

An auditor will examine financial statements prepared by management who ought to take primary responsibility for their preparation and their authenticity. This message needs to be hammered home clearly and loudly.

IFAC

IFAC may revisit International Auditing Standards together with oversight responsibilities and help develop systems of audit to inspire confidence of users of financial statements to improve investment climate and strengthen capital markets to play positive and productive role. Oversight Board set up by IFAC may take Satyam as a test case and initiate steps to uncover the fraud in the above company.

Feedback

As the investigations are continuing in the self-confessed accounting fraud and manipulation in the financial statements, we need to wait for the results. In the light of these results, positive feedback be used to revisit the existing accounting and auditing systems and legislative aspects to introduce reforms to help avoid recurrence of Satyam.

Top Twenty Mistakes

Corporate Accountants Make

The top twenty blunders the corporate accountant has made since Luca Paciolo first wrote in 1494 about double entry book keeping

David Parmenter

As a failed corporate accountant, by that I mean I had to organize my own 'leaving do', I feel particularly well qualified to write this article. I have, however, discovered many better practices from accountants across the world as that is what I do for a living. The twenty major blunders, since Paciolo sent us on our way, are randomly listed below.

1. Having over 80 account codes for the P/L

Show me a company with less than 60 account codes for their P/L and I will show you a management accountant who has seen the light. However, I have seen many chart of accounts with more than 300 expense account codes in the G/L, with up to 30 accounts for repairs and maintenance!

Why is it that the least experienced accountant volunteers for re-setting the chart of accounts? I think I know the answer. All the wise owls duck for cover. Yet, the chart of accounts sets the Finance team up for disaster in many ways. It determines how we report and set targets.

Common sense goes out the window, the CFO's eyes just glaze over at the chart of accounts in progress meetings, the objective to reduce the account codes by over 40% gets lost, and slowly but surely, just like the budget instructions, the chart of accounts takes on a life of its own.

Action:
Do not breakdown costs into a separate account unless they represent at least 1% or greater of total expenses. This will reduce your costs to somewhere between 40 to 60 account codes.

Do not break revenue in separate codes unless revenues represent over 3% or greater of total revenue. This will reduce your revenue to somewhere between 15 to 20 account codes.

Have larger buckets and when you are asked a stupid question ask them what decision is going to be made based on the information requested or tell them the answer is '42'. A skilled management accountant can always investigate 6 weeks of expenditure and then annualise the number. Remember: Whatever the answer is, you can assume it is a true and fair view. Besides, nobody else is going to follow you into that canyon.

2. Only Forecasting to Year-End

Typically corporate accountants have to monthly reforecast the year-end numbers. This is flawed on a number of counts. Firstly, why should one bad month or one good month translate into a change of year-end position? We gain and loose major customers, key products rise and wane, this is the life cycle we have witnessed many times. Secondly, the forecast is a top-top forecast with little input and no buy-in from the budget holders. Thirdly, two months before year-end management appears to ignore the oncoming year. Fourthly, management and the Board know what ever number you have told them is wrong. You will change it next month.

Action:
Forecast quarterly six quarters ahead using a planning tool (not Excel) as it is a commonly accepted better practice. The trick to this rolling forecasting is to make it a fast light touch, so managers can do it quickly. Quarters 2 to 6 are not the important ones. The key is to get quarter one correct.

3. Investing in a complex G/L and upgrading unnecessarily

If I owned an accounting package company I too would be issuing upgrades every time I wanted to improve my bottom-line. I cannot understand that accountants who, and I include myself here, are notoriously 'careful with money' waste money on G/L upgrades, or worse invest in a more complex G/L. Yet corporate accountants will spend hundreds of thousands on a G/L package where the core services could be delivered for a fraction of the investment.

Who do you think designed these complex G/L monsters? Do you think it was a bunch of CFOs with many war stories between them or was it some young guns, under thirty, who have never *fired a gun in anger*? I mean this figuratively. No accountant with grey hair, who has worked in industry, would have given birth to such monsters. The task of the G/L is very simple, recording the expenditure and revenue. Nowadays the G/L is not required to report the numbers, hold budget figures or be the enquiry tool. These are all done by user friendly tools. I jokingly say that there are only ten experts in SAP who know all the on/off switches and I am often pulled aside by experienced implementers who say I have overstated the number.

I came across a CFO who is managing a FTSE 500 company who uses MYOB, a $500 package. He quite wisely said, "Why should I spend more? The only users of the G/L are my management accountants. We have an analysis tool for budget holders to access their accounts. We have a planning tool for forecasting and reporting against actual. Besides, changing the G/L writes-off some of your experienced staff for three to five months achieving an 'own goal'. Tell me when you last received a thank you from the budget holders for implementing a new G/L?"

Action:
You really only need to acquire a new G/L if your existing G/L does not support 21st century accounts payable options.

Stick with your existing system, maximise its use especially all the accounts payable features such as storing scanned images of invoices, electronic ordering and receipting etc.

Excel has no place in reporting, forecasting, budgeting and other core financial routines. Excel was never intended for the uses we put it to.

4. Letting Excel dominate the finance system

I bet that not in his wildest dreams had Bill Gates ever thought Excel would become the core financial system in many companies and that the models would reach gigantic proportions. This epidemic has a cure. It is called a moratorium of new Excel models and a deadline to remove the rest that are used daily, weekly or monthly in deriving the numbers.

KPMG have said that for every 150 rows of a spreadsheet there is a 90% chance of a logical error.

Let's face it. Excel is great for doing a diagram, doing a one-off costing, being a table of numbers. It is not, and never should have been, a forecasting or reporting system.

Excel has no place in reporting, forecasting, budgeting and other core financial routines. Excel was never intended for the uses we put it to. In fact many of us would be using Excel for the space program if we worked for NASA and would probably have a good go at it. I would not like to be the astronaut in outer space finding out that there is a 90% chance of a logical error for every 150 rows in the workbook.

Action:
We need to embrace the new tools that are available. These include:

- a drill down tool so budget holders never need to look at the G/L
- a planning tool for forecasting and recording the annual plan
- a reporting tool to replace the procedure of dumping the monthly numbers to the G/L
- balance scorecard tools for displaying performance measures

The annual planning process may have worked for Julius Caesar, but it doesn't work for corporate accountants. The nightmare of three to four months arguing over resource allocation when nobody knows the answer, the endless cutback rounds, the game playing, the 'spend it or loos e it' mentality does not befit the accountant of the 21st century.

5. Doing another annual plan --- just like the last one

The annual planning process is not adding value, instead it is undermining an efficient allocation of resources, encouraging dysfunctional budget holder behaviour, negating the value of monthly variance reporting and consuming huge amounts of time from the Board, senior management team, budget holders, their assistants and, of course, the finance team.

When was the last time you were thanked for the annual planning process? At best you have a situation where budget holders have been antagonized; at worst, budget holders who now flatly refuse to co-operate.

Like laboratory rats we go do the same pathway each year to find that there is no cheese, no passing 'Go' and collecting £200, just mayhem. The annual planning process may have worked for Julius Caesar but certainly not for us.

The nightmare of three to four months arguing over resource allocation when nobody knows the answer, the endless cutback rounds, the game playing, the 'spend it or loose it' mentality does not befit the 21st century. The only things holding us back as corporate accountants from making this change are:

- committing time to understand the solution
- learning how to sell change
- finding the gap in our busy workload to make it happen

Action:
Jeremy Hope of *Beyond Budgeting* fame was the first to write about the extermination of the annual plan. To test the hypothesis that organizations would thrive without an annual plan he went about searching for organizations that have never had the process in the first place. These organizations exist and are thriving. The Beyond Budgeting movement has many converts. The best place to start this journey is to read Jeremy Hope's work.

6. Breaking down the annual plan into twelve before the year starts

As accountants we like to balance things. It is neat and tidy. Thus, it appeared logical to break the annual plan down in to twelve monthly breaks before the year had started. We could have been more flexible. Instead we created a reporting yardstick that undermined our value to the organization. Every month we make management, all around the organization, write variance analysis which I could do just as well from my office in New Zealand. 'It is a timing difference….', 'We were not expecting this to happen', 'The market conditions have changed radically since the Plan' etc.

Action:
If you still need to perform an annual planning process you can at least remove the need for twelve monthly targets arising from this process. You should instead report against more recent targets derived from quarterly rolling forecasting process. This change has a major impact on reporting. You will no longer be reporting against a monthly budget that was set, in some cases 17 months before the period being reviewed.

7. Giving budget holders an annual entitlement

Doing an annual plan is daft enough but to compound it with asking budget holders what they want and then, after many arguments, giving them an 'annual entitlement' to funding is the worst form of management we have ever presided over.

I use the example of portioning out a birthday cake at a nine year old's birthday party to explain the stupidity of an annual plan. A clever parent says to the other party guests, “Here is the first slice. If you finish that slice and want more, I will give you a second slice.” What we do in the annual planning process is divide the cake up and portion all of it to the budget holders. Like nine year olds, the budget holders lick the edges off their cake so even if they do not need all of it nobody else can have it. Why not instead, like the clever parent, give the managers what they need for the first three months and then say, “What do you need for the next three months?” and so on. This way, you can apportion the amount each time that is appropriate for the current conditions.

Action:
The better practice is to say to a budget holder that we are aware of your annual request but will only fund you for what you need to run the next quarter. This small but significant change means:

- 'Spend it or lose it' can no longer work; budget holders find it nearly impossible to hide their reserves in the next three month period
- budget holders are encouraged to seek funding for initiatives that were not in the annual plan, as long as they have a sound fit with the organisation's strategic objectives
- budget holders will be weaned off asking for an annual entitlement they do not need, or may not need, when they know there's no point participating when the real action occurs once a quarter, just before the new quarter starts.

8. Budgeting at account level code

What ever made accountants conceive the notion that we needed to set targets at account code level? Since it was done by our forefathers, we duly followed in their well trodden steps. It makes no sense.

Having budgets at account code level has encouraged budget holders to allocate expenditure to an account that has room for it. Thus, at a single stroke it undermines the purpose of the G/L which is to account for costs and revenue in the right areas.

Do you need a target or budget at account code level if you have good trend analysis captured in the reporting tool? I think not. We need to apply Pareto's 80/20 rule and establish a category heading which includes a number of G/L codes.

Action:
Limit the number of categories in a budget holder's (BH) budget to no more than twelve. Have a budget category line if the account code is over 10% of the total, for e.g. show revenue line if account code is over 10% of the total revenue. If the account code is under 10%, consolidate it with other account codes until it forms a category representing over 10% of the total.

Map the account code expenditure history to these categories - a planning tool can easily cope with this issue without the need for a revisit of the chart of accounts.

9. Producing numbing monthly financial reports

Many management reports are not a management tool; they are merely memorandums of information. Too many of our reports are issued well after the horse has bolted. As a management tool management reports should encourage timely action in the right direction, by reporting on those activities that the Board, the management, and the staff need to focus on.

Many monthly finance reports, prepared by the finance team, are never read. They include endless detail, often a result of having a common template for all subsidiaries regardless of size. The result is a consolidated pack with a four to five page essay, consolidated numbers, and a copy of each subsidiary's submission. I once saw a 140 page pack.

Action:
Reduce the finance pack down to fewer than ten pages. Eliminate the essay and simply have a small comments box on each statement. Only have one page to summarise the subsidiaries results and only include the large ones and any

others that are in trouble. Small subsidiaries that are performing well do not need to be included in the pack.

Educate and engage with senior and middle management. Find out and assess what they really need to manage the business, and ruthlessly eliminate the eye sight ruining and worthless pages that engineers and middle management are so fond of.

Quote from a wise CFO

10. Reporting on the wrong performance measures

Many companies are working with the wrong measures, many of which are incorrectly termed key performance indicators (KPIs). For many years accountants and other senior officials, with a spare afternoon at hand, have sat down and thought up another suite of measures. This has lead to a potpourri of performance measurement and reporting that has done nothing for the organization. None of these measures were in anyway tied to the critical success factors of the organization.

From my research, very few organizations really monitor their true KPIs. The reason is that very few organizations, business leaders, writers, accountants, consultants have explored what a KPI actually is. From the extensive research I have performed and as a by-product of the years of writing a book on KPIs, I have come to the conclusion that there are four types of performance measures:

- key result indicators (KRIs) - give an overview on past performance and are ideal for the Board as they communicate how management have done in a critical success factor or balanced scorecard perspective
- performance indicators (PIs) - tell staff and management what to do
- result indicators (RIs) - tell staff what they have done
- key performance indicators (KPIs) - tell staff and management what to do to increase performance dramatically.

Action:
If you wish to gain more insight on the subject, you might want to read these two books:

Robert Kaplan & David Norton, T*ranslating Strategy into Action: The Balanced Scorecard*

David Parmenter, *Key Performance Indicators - Developing, Implementing and Using Winning KPIs*

Many initiatives driven from the finance team fail because we attempt to change the culture through selling logic, writing reports, issuing commands via email. It does not work.

11. Selling change by logic

Nothing was ever sold by logic!! You sell through emotional drivers. Remember your last car purchase. The car sales person, as they make their way towards you weigh up what might be your emotional drivers. To a 23 year old IT geek, they will point out the 180 BHP, the low profile tyres, and say," This car needs to be driven by an excellent driver as it is quite dangerous." To me, having spotted the grey hair, they will point out the six air bags and say, "This car has enough power to get you out of any trouble you find yourself in, and you will never loose traction with those tyres." To a Gucci lady they might say, "Sit inside and look at the quality of the décor, it has been designed by Tom Ford." These three buyers have all been shown the same car.

Many initiatives driven from the finance team fail at this hurdle because we attempt to change the culture through selling logic, writing reports, issuing commands via email. It does not work.

Action:
We need to radically alter the way we pitch a sale to the senior management and the Board. We first have to make sure we have a good proposal with a sound focus on the emotional drivers that matter to them. We then need to focus on selling to the thought leader on the senior management and Board before we present the proposal. This may involve informal meetings, sending copies of appropriate articles, telling better practice stories etc. to arouse interest.

All major projects need a public relations (PR) machine behind it. No presentation, email, memo, paper related to a major change should go out unless it has been vetted by your PR expert. They are experts on emotional drivers. All your presentations should be road tested in front of the PR expert. Your PR strategy should include how to sell the change to staff, budget holders, senior management and the Board.

12. Allowing month-end reporting to go past three working days

Is your team one of the many who are sucked in by processes that have more in common with the Charles Dickens era than the 21st century? When I was a corporate accountant each month end was a disaster waiting to happen. Each month end had a life of its own. You never knew when and where the next problem was going to come from. Always two or three days before we seemed to have it under control and yet each month we were faxing (email was not on the scene, yet) the result five minutes before the deadline. We'd keep our fingers were crossed as a series of late adjustments meant that the quality assurance work we had done was invalid and we did not have the luxury of doing it again. Does this sound familiar?

Quick month end reporting has been around since the early 1990s when far seeking CFOs started looking at the concept of 'day one' reporting. However, this has been superseded by those who have developed systems capable of giving the CFO a full accrual net result at any time during the month. The virtual close, as it is called, is reputedly performed by CISCO, Motorola, Oracle, Dell, Wells Fargo, Citigroup, JP Morgan Chase and Alcoa.

Up to 70% of a corporate accountant's time is spent on month end reporting, the annual accounts and the annual planning process. I call these three activities the *trifecta* of lost opportunities for the accounting team. You need to attack the month-end first.

13. Spending months on the annual accounts

The annual reporting, whilst an important legal requirement, does not create any value within your organization. Thus seldom is it a task where your team has received any form of gratitude in the past. Accounting functions need to find ways to extract value from the process while at the same time bringing it down into a tight time frame.

How many times has the final year end audited number been within 5% of the month twelve number? We spend far too much time chasing our tail. There is absolutely no reason in 99% of the cases why the 'first cut' of year end for internal reporting should not be the same as the last cut for external reporting.

Allowing the auditors the luxury of a leisurely year end sign-off based around their workload provides them with many months of hindsight where unrecorded liabilities and the like are there for all to see. It is daft to hang the dirty washing out for that length of time.

Action:
Make it a level playing field and request a sign-off within 15 working days from year end.

14. Using Julius Caesar's calendar as a reporting tool

Julius Caesar gave us the calendar we use today. It is not a good business tool because it creates 12 dramas a year for the finance team and budget holders, with each month being slightly different.

Each year, between three and five months will end on a weekend, and finance teams often find that the month end processes are smoother for these months. Why not close off on the last or nearest Friday/Saturday of every month like many U.S. companies do? The benefits of this include precise four or five week months which make comparisons more meaningful, and there is less impact on the working week as the systems are rolled over at the weekend.

Otherwise every month is a drama because we close on a different calendar day. Every month we have to issue detailed instructions which effectively says, "What you did on Wednesday last month please do on Thursday, what you did on Thursday…." and so on.

Closing off at the weekend can be done for all sectors. Some will require more liaison than others. It would also make a big difference in the public and not-for-profit sectors. You simply present June's result and balance sheet to the Board. You do not need to highlight the July 2nd close. At year end the missing two or extra two days of income and balance sheet movement will be taken up in the auditor's 'overs and unders' schedule.

By making this change you are beginning to create 12 non events a year, the *El Dorado* of all corporate accountants.

Action:
Contact your G/L provider and ask who uses our G/L and closes on a set day each month? They will link you to them and you will see the benefits first hand. Choose which day. It is best to be the nearest day rather than the last Friday or Saturday to month end etc. The last Saturday can have you closing six days before month end, whereas the preferred option of nearest Saturday will only be a maximum of two working days out.

Just do it! And you will see how easy and beneficial it is.

15. Letting emails dominate our day

Why do we accountants need to check our emails 24/7? Are we that important that checking our inboxes at the weekend, at a friend's party, while we are having quality time with our children is so essential? The fact is that nobody dies or risks death because they have not checked their emails. If you want to be that important to the human race you should retrain as a paramedic, a nurse in the emergency ward, or a surgeon.

Checking your emails first thing in the morning is the most destructive habit you can have. You have guaranteed loosing at least one hour getting nowhere, really.

Action:
Take up this challenge for eight weeks. Check your emails two or three times during the working day, but never before 10:30 A.M. Eliminate weekend email correspondence.

16. Not investing enough resources in producing daily/weekly decision based reports

For leading organizations decision based information is based around daily / weekly information on progress within the organization's critical success factors (CSFs). In one company the senior management team have a 9 o'clock news report every morning followed by further weekly information. At the monthly management meeting to discuss results even the HR manager is able to take a shot at guessing the month end result.

I believe, as a corporate accountant, you have arrived when your management team intuitively know whether the month is a good month or a bad month enabling them to do something about it.

Senior finance people should be insisting that assistant accountant level staff be engaged with staff across the business as this is where you often find out the true story rather than the story for public consumption.

In addition there are highly intelligent people in key parts of the business with great systems and an absolute finger on the pulse of their part of the operation. So don't be a typical isolationist bean counter. Network and forge relationships with marketers, logistics, production, and be prepared to use their systems and information to add depth and quality to your forecasts. You'll get a better result, gain respect across the business and have more fun if you leverage off what's out there rather than reinventing the wheel every time. These connections need to happen at all levels of the finance team.

Quote from a wise CFO

If this networking and leveraging off other parts of the organization is ignored, the finance people will always be the first ones to be made to look like chumps when that session with senior management starts getting heated.

Action:
Corporate accountants should look at providing the following daily and weekly reporting:

- yesterday's sales reported by 9:00 A.M. the following day
- transactions with key customers reported on a weekly basis
- weekly reporting on 'late projects' and 'late reports'
- reporting some weekly information on key direct costs
- daily / weekly on the KPIs

17. Not investing enough in Accounts Payable

An accounts payable team is at the centre of an accounting function for without its smooth operation monthly accounts cannot be prepared promptly; the company does not, at any point in time, know of its total liabilities; budget holders spend too much of their valuable time processing orders and approving invoices for payment; there's low level of accuracy in the monthly accounts due to missed liabilities and posting errors etc.

Many accounts payable processing procedures seem to come from a bygone era than the 21st century. Why do we go from an electronic transaction in the suppliers accounting system to a paper based invoice? Surely, we should be able to change this easily with our major suppliers.

18. Not adopting the purchase card --- a free AP system

I understand that the average cost of the whole purchase cycle has been estimated at between US$65 - US$85 per transaction. Pretty horrific, when you realize that a high portion of your transactions are for minor amounts. The bulk of invoices can be for low value amounts, especially if consolidated invoices have not yet been organized.

Remember it costs the same to process a $10 transaction as it does a $100,000 transaction. In addition, is it appropriate to request budget holders to raise an order in your purchase order system for a $20 transaction? Surely the purchase order system would be better if it focused on the larger invoices, where 100% compliance was a given.

Purchase cards are different from a credit card and are here to stay. There are three liability options (limited to genuine business, company has sole liability and individual has sole liability). They work particularly well with high value low volume items where you are purchasing through the same suppliers as they will be able to insert G/L code information on the transaction, e.g. organizations have given their national stationery supplier the G/L code for stationery and have given them the department codes associated with purchase cards. The purchase card is certainly a way for you to take control of processing these minor value / high volume transactions where they cannot be organized through an electronic consolidated invoice.

19. Not celebrating enough!

I have come across an accounting team who were too busy to even organize their Christmas celebration. The marketing department organized it. Accountants have yet to realize that a festive occasion, a celebration is a great communication tool.

By being too busy to celebrate your achievements you are effectively saying you have nothing to celebrate.

Action:
Schedule your next celebration and make it happen. Invite members of the senior management team along.

- celebrate every project completion
- hold a staff meeting in the cafeteria once a month and buy the whole team coffee and muffins
- set up a regime where birthdays are honoured and celebrated
- take your team out to lunch or the movies
- give your staff options - movie and lunch, or an office party
- during team meetings praise and thank at least three team members

20. Getting sucked into activity based costing/ activity based management

Jeremy Hope has pointed out the fallacy of activity based costing. These systems cost a lot to put in and maintain, provide information of dubious quality, and are run 24/7 when you only need such information infrequently.

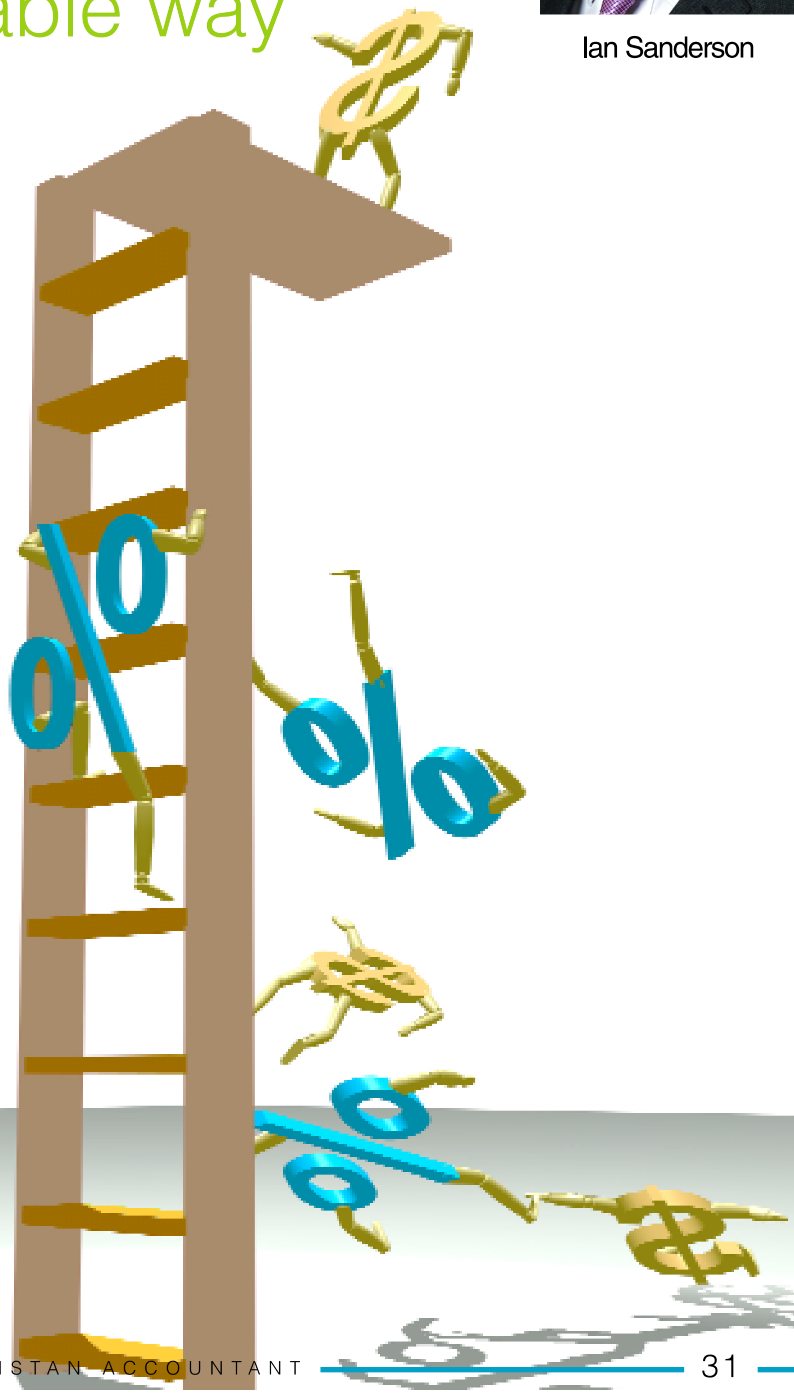
If you feel this is necessary make sure you have sorted out all the other areas I have mentioned before. After that read Jeremy Hope's work. I am sure you will start having second thoughts.

David Parmenter, FCA is an international presenter and writer. This article is an extract from his book Pareto's 80/20 Rule for Corporate Accountants. He can be contacted at parmenter@waymark.co.nz

Why accounting for the Credit Crisis must be done in a transparent and understandable way

Ian Sanderson

These are interesting times in public sector accounting. Throughout the world governments are intervening in the hope of reviving their flagging economies. Governments are cutting taxes; investing in infrastructure; providing financial support to sectors of the economy by providing liquidity; guaranteeing loans; injecting capital; purchasing assets; and, in some cases nationalising enterprises.



The global economy is linked by trade

The global economy is so interlinked that it appears impossible to be immune to the effects of the credit crisis. Countries which rely heavily on exports for economic growth such as Southeast Asian “Tiger Economies” like Taiwan, South Korea and Singapore are shrinking as overseas demand for their products contracts. Countries in the Indian sub-continent as still forecasting growth, although growth rates are falling.

Developing countries are often reliant on trade to create economic growth; money that comes from exports increases the living standards of citizens. While some economic growth is better than none, many economies need to sustain high growth rates to ensure that their economies have sufficient financial resources available to build the infrastructure necessary to support their rapidly expanding cities as people move into them from rural areas.

A weakening of economic growth also causes other potential problems. Developed countries are pushing to increase the size of the International Monetary Fund's (IMF) resources to help developing countries; they fear a fall in growth rates may cause political and social unrest. An economic crisis can quickly spread.

The global economy is increasingly linked by accounting standards

In the same way as the world is increasingly connected by trade it is becoming increasingly connected by accounting standards; this is logical because as trade increases investors and lenders want a common set of accounting standards which will allow them assess the prospects of a company in the UK just as easily as they can assess the prospects of a company in Pakistan.

Many counties are adopting International Public Sector Accounting Standards (IPSAS) which are closely aligned to International Financial Reporting Standards (IFRS). While a common set of public sector accounting standards should allow buyers of a country's debt to better assess the risks associated with it, in times of crisis when governments have to sell debt to support their economies, the extra transparency that could come from comparable financial statements may for some countries actually make debt more expensive to service. Transparency is not always desirable.

Government intervention in the credit crisis - the need for transparency

During the current global financial crisis the need for financial transparency is greater than ever. In the public sector the potential users of financial statements are more diverse than the private sector. Private sector financial statements are largely aimed at investors or lenders, who are often adept at understanding financial statements; while the potential users of public sector financial statements include citizens, taxpayers, legislatures, the media and those deciding whether to invest in government debt.

What are the attributes that make financial information useful to users? Both the IPSAS Board and the IASB, in the Conceptual Frameworks they are currently consulting on, consider the qualitative characteristics of financial information which underpin financial statements to be, relevance; faithful representation; understandability; timeliness; and, verifiability.

Many commentators believe that the current credit crisis is caused by a lack of liquidity in the economic system; many banks are simply too scared to lend to businesses at the moment in case they can't get their money back. A well functioning economy needs businesses to have access to liquidity. Governments realise that getting cash and liquidity back into the economy may encourage banks to lend again and hopefully this will lead the economy to pick up.

Bad banks

Some government are currently setting up “bad banks” where they buy the illiquid assets of a bank and put them into a government controlled special purpose entity that will then hopefully dispose of the illiquid assets at some time in the future at a profit. The hope is that by exchanging illiquid assets for cash you can encourage banks to lend again.

From an accounting point of view when the government buys these illiquid assets they will have to appear on a balance sheet somewhere, but who intervenes in the market will influence whether the interventions will appear on a government's balance sheet or not.

For example if a central bank buys the illiquid assets of a bank and puts them into a special purpose entity that the central bank controls, the illiquid assets may not appear on a government's balance sheet, while if a Ministry of Finance intervenes and sets up a special purpose entity which it controls, the assets may appear on a government's balance sheet.

Such a situation can arise because a central bank is often not considered to be controlled by government and its independence is often enshrined in legislation. To prove control would require that the government has the power to govern the financial and operating polices of a central bank and that it can benefit from the activities of a reserve bank or be exposed to a financial burden as a result of it activities (IAS 27 and IPSAS 6).

The result in terms of financial reporting can be confusing. A central bank may be best equipped to intervene in markets, but following accounting standards may actually result in any “bad bank” which is created appearing off the balance sheet of government. The result could be interpreted by users of financial reports as a lack of transparency, even though the accounting may be perfectly legitimate.

Amend an accounting standard and save $21 billion

Many commentators have blamed “fair value” accounting for much of the credit crisis; banks must typically carry sufficient risk-weighted capital to ensure they can absorb a reasonable amount of losses; however, if a bank has to mark down the value of its assets to market prices in accordance with fair value accounting it reduces the banks capital buffer and makes it less willing to lend.

One of the first countries to set up a “bad bank” during the current crisis was Switzerland, where the Swiss National Bank created a Stabilisation Fund to buy and dispose of the illiquid assets of one of Switzerland's major banks.

When the Swiss National Bank set up its Stabilisation Fund it was anticipated that it would buy US$60 billion of illiquid assets; however, as a result of amendments made to *IAS 39 Financial Instruments: Recognition and Measurement* in October 2008 it became possible to reclassify certain assets as loans and receivables without the need to value the assets at market prices. The result was that it became no longer imperative for the Swiss National Bank to buy US$21 billion of the assets it originally intended to buy.

To some degree this event supports the view of commentators who considered that fair value accounting has made the credit crisis worse; the change in IAS 39 meant that fewer assets had to be bought by the Swiss National Bank to ensure that the bank it was supporting has sufficient risk weighted capital reserves to guard against potential losses. However, the impact of this amendment could also demonstrate just how confusing “fair value” accounting can be?

Cash versus accruals accounting

Pakistan, Afghanistan, Bangladesh, India and Sri Lanka all have IPSAS projects underway or have passed legislation to adopt IPSAS. The first step in implementation of IPSAS is typically the cash basis of IPSAS, which will then hopefully lead to the implementation of a full accrual basis of accounting.

Cash accounting shows the cash flows of a period; however, the absence of a statement of financial position (i.e. a balance sheet) and a statement of financial performance (i.e. income and expenses account) means that cash information by itself is too limited to allow a reasonable assessment of the financial health of a government. Although governments which apply cash accounting tend to make up for this shortfall by publishing supplementary information that does not necessarily reconcile to the primary financial statements.

Accrual accounting can provide meaningful information both for accountability and decision-making. Financial information prepared on an accrual basis can allow users to make better balanced comparisons between alternative uses of resources, to better assess the financial position of the government, and to better evaluate a government's ongoing ability to finance its activities and to meet its liabilities and commitments.

While it is easy to spot the weaknesses in cash accounting it should not detract from the fact that even principles based accounting standards can create transparency and understandability problems.

Departures from accounting standards

One example of where accrual based public sector accounting standards may not have addressed user needs during the credit crisis can seen in the Netherlands where the Ministry of Finance now has control of many of the largest Dutch banks.

Although the Ministry has control of the banks and should consolidate them in accordance with control standards such as IAS 27 or IPSAS 6 (which are both titled, “Consolidated and Separate Financial Statements”) it has chosen not to consolidate its banking interests but will instead separately disclose them. The rationale for non-consolidation is that some of the qualitative characteristics of financial statements which make them useful to users, such as being relevant, understandable and comparable would not be met by the applying the standards and consolidating the banks into the financial statements of the Ministry of Finance.

Where next?

We are living in fascinating times. Taxpayers in all countries know that they will have to pay for the cost of the credit crisis in the future through increasing tax revenues; the interesting question is will they get to see and understand how governments have intervened in their economies in a transparent way.

Ian Sanderson is a Fellow of the Institute of Chartered Accountants in England and Wales and a specialist on IFRS and IPSAS. He works in Switzerland.

Overcoming the Challenges of Applying Fair Value Accounting in the Region in Current Financial Turmoil- Is it the best measurement?

Syed Mohammad Shabbar Zaidi, FCA

The aforesaid matter has been discussed within the context of the following parameters:

- **Financial Turmoil-An Analysis**
- **Asset Pricing**
- **Markets and Human Behavior**
- **Predictions and Analysis if this arises**
- **Government intervention in USA - Effects and Results**
- **Controversies Surrounding Fair Market Accounting**
- **Expected Difference in Outlook**
- **Sub-continent's Economies - Characteristics**
- **Suggestions**

FINANCIAL TURMOIL- AN ANALYSIS

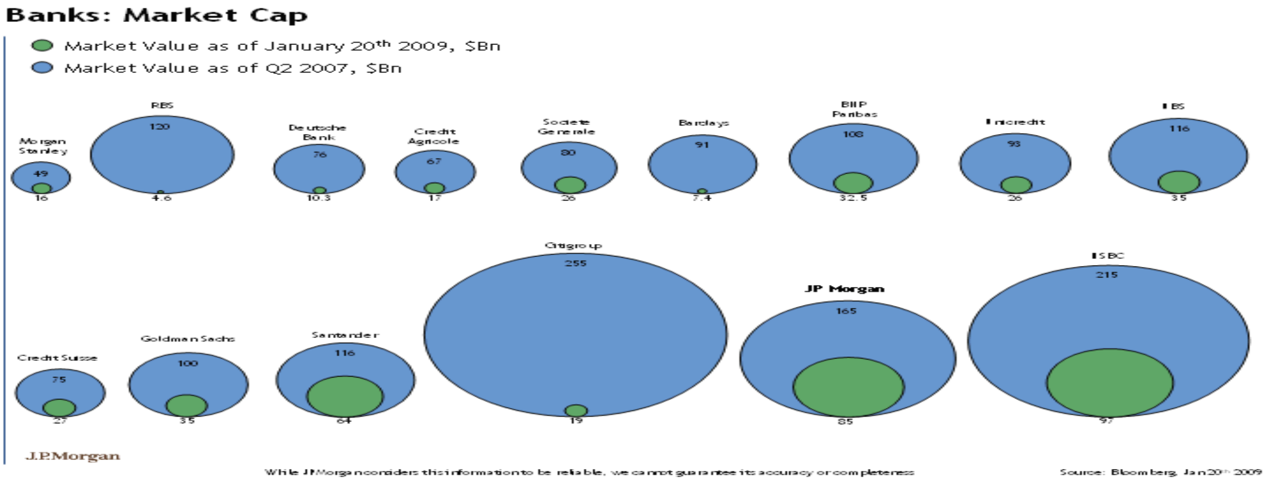
The Chinese President Wen Jiabao summarized the causes of present financial crises recently in Davos to be on account of (i) Inappropriate macroeconomic policies of some economies and their unsustainable model of development characterized by prolonged low saving and high consumption; (ii) Excessive expansion of the financial institutions in the blind pursuit of profits; (iii) Lack of self-discipline among financial institutions and rating agencies and ensuing distortion of risk information and asset pricing; (iv) The failure of financial supervision and regulation to keep up with financial innovations which allowed risk of financial derivatives to build and spread.

ASSET PRICING

This means that 'asset pricing' and 'building and spreading of financial derivatives' are being questioned. Does this mean a rollback on Fair Value Accounting? Probably,not. If yes, then we accountants have to come forward to safeguard what we believe is correct. Fair value is the preferable, rather the only option. However, the manner of determination of fair value and recording of the effects are being questioned; This is an issue which we can not ignore. Let us understand it, firstly through an analysis of present events and then the Theory of Valuation, Markets and Human Behavior.

Market capitalization has plummeted substantially. Present scenario is reflected in the following points. However, if this would have been restricted to banks the issue would have been different. Fall occurred even in those securities where there is no significant change in the underlying business assumptions and nature of operations. Even if there is a change, that was not commensurate with the fall in asset pricing. This shows that macroeconomic policies of major economies of the world, international trade considerations, and countless other factors considerably effect the financial asset's pricing in this integrated financial world.

The pendulum moves in both directions. In the past, we all saw constant upward trends. Was it a fair value ? Now in 2008, the pendulum has moved in the other direction. Is it real and fair? The question now reemerging is whether the definition of fair value being *amount for which an asset would be exchanged, or a liability settled, between knowledgeable, willing parties in arm's length consideration* necessarily and effectively means 'Stock Market Prices' for financial assets. Is there any space for deviation? Furthermore, what about other assets' valuation in our markets?



Valuation is essentially a function of economics. Is it not correct, that we accountants have taken a simplistic, rather a convenient view (which is not wrong) by adopting share market price as the only indicator specially for financial assets? With reference to our economies, does it mean that price movements in share prices due to liquidity crunch, certain other considerations and actions of market players at Mumbai, Karachi and Dhaka Stock Exchanges reflect that 'values' of such companies have eroded to the extent as are prevailing now. This is not the reality. However, it is the only reasonable measurement available at the moment. The question is whether it is a fair value. This leads to the second question whether it was fair to value such assets at exceptionally higher price in the past? Do we appreciate that there is some problem in this mechanism? Are we sure that our Balance Sheets reflected true values. Present phenomenon leads to the primary question of fair value accounting in our region, issues and concerns and the way forward.

MARKETS AND HUMAN BEHAVIOR

The reason for inherent instability of a financial system is 'Human Behavior'. The cognitive traps are:

Availability bias, which causes us to base decisions on information that is more readily available in our memories, rather than the data we really need;

Hindsight bias, which causes us to attach higher probabilities to events after they have happened (ex post) than we did before they happened (ex ante);

The problem of induction, which leads us to formulate general rules on the basis of insufficient information;

The fallacy of conjunction (or disjunction), which means we tend to overestimate the probability that seven events of 90 per cent probability will all occur, while underestimating the probability that at least one of seven events of 10 per cent probability will occur;

Confirmation bias, which inclines us to look for confirming evidence of an initial hypothesis, rather than falsifying evidence that would disprove it;

Contamination effects, whereby we allow irrelevant but proximate information to influence a decision;

***The affect heuristic*,** whereby preconceived value-judgements interfere with our assessment of costs and benefits;

Scope neglect, which prevents us from proportionately adjusting what we should be willing to sacrifice to avoid harms of different orders of magnitude;

Overconfidence in calibration, which leads us to underestimate the confidence intervals within which our estimates will be robust (e.g. to conflate the 'best case' scenario with the 'most probable'); and

Bystander apathy, which inclines us to abdicate individual responsibility when in a crowd.

PREDICTIONS AND ANALYSIS

Let us analyse what happened in the West and how it was seen earlier. Karl Marx said in 1867:

> *"owners of capital will stimulate working class to buy more and more of expensive goods, houses and technology, pushing them to take more and more expensive credits, until their debt becomes unbearable. The unpaid debts will lead to bankruptcy of banks which will have to be nationalized and state will have to take the road which will eventually lead to communism."*

Furthermore, Glass-Steagall Act of USA provided adequate regulatory framework for banking industry. Through Depository Institution Deregulation and Monetary Control Act 1980; the spirit of Glass Seagull Act was changed. At the time of change it was predicted:

1. Conflicts of interest characterize the granting of credit - lending - and the use of credit - investing - by the same entity, which led to abuses that originally produced the Act.

2. Depository institutions possess enormous financial power, by virtue of their control of other people's money; its extent must be limited to ensure soundness and competition in the market for funds, whether loans or investments.

3. Securities activities can be risky, leading to enormous losses. Such losses could threaten the integrity of deposits. In turn, the Government insures deposits and could be required to pay large sums if depository institutions were to collapse as the result of securities losses.

4. Depository institutions are supposed to be managed to limit risk. Their managers thus may not be conditioned to operate prudently in more speculative securities businesses. An example is the crash of real estate investment trusts sponsored by bank holding companies in the 1970s and 1980s.

The objective of this quotation is to highlight that the other world was built on a different structure. We are structurally different, so is China. In their case the markets are organized and close to perfection. Do we have the same? If not, then are we not supposed to take into account other indicators whilst determining fair values? We, in the region, representing largest potential resource for accounting professionals believe the system is ideal. However, the question now being raised is whether the system and models being presented are per se applicable to our economies. We would have to go back to controversies associated with Fair Value Accounting with special perspective on our region.

GOVERNMENT INTERVENTION IN USA - EFFECTS AND RESULTS

Niell Ferguson concluded his book The Ascent of Money with the following remarks:

"Every shock to the financial system must result in casualties. Left to itself, natural selection should work fast to eliminate the weakest institution in the market, which typically are gobbled up by the successful. But most crises also usher in new rules and regulations, as legislators and regulators rush to stabilize the financial system and to protect the consumer / voter. The critical point is that the possibility of extinction cannot and should not be removed by excessively precautionary rules. As Joseph Schumpeter wrote more than seventy years ago, 'This economic system cannot do without the ultima ratio of the complete destruction of those existences which are irretrievably associated with the hopelessly unadapted.' This meant, in his view, nothing less than the disappearance of 'those firms which are unfit to live'.

The question which is being raised now is, 'is there any intervention?' Yes. Fair Value effectively requires natural environment. When we have disturbed the natural system, then all its corollaries need re-examination.

CONTROVERSIES SURROUNDING FAIR MARKET ACCOUNTING

While many agree that fair value yields a more relevant measure than historical cost, it is not perfect. Two controversies surround fair value measurements today:

(a) the application of fair value accounting in illiquid markets; and

(b) how and when modeling should be used as the method to determine fair value.

Recent credit market conditions have resulted in large write-downs through the application of fair value measurements. The requirements to use fair value measurements have been criticized for producing inaccurate results in the unusual market conditions recently experienced. Such results, it is argued, hurt the company in the long run. If a company must record losses in such an environment, critics claim, it signals bad news to investors that may ultimately be misleading. Therefore, they say, it is preferable to record only realized gains and losses. This issue is very relevant to our economics. In considering this controversy, it is important to recognize that accounting principles such as fair value are developed with the objective of providing information that will best serve the interests of investors, businesses and policy makers over the long term.

EXPECTED DIFFERENCE IN OUTLOOK

The 'Economists' Outlook' has projected that:

A Competition of Misery: Global GDP figures 2009-10

	Consensus Estimate for 2009 (made in June 2008)	Consensus Estimate for 2009 (made in Dec 2008)	Worst case 2009	2010
World at ppp	3.7	0.7	0.0/-0.5	2.2
USA	+1.2	-1.8/-2.2	-2.5/-3.0	0.7/1.3
Japan	+1.5	-1.6	-2.5	0.2
Eurozone	+1.3	-1.8/-2.5	-3.5	0.6
Germany	+1.7	-2.5%	-3.8	0.4
France	+1.3	-1.5/-2.5	-2.8	0.4
Italy	+0.8	-1.8/-2.5	-3.5	0.3
Spain	+1.2	-1.3/-2.3	-4.0	0.4
UK	+1.1	-2.3/-2.7	-3.8	0.2
China	+9.6	+7.3/6.0	+5.0	+7.0
India	+8.3	+6.1/+5.6	+4.5	+6.5
Russia	+5.5	+2.5/+1.5	0.0/-1.5	+3.0
Brazil	+3.8	+2.4/+1.8	+0.5	+3.0
Turkey	+2.5	+1.0/0.0	-3.0	+2.0
Poland	+3.8	+2.2/+1.2	+0.5	+2.0
Hungary	+0.8	-1.5/-2.0	-3.3	+0.5
Czech Republic	+4.3	+2.8/+2.5	+1.0	+2.5
South Africa	+3.5	+2.3/+1.8	+0.8	+2.5

Note : if credit does not flow and if China's figures turn out worse, then even these worst case figures for 2009 will nto be worse enough. Executives do have to factor in their budget plans "a virtual doomsday scenario".

ECONOMIES IN SUBCONTINENT REGION

Almost all the economies of the subcontinent are characterized by the following:

- That a substantial part of GDP / economic activity is undertaken by entities not publicly traded;
- There is effectively no secondary debt or capital market;
- There is no protection, guarantee or insurance for minority shareholders / depositor;
- Governments are financially weak;
- Family owned corporate culture / 'issue of control' in almost all the major companies;
- Market volumes are effectively determined by available liquidity in the market for the brokers;
- Professional Valuers' industry in evolutionary stage; and
- Lack of independent analysts.

All these factors lead to the following two questions:

a) Does the Fair Value measurement in the manner traditionally determined in our countries reflect the true fair value' of underlying issues?
b) Could there be a rethinking for classification of realised / unrealised loss / treatment for permanent and temporary diminution?

The question is relevant. However, the answer is not simple. We do not advocate or suggest any special treatment or accounting standard. The issue is appreciation of fact that Fair Value determination in our economies and recording of resultant difference would require relatively higher reliance on financial modeling and other factors rather then quoted prices.

SUGGESTION

In the light of the aforesaid discussions it is suggested that International Accounting Standard Board (IASB) should:

1. Review IAS-39.
2. Insert a definition of different 'Market Environments'.
3. Mandatory use of more than one method in these particular market environments.
4. Review of treatment of resultant gain / losses in case of Available for Sale securities.

Furthermore, within the region, there should be capacity building of the professional valuers' industry and analysts.

IFRIC 13: Customer Loyalty Programmes

Goind Khatri

Background

Many businesses have loyalty programmes in place to provide incentives to buy their goods and services. An example of this is loyalty or club cards issued by supermarkets, airlines, telecommunication operators, hotels and credit card providers. If customers buy goods or services, the entity grants award points which can be redeemed to buy discounted or free goods and services.

There had been two different views about accounting and measurement of the obligation to provide free or discounted goods or services when customers can redeem award credits. One view was to account for award credits as a *separately identifiable component* of a sales transaction in which they are granted, which mirrors the requirements of Paragraph 13 of IAS 18. Another view was to account for revenue and expenses (relating to award credits) *simultaneously* as per Paragraph 19 of IAS 18.

Accounting treatment as per IFRIC 13

On June 28, 2007, the International Financial Reporting Interpretations Committee (IFRIC) issued IFRIC 13: Customer Loyalty Programmes (the interpretation). This interpretation addresses accounting by entities that provide award points to their customers to buy goods or services.

The interpretation requires the entity that grants awards to account for award credits as a separately identifiable component of the sales transaction(s) in which they are granted. The fair value of the consideration received or receivable in respect of the sale shall be allocated between the award credits and the other components of the sale.

Award credits can be distinguished from marketing expenses because they are granted to customers as an integral part of sales transactions. Marketing expenses, in contrast, are incurred independently of the sales transactions they are designed to secure.

Example 1: As part of its Eid promotion, Super Stores, a chain of grocery stores, issues a voucher to all its customers entitling Rs.100 off the price of a particular brand of chocolates. Voucher is published in a local newspaper and any one bringing a copy is entitled to Rs. 100 off the price of that brand of chocolates.

How should the above transaction be treated in the books of Super Stores?

Solution: The vouchers issued are outside the scope of IFRIC 13 because they are distributed free of charge. These are marketing activities to stimulate sales rather than award credits which are an integral part of sales transactions.

Example 2: Safe Air Plc is engaged in the air transportation business. The company has a customer loyalty programme in place whereby any passenger spending Rs.100 on the purchase of an air ticket is awarded one mile award. Miles awarded can be redeemed by passengers, within three years of award, by purchasing a ticket from the airline. One mile is equivalent to Re.1. The company has 1,000,000 Points outstanding at year end and records the following entry in the books of account:

Debit - Award expenses Rs.1,000,000

Credit - Award expenses payable Rs.1,000,000

CFO of the company further explains that the above transaction is recorded to comply with the matching concept and that liability component of above will be transferred to revenue on actual redemption of award points.

Do you agree that the accounting treatment followed by Safe Air Plc complies with IFRIC 13?
If not, suggest correct treatment.

Solution: IFRIC 13 requires accounting for award credits as a separately identifiable component of the sales transaction in which they are granted. The treatment followed by the company, although meeting the matching concept, does not comply with IFRIC 13.

Therefore, the company is required to separate the fair value of award credits from the sales amount and defer it until these points have been actually redeemed by passengers.

If the entity supplies the awards itself, it shall recognise the consideration allocated to award credits as revenue when award credits are redeemed and it fulfills its obligations to supply awards. The amount of revenue recognised shall be based on the number of award credits that have been redeemed in exchange for awards, relative to the total number expected to be redeemed.

Fair value of award credits

The consideration allocated to the award credits shall be measured by reference to their fair value, i.e. the amount for which award credits could be sold separately. If the fair value is not directly observable, it should be estimated by reference to the fair value of awards for which they could be redeemed.

Example 3: Technology vision is an electronic retail store. Under a loyalty program in place, it grants customers loyalty points when they spend specified amount on purchase of laptops. During the year 20X1 the entity grants 100 points. Fair value of each point is Re.1. Management expects that 85 of these points will be redeemed and accordingly defer revenue of Rs. 100.

In 20X2, 45 points have been redeemed and the entity records revenue of Rs. 53 (45 point/ 85 points) X Rs. 100.

In 20X3, management revises its expectation and now expects that 95 points will be redeemed. During the year 30 points are redeemed, bringing the total points redeemed to date to 75. Entity records revenue of Rs. 26, relating points redeemed. Rs. 26 is calculated as:

Cumulative revenue (75 points/95 points) X 100	Rs. 79
Less: revenue recognised in 20X2	(Rs.53)
Revenue recognised in 20X3	Rs. 26

Fair value estimation should be revised as a result of a change in expectation or market conditions which indicate that lower or higher than expected award credits may be claimed.

The fair value of award credits would be reduced to take into account the award credits that are not expected to be redeemed and the fair value of award credits that would be offered to customers who have not earned award credits from an initial sale. (See Example 3)

Award supplied by third parties

When the awards are supplied by third parties, the amount of revenue recognition is dependent on whether the entity is collecting the consideration related to the awards on its own account or on behalf of the third party.

If the entity is collecting the consideration on its own account, it shall measure its revenue as the gross consideration allocated to the award credits and recognise the revenue when it fulfills its obligations in respect of the awards.

If the entity is collecting the consideration on behalf of the third party, it shall:

(i) measure its revenue as the net amount retained on its own account, i.e. the difference between the consideration allocated to the award credits and the amount payable to the third party for supplying the awards; and

(ii) recognise this net amount as revenue, when the third party becomes obliged to supply the awards and entitled to receive consideration for doing so. These events may occur as soon as the award credits are granted. Alternatively, if the customer can choose to claim awards from either the entity or a third party, these events may occur only when the customer chooses to claim awards from the third party.

Effective date

This interpretation is effective for annual periods beginning on or after 1 July 2008 with early adoption permitted. If an entity applies the interpretation for a period beginning before 1 July 2008, it shall disclose that fact.

Transitional provisions

There is no specific transitional provision specified. In the absence of the transitional provision, the amendment should be applied retrospectively in accordance with the provisions of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.*

Recruitment by Small and Medium Sized Practices Still a Challenge!

Safura Fatima

Recruiting and retaining the best and brightest trainees for careers in the accounting profession is a challenge for Small and Medium Sized Practices (SMPs). Changes in demographics, the needs of the profession and societal attitudes all affect recruiting and retention in our profession. If we are to be successful in our endeavors, proactive strategies to deal with these issues, are necessary.

The Past and Present

In the past, recruiting graduating students was simple, or at least straightforward. The typical recruit was about 22 years old, usually male, had entered the profession after passing exams of Higher Secondary Certificate / A Levels.

Today, the demographics have changed drastically. The emergence of the "non-traditional" students and the increased prominence of females and other minorities have altered the profile of students entering in to the profession of Chartered Accountancy. In fact, the ratio of "typical" graduates is quite minimal compared to the last decade. Furthermore, approximately 50% of accounting graduates are female. For some students, entering the profession of accountancy may be the start of a second career. Others may have graduate degrees. Thus, the typical recruit is very loosely defined.

Recent changes in the professional environment have influenced recruitment requirements. Technological advances of the past decade have necessitated the hiring of recruits with broad backgrounds in areas other than simply accounting and auditing.

Computer skills and information systems training are increasing in importance. Communication skills, as well, are even more crucial today. In the current business environment, oral and written skills are paramount for succes.

These and other factors, including the internationalization of business, the proliferation of auditing and accounting standards and the ever-changing tax laws, etc. have influenced human resource strategies in every sector. All organizations, from the sole practitioner in public accounting to the multinational conglomerate, have been affected. Tomorrow's recruit will indeed be very different from those of yesterday.

It is disappointing to note that significant numbers of SMPs in Pakistan do not have the capacity to train students, or if they do have such capacity they are unable to effectively market it. Statistics have showed that quite a number of students leave the profession after passing their modular examinations. As per the records available with the Institute approximately 12% of the students who passed Module D in Spring and Autumn 2007 left the profession. This creates opportunity for SMPs to capture such students for their own benefit as well as for the benefit of the profession as a whole.

In order to overcome this drastic problem I offer the following tips which may assist SMPs in recruiting and retaining talented trainees:

- **Articulate your firm's unique differentiators** - All firms have their positive as well as negative points. The question is: What sets you apart from the rest? It is very crucial to get participation from the team members to question and use their responses to define your firm's unique selling features. Be sure to articulate this in marketing materials which may include firm's brochures and website. However, care should be taken so as not to contravene the provisions of the Code of Ethics for Chartered Accountants issued by the International Federation of Accountants and adopted by the Institute as well as those contained in the Bye-laws of the Chartered Accountants Ordinance, 1961. Differences in the firms might include easier access to firm partners, greater variety in assignments, respect for work/life balance, ability to create individual career timetables and a friendly environment conducive to growth.

- **Conduct a firm needs assessment** - SMPs should take the time once a year to look at their current employees, gauge the anticipated needs of the firm, internal promotion possibilities for the upcoming year, estimate of the staff who might leave the firm resulting in the need to hire new employees and calculate future needs. This is also a good time to reevaluate the firm's job qualifications and descriptions to make sure they align with the firm's vision so that long-term objectives of the firm can be achieved as well. Firms should also consider changes in the information and related technologies which have been quite rapid in the last few years.

- **Have a strong Registered Accounting Educating Tutor's (RAETs) presence:** Recruiting should not be reserved for the largest firms. Candidates who are about to join the firm need to know there are several firm options other then the Big Four , and it should be up to them to figure out which firm makes the best fit based on size, culture and career growth opportunities. SMP firms should make their presence felt at RAETs where they should be allowed to make presentations illustrating to the potential candidates what benefits they would reap from joining them.

- **Create a prospective list database** - Firms should get their younger team members involved in school / college visits to increase interest in the profession. They may create awareness about the profession. This in turn can be the start of a prospective list that the firm can use to track students and keep in touch with them during their school / college life. This not only increases the potential pool of candidates, but also their involvement gives younger team members a lesson in business development. In order to carry out the above mentioned activities the Institute is ready to offer them support and assistance.

- **Look for non-traditional ways to find experienced recruits** - If you have not been tracking your candidates from recruiting, start capturing that data now. Firms can use a simple Excel spreadsheet to track recruits. The sheet should include how the person did in the initial interview, personal contact information including cell phone number, and where that recruit ended up working. Use that tracking list to go back three to five years and call people who previously were interested in your firm. Also, revisit your firm's alumni list of previous employees to see if any are looking to return to public accounting. In addition to tracking tools, web tools such as Facebook, Orkut, Googlemail, Yahoo, Hi5, Wayn, etc. can make it easier for firms of all sizes to keep in touch with recruits and alumni.

- **Higher stipend offered to the trainees** - Competitive stipend rates can also be an important factor in inducting and securing trainees who are talented and possess skills which may benefit the firm and bring improvement in the quality of work.

Advantages of being a part of SMPs that may be pointed out to potential candidates may include:

- **Frequent client contact** - offering staff the chance to meet clients and learn more about their businesses as well as your own is a powerful retention tool. Thus, SMPs can definitely leverage their advantage here since they can provide many chances to involve staff in the close client relationships that are typical in smaller practices.

- **Greater access to partners and the chance to affect the firm's future** - unlike large firms, it is simpler and easier in SMPs to solicit trainee suggestions and to inform them what value is given to the ideas given by them and how have they been implemented. In this way they feel important and feel that their suggestions have been given due importance and weightage. Partners can directly interact with the trainees and impart necessary knowledge to them. It is an effective way to motivate them and give them the required willingness and commitment to work harder and put in their best.

- **Opportunities and career paths that can better meet individual needs and aspirations -** since an SMP does not have rigid development paths, the staff can forge their own futures in a flexible environment as compared to larger firms where the staff must adapt to the environment and systems put in place.

- **The chance to take on greater responsibility at an early career stage** - since the larger firms have a lot of staff, a particular hierarchy has to be followed and every team member is assigned very little part of the overall job to be audited. On the other hand, due to the strength of the staff in the SMPs, the trainees are given greater responsibility and thus get the opportunity to be involved in the whole job at a very early stage of their career.

Conclusion

The changing demographics of the trainees entering the firm and societal attitudes as well as increasing technical complexities are factors which have contributed towards the necessity to highlight the benefits and opportunities of a career in accounting. However, we, as professionals, must take an active role in promoting accounting career. We must aggressively recruit the best and the brightest candidates as we are and will continue to be in direct competition with other professions.

Common Scenarios Faced by Managers and Seniors in SMPs

CASE I:

Sara has recently joined an SMP. One of the partners calls her in and informs her that she has been posted to a client. She is very excited about the fact since it's her first job and she wants to prove herself. Unfortunately, due to lack of staffing she has no senior, meaning she is all alone. She has to go over last year's files in order to understand how she should go about the audit.

Reason: Lack of guidance and mentoring

CASE II:

Salman is an Audit Senior and is on the audit of a listed client. Being the Audit Senior, he has highlighted various accounting as well as auditing issues and has given their summary to the partner in-charge so that they may be discussed with the management of the client. To Salman's surprise, when the signing date of the audit report arrives he finds out that all the highlighted issues have been resolved by the partner himself without involving him in the discussion. He is quite disappointed since he has been kept out of all the important discussions which he thinks he had the right to be involved in.

Reason: Lack of co-ordination between the team members

CASE III:

Saba is Assistant Manager Audit in an SMP. Since her partner is out of town she, being the senior most on her job, has to make a presentation to the client. She is worried and confused as she has never been trained to give presentations in all of her audit life. All she was told during her articleship was to carry out audits and give the partner the final set of financial statements. Despite the fact that she is technically sound, she is unable to have that confidence to make a presentation.

Reason: Lack of Communication and Presentation Skills

The Myth and Reality of Sales Tax Refunds

Adnan Mufti, FCA

The woes of economic turbulences which a developing country like Pakistan is facing are attributed to both internal and external factors. The ever increasing inflation, shrinking demand, growing unemployment, rising cost of doing business, tariff hike and last, but not least, liquidity crunch is fatally confronting today's business. Besides the tightening of monetary policy by the Central Bank, the businesses are also being deprived from another vital source of funds - its legitimate tax sales tax refunds.

In all modern VAT jurisdictions, in order to boost exports, motivate businesses to bring foreign currency and help reduce the trade deficit, exports are zero rated for sales tax purposes. Pakistan is no exception to this cardinal principle. However, it is seldom that the tax administration has been able to put aside and address the consistent complaints of red tapism, delay and rejection of lawful sales tax refunds of taxpayers which, by no means, run into billions even as of today.

Since last few years, refunds are processed by way of STARR - an electronic software which primarily matches the payment of output tax by the seller with that of refund claimed by the buyer of taxable goods. In the beginning, it was conceived that use of software would reduce taxpayers' grievances and lessen contact with tax officials; however, on the contrary, the electronic verification and processing of refunds has resulted into multiple issues and chronic departmental objections - most of which are beyond the statute and the rules framed in this regard.

At present, all types of sales tax refund claims are being rejected on the basis of the following objections reportedly raised by the refund verification software, i.e., supplier's exceed declared output, scrutiny for verification of input tax paid by supplier, supplier appearing as non-filer, supplier blacklisted or deregistered, supplier showing abnormal tax profile, etc. A perusal of all such objections reveals that they are primarily focused to the seller, i.e., person who sold out goods to the refund claimant and issued related tax invoice. In response to such objections, the refund claimant is asked to produce supplier's tax returns, summaries of purchase and sales, etc. Moreover, the refund claimant is often asked to 'get the supplier's tax records audited' by tax authorities and produce audit report there against.

It is notable that the tax department is primarily responsible to verify the genuineness of refund claims in the light of the provisions of Sales Tax Act 1990 and related rules. The department is bound to examine the refund claims in the light of the documents as stipulated in Rule 38 of Sales Tax Refund Rules 2006 which specifies a list of "supportive documents" the refund claimant is required to file with tax authorities in support of his refund claim. Interestingly, the above objections raised by the software and insistence of tax authorities for filing of supplier's confidential tax records do not find any place in the statute or the rules.

Legally, under Section 10 read with Refund Rules, the refund claimant cannot be held responsible for anything done wrong / non compliance on the part of the supplier. For instance, refund cannot be withheld if the supplier's tax profile has been declared to be abnormal by the software. Likewise, the legislature does not intend to debar buyer's legitimate input tax if the relevant supplier cannot be found in existence by the department. In short, the refund claimant cannot be penalized for any of the wrongdoings in which he was never a party and on which he had no control. Further, the statute does not, at any place, empower the department to withhold refund on account of STARR objections.

The aforesaid objections manifest that the tax authorities are traveling outside the purview of sections 7, 8, 10 and 73 of the Act as none of the said provisions render the refund claims inadmissible only on the grounds as mentioned by STARR. It is notable that the Honorable Sindh High Court, in a recently reported case, has held that the rules or SRO cannot go outside the purview of the main law which is the supreme legislation.

The departmental point of view on STARR further gets weakened in the wake of inconsistent policy and practice adopted by various Collectorates for refund processing. In certain cases, the department issues notices directly to concerned supplier to verify the payment of output tax on his part and to verify his other compliances. In the rest of the cases, the onus of such verifications is shifted upon the buyer's (refund claimant's) account resulting in rejection of his refund.

The pre-refund audit approach conducted by the department also lacks legitimacy since it contravenes the requirement of section 25 of the Act. The provision of section 25 read with section 22 and refund rules do not require the refund claimant to submit supplier's records as are required by the department under refund audit. It is also pertinent to note that the registered persons, who adjust the relevant input tax against output tax liability, are never required during audit under section 25 to furnish supplier's tax returns, summaries, etc. This proves application of two varied approaches for audit; one for audit under section 25 and the other for audit under section 10 of the Act. Needless to mention, the law does not approve such variation in audit parameters.

The departmental objections and insistence upon suppliers' tax details and declarations are meaningless even when they are analyzed on logical grounds. In most of the cases, the refund claimant [buyer] and the related supplier are registered in the same Collectorate. The department can easily track down their details and tax profile. However, instead of focusing on supplier's tax profile and supportive statutory declarations, the department requires the buyer to submit all such information. This matter was also taken under cognizance by the Federal Tax Ombudsman (FTO) in a recent case who pronounced that the refund claimant was harassed for failure of tax department to enforce compliance on non-filers or nil-filers despite the fact that those units are registered by them. The FTO further held that once the document of refund has supportive claims required under the return, it is the obligation of the tax department to ensure that a registered supplier fulfills his obligation under the law and rules.

Another practical problem being faced by businesses is the non-cooperation of relevant suppliers. In response to requests lodged for furnishing of documents identified by STARR, the suppliers often question the legality whereby they are, or may be, made liable to share their confidential and sensitive tax information with an independent private business concern which happened to be their buyer in the past just on the pretext that the latter's refund are disputed for want of former's details. Especially in the corporate sector, businesses are finding it hard to tackle this issue which is jeopardizing commercial and mutual relationships.

Despite little legal backing, the above practice of processing refunds through STARR mechanism was in vogue all across the country until recently when the Large Taxpayers' Unit (LTU) Karachi discontinued the above refund verification mechanism which has resulted in two sets of practices prevailing in Regional Tax Office and LTU. The LTU now requires the refund claimants to get the invoice summary statements, sales tax returns etc. of their suppliers verified / authenticated from their respective Collectorates, failing which the Bank Guarantees furnished by refund claimants are at risk to be encashed anytime by LTU. Series of meetings have been held between business community and LTU administration over the new refund framework; however, no substantial outcome has arisen so far to the rescue of multinationals, OMCs and banks registered with LTU.

In view of the foregoing discussions and keeping in view the fragile business scenario of the country, it is imperative that the government must come up with tangible incentives to the manufacturing sector in general, and exporters in particular, so as to keep alive the industrial and export oriented industries. This objective can be easily met by way of streamlining the refund mechanism in the light of statute and best practices in identical VAT jurisdictions. However, we must not forget that any ideal work plan and framework must also correspond to local environment, ground realities, and should be workable in the end.

Problems Under WHT Regime

Mohammad Ashraf

The income tax allows the government to confiscate the wealth of its citizens. The curse of the withholding tax is that it allows the government to commit this crime systematically, effortlessly, painlessly, and benevolently.
Laurence M. Vance

Withholding is an act of deduction or collection of tax at source and is in the nature of an advance tax payment. Historically, the contribution of Withholding Tax was 41 percent of total direct tax revenues but now it is contributing more than 90 percent of the Regional Tax Offices.

Income Tax Act, 1913 and 1918 did not contain any provision for withholding tax. However, under repealed Income Tax Act, 1922, tax was deducted from two main sources of income - Salaries and Interest on securities and the position remained intact under the repealed Income Tax Ordinance, 1979.

However, in the early 1990s, withholding tax net was expanded extensively by providing for withholding tax on a wider variety of transactions and making most of them presumptive. In the Income Tax Ordinance, 2001, provisions are more or less the same, except for a few changes and additions.

Important withholding provisions relate to salary, imports, exports, commission and brokerage, dividend, contracts, profit on debt, utilities, vehicles tax, stock exchange-related provisions and non-residents etc., with varying rates. This article is an endeavor to highlight the issues in the withholding tax regime.

Transaction Types

Following types of transactions are covered under the WHT Regime.

Import

Reduction in tax rate is the worst decision implemented through the Finance Act, 2008 at the cost of death of local industry and 400 percent reduction in collection. A mere trader of import items is absolved from audit not only in income but also in sales tax. It is suggested that SRO 638(I)/2005 requires fresh thought in the light of SRO 947(I)/2008 as we need to promote raw material import and capital equipments.

In furtherance, the import of home consumption goods including those returning to Pakistan during the global economic crisis need to be excluded from the purview of section 148. In more furtherance, clause 13C of Part II of 2nd Schedule seems excessive as it contains 2 percent rate while general rates are also 2 percent.

Moreover, the concept of tax on tax in the definition of value of goods provided in sub-section (9) of section 148 needs to be eliminated. The revenue authorities need to collect revenue gracefully not in the garb of valuation mechanism. The tax under section 148 needs to be collected on value of goods under the Customs Act, 1969.

Salary

Section 149 allows the employer to deduct the tax at average rate of tax after adjustment of tax credits, un-adjustable WHT, and excess or deficient tax. It is suggested that the employer be explicitly allowed to adjust excess or refundable tax under section 149(1) (ii) on the basis of return, which is deemed assessment order. Currently, salaried persons are required to obtain refund order for adjustment of excess tax by employer.

In furtherance, there is no compulsive provision to effectively enforce rule 42(2) of the Income Tax Rules, 2002. In more furtherance, neither the monthly nor the annual statement contains any field whereby the status of employee like resigned, retired etc. has to be mentioned. At the same time, there is no effective mechanism whereby an employee, leaving an employment and joining a new one, is obliged to submit his old tax deduction during the part of that year to the new employer. Absence of these might have caused serious revenue implications for the exchequer.

Profit on Debt

Currently, the profit on debt is sometimes paid on daily, weekly, monthly, quarterly, bi-annual or annual basis according to the changing dynamics of the financial products offered by the financial institutions. Sub-section (1) of section 151 allows the payer of profit to deduct tax after reduction of Zakat.

However, neither the current statement under section 115(4) nor the composite format of Return of Total Income under section 114 and statement under section 115(4) allows for such adjustment; hence, it requires modification.

In furtherance, currently the department is challenging payment of profit on loan from Directors/Associates without understanding the fact that provision of section 151 are applicable over instruments in the nature of bonds, certificates, securities or instrument of any kind.

The key to the issue is the word instrument defined in the Negotiable Instruments Act that needs to be understood in the light of Doctrine of *ejusdem generis* discussed in Jamaat-e-Islami versus Federation of Pakistan [2000 PLD Supreme Court III] and principles enunciated in CIT versus Orix Leasing Pakistan Ltd. [2007 PTR 214 (H.C.Kar.)]. An explanatory circular would suffice in this regard to avoid unnecessary litigation.

Payment to Non-Resident

Apparently, the order of the commissioner under section 152(6) is non-appealable. However, provisions of section 152(6) used to be appealable by invoking section 221. It is suggested that the order should be made appealable straight without recourse to section 221. In furtherance, sub-section (2) needs to be amended to exclude sub-section (1AA) like sub-section (1A).

Payment for Goods and Services

With the passage of time, section 153 is specifically targeted for amendments from Finance Act, 2002 through Finance Act, 2008. However, Finance Act, 2004 is the only Finance Act that did not bring about any amendment in section 153. Such necessary amendments have made section 153 the most cumbersome to understand among the WHT provisions. This section emerges as the desired candidate for re-phrasing for the sake of simplicity.

Further, astonishingly, the Provincial Government is not listed in the prescribed person obliged to deduct tax under section 153. Moreover, clause (47A) of Part IV of second schedule seems excessive in the presence of sub-section (5) of section 153.

Purchase of Motor Cars and Jeeps

An amount of Rupees 16,875 is prescribed for three different categories of cars.

Tax on Motor Vehicles

Tax Ordinance, 2001 is applicable to persons; however, section 234 is an exception that levies tax on motor vehicles. For the sake of argument, even if it is levied on the owner of motor vehicle then in the presence of 2 percent rate of tax under section 153 it is tantamount to double taxation. Harmonization and clarification is required in this regard.

Telephone Users

There is no *modus operandi* prescribed for claiming advance tax on pre-paid calling cards that are used on PTCL. The tax does not even appear on the face of PTCL bills. FBR should liaise with PTCL in this regard.

Media or Advertising

Advertising is the only transaction, which is mentioned at four different places of the Ordinance, i.e., sections 152, 153, 153A and 233. There is a need to clarify the issue once and for all. Moreover, there is an urgent need to specify the definition of 'media'.

Unspecified Transaction

The list of transactions covered under the Income Tax Ordinance, 2001 is not exhaustive and cannot cater to the dynamics of transactions in the modern business world. There is no provision for resident taxpayer comparable to section 152 whereby if a transaction is not covered then it will fall under that section. Consequently, the department makes every effort to categorize such unspecified transactions under the existing WHT provisions. However, the *modus operandi* of non-categorization, powers of Commissioner of Income Tax, and scope of section 161 needs to be enhanced at the same time.

Composite Transaction

As stated earlier, the list of transactions covered under the Income Tax Ordinance, 2001 is not exhaustive and cannot cater to the dynamics of composite transactions in the modern business world. Presently, section 153 encompasses contractual transactions but sometimes the contract contains varied transactions covered under various sections. The law is silent in this regard.

Time of Deduction of Tax

Section 158 of the Income Tax Ordinance, 2001 prescribes the timing of deduction of tax by broadly categorizing the transactions into two types. Tax needs to be deducted on the earlier of payment or credit, while other tax needs to be deducted at the time of payment.

However, recently, explanatory circular number 01 of 2009 has been issued whereby inter-account adjustment and netting-off of debtor and creditor would comprise a point of time for deduction of tax. This can be understood from the following example.

ABC Limited

Ledger Account for the year ending June 30, 2009

Date	Description	VT	DR	CR	BALANCE
Jan 4, 09	Purchase	JV		100,000	(100,000)
Mar 5, 09	Sale	JV	100,000		-
Mar 5, 09	WHT	JV	3,500		3,500

In the example, ABC Limited is the creditor and customer of same company. No sooner has the accountant recorded the sale transaction on March 5, 2009, s/he is required to deduct tax from the purchases made on Jan 4, 2009. In accordance with the International Accounting Standards and International Financial Reporting Standards, an entity may adjust the receivable and payable on the Balance Sheet date. Consequently, whether such adjustment for presentation purposes would be treated as point of deduction or not - requires clarification.

Certificate of Collection or Deduction of Tax

Section 164 provides for issuance of certificate of collection or deduction of tax. It is suggested that issuance of serialized number of certificate be made mandatory at the time of issuance of payment instrument. Further, Tax Payment Receipt and Monthly/Annual statement under section 165 be amended to incorporate the reference of serial number of such certificate. This would help timely allowance of tax deducted or collected.

Monitoring of Withholding Tax

Presently, notices are issued under section 176 to collect the reconciliation statement under rule 44(4) of the Income Tax Rules, 2002. These are discussed in the ensuing paragraphs.

Reconciliation Statement

Reconciliation statement has currently been sought from the WHT agents under section 176. However, the *modus operandi* of obliging the taxpayer to prepare such reconciliation in accordance with notice is neither prescribed under section 176 nor in accordance with the basic accounting principles. FBR needs to look into standardization of such exercise after careful and fresh consideration, as reconciliation for a complete tax year cannot be completed either in a week or a month.

Failure to Pay Tax Collected or Deducted

In most of the cases, the information sought under section 176, including reconciliation statements under rule 44, ends up in a notice under section 161. This requires ample time for proceeding with the case of the taxpayer. It is suggested that the words *'an opportunity of being heard'* used in sub section (1A) of section 161 be replaced with *'reasonable opportunity of being heard'*.

Conclusion

The above suggestions will streamline the provision relating to WHT regime which would not only result in more transparency for the taxpayer, but also in lesser unnecessary litigation.

Smart Tips for Power Users
Microsoft EXCEL

Zafar Abbas Badami, FCA

Filling repetitive data

When you need to type a series of repetitive data very frequently, you may use the AutoFill option of Microsoft Excel to make the job easier. Try-out a small exercise given below to practice this task:

See how to quickly fill a series of cells with the names of the calendar months:

1. Start Excel. A new, blank workbook appears.
2. In cell A1, type **January** and then press ENTER.
3. Click anywhere inside cell A1, and rest the mouse pointer on the square at the lower right-hand corner of cell A1. The mouse pointer changes into a plus symbol (+).
4. Press and hold the right (alternate) mouse button, drag the mouse pointer to cell A12, and release the right (alternate) mouse button. A menu appears.
5. Click Fill Months. The names of the months February, March, and so on appear in cells A2 through A12

.

See how to quickly fill several cells with the same value:

1. In cell B1, type 2009 and press ENTER.
2. Click anywhere inside of cell B1, and rest the mouse pointer on the square at the lower right-hand corner of cell B1. The mouse pointer changes into a plus symbol (+).
3. Press and hold the right (alternate) mouse button, drag the mouse pointer to cell B12, and release the right (alternate) mouse button. A menu appears.
4. Click Copy Cells. The value 2009 appears in cells B2 though B12.

Finally, see how to quickly fill in several cells with a range of numbers:

1. In cell C1, type 1000.
2. Click anywhere inside of cell C1, and rest the mouse pointer on the square at the lower right-hand corner of cell C1. The mouse pointer changes into a plus symbol (+).
3. Press and hold the right (alternate) mouse button, drag the mouse pointer to cell C12, and release the right (alternate) mouse button. A menu appears.
4. Click Series.
5. In the Step value box, type 100, and click OK. The Series dialog box disappears, the value 1100 appears in cell C2, and the number increases by 100 in each cell in column C up to an ending value of 2100 in cell C12.

Share an Excel workbook

Several times you may need to work with your colleagues simultaneously on a project. This process may require you to update and share data with number of users. Microsoft Excel allows you to share a single file by more than one user. Follow the procedure give below:

1. With an Excel workbook open, on the Tools menu, click Share Workbook.
2. On the Editing tab, select Allow changes by more than one user at the same time. This also allows workbook merging.
3. On the Advanced tab, select the Automatically every option and then click OK.

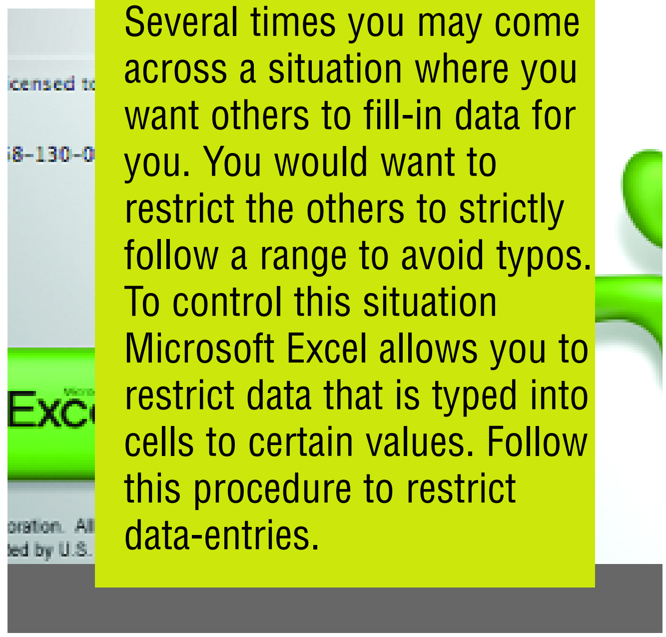
When you save the workbook, the workbook is now shared with others who have access to it, and changes to the workbook are updated every 15 minutes by default.

Restrict data-entries within a certain range

Several times you may come across a situation where you want others to fill-in data for you. You would want to restrict the others to strictly follow a range to avoid typos. To control this situation Microsoft Excel allows you to restrict data that is typed into cells to certain values. Follow this procedure to restrict data-entries.

First, assign a validation condition to a group of cells:

1. Start Excel. A new, blank workbook appears.
2. Select cells A1 through B10, inclusive.
3. On the Data menu, click Validation.
4. On the Settings tab, in the Allow list, select Whole number.
5. In the Data list, select less than.
6. In the Maximum list, type 100.
7. On the Input Message tab, in the Title box, type Testing Validation.
8. In the Input message box, type Type a number less than 100.
9. On the Error Alert tab, in the Title box, type Failed Validation.
10. In the Error message box, type You must type a number less than 100.
11. Click OK to assign the validation condition and close the Data Validation dialog box.



Several times you may come across a situation where you want others to fill-in data for you. You would want to restrict the others to strictly follow a range to avoid typos. To control this situation Microsoft Excel allows you to restrict data that is typed into cells to certain values. Follow this procedure to restrict data-entries.

Next, type numbers in specific cells to see how validation works:

1. In cell D1, type 105, and press ENTER. No validation message is displayed because cell D1 does not contain any validation conditions.
2. In cell A1, type 95, and press ENTER. No validation message is displayed because the value of cell A1 is less than 100.
3. In cell B10, type 105, and press ENTER. A validation message appears, stating that you must type a number less than 100.
4. Click Retry to try typing a different value.
5. In cell B10, type 99, and press ENTER. No validation message appears because the value of cell B10 is less than 100.

To remove the validation condition:

1. Select cells A1 through B10, inclusive.
2. On the Data menu, click Validation.
3. Click Clear All. All validation conditions are removed from cells A1 through B10.
4. Click OK to close the Data Validation dialog box.

Finally, type numbers in specific cells to make sure that the validation condition was removed:

1. In cell A1, type 105, and press ENTER. No validation message is displayed because cell A1 does not contain any validation conditions.

Takaful
mutual assistance under Islam

Saima Batool & Jafar Razi Khan

Meaning of Takaful

Takaful comes from the Arabic root-word 'kafala'- guarantee. Takaful means mutual protection and joint guarantee. Operationally, Takaful refers to participants mutually contributing to the same fund with the purpose of having mutual indemnity in the case of peril or loss.

Reference Al Quran:

'Help (ta awan) one another in furthering virtue (birr) and Allah consciousness (taqwa) and do not help one another in furthering evil and enmity" al maidah: verse 2 (5:2).

Takaful is a form of mutual help (ta'awun) in furthering good/virtue by helping others who are in need/in hardship. Takaful provides a strategy of risk mitigation/reduction by virtue of collective risk taking that distributes risks and losses to large numbers of participants. This mitigates the otherwise very damaging losses, if borne individually.

Basic Elements of Takaful

- Mutuality and cooperation.
- Tabarru (contribution)
- Eliminates the elements of Gharrar, Maisir and Riba.
- Wakalah/Modarabah basis of operations.
- Constitution of separate "Participants' Takaful Fund".
- Constitution of "Shariah Advisory Board".
- Investments as per Shariah.

Main drivers of Takaful

- Piety (individual purification)
- Brotherhood (mutual assistance)
- Charity (Tabarru or contribution)
- Mutual Guarantee
- Community well-being as opposed to profit maximization.

Objections to Conventional Insurance are based on the Elements of:

- Uncertainty - Gharar
- Gambling - Maisir
- Interest - Riba
- Under Writing + Investment Profit belongs to the Company

Uncertainty - Gharar:

Conventional insurance contract is basically a contract of exchange (mu'awadat) i.e. buying and selling whereby policy (indemnity) is sold as goods, with the premium as the price or consideration. The consideration must be certain for an exchange contract. The amount to be paid is not known. The time it will occur is not known. Thus, it involves an element of uncertainty in the subject matter of the insurance sales contract, which renders it void under the Islamic law.

Gambling - Maisir:

The insured loses the money paid for the premium when the insured event does not occur. The company will be in deficit if claims are higher than premium.

Interest - Riba

"   . Allah has permitted trading and forbidden riba" (Al Baqarah 2 : 275)

Insurance funds invested in financial instruments which contain element of Riba.

Comparing Takaful to Conventional Insurance

Takaful Models

Mudaraba Model

The surplus is shared between the participants with a takaful operator. The sharing of such profit (surplus) may be in a ratio 5:5 , 6:4 etc. as mutually agreed between the contracting parties. Generally, these risk sharing arrangements allow the takaful operator to share in the underwriting results from operations as well as the favourable performance returns on invested premiums.

Wakala Model
Cooperative risk sharing occurs among participants where a takaful operator earns a fee for services (as a Wakeel or Agent) and does not participate or share in any underwriting results as these belong to participants as surplus or deficit. Under the *Al-Wakala model* the operator may also charge a fund management fee and performance incentive fee.

Takaful Products

General Takaful - offers all kinds of non-life risk coverages products like motor takaful, marine takaful, fire takaful, home takaful, shop takaful, etc.

Family Takaful - offers life coverage.

Banca-Takaful - tailored coverages for banks.

Takaful Worldwide

The first ever Takaful company was established in 1979 - the Islamic Insurance Company of Sudan. There are now more than seventy Takaful Companies in over 20 countries. Takaful premium is 0.1% (USD3 billion in 2004) of the global insurance premium and is expected to increase to USD12.5 billion by 2015. It is claimed by certain quarters that the average growth rate is higher than conventional insurance companies. Non - Muslims are also increasingly opting for Takaful products for commercial benefits.

Foundations of Takaful in Pakistan

1949 - Declaration made in the Objectives Resolution adopted by the Constituent Assembly of Pakistan *"Sovereign state of Pakistan is established to enable Muslims individually and collectively to order their lives in accordance with the injunctions of the Holy Qur'an and Sunnah".*

1973 - The Constitution of Pakistan declares Pakistan as "Islamic Republic of Pakistan and Islam as the official religion of the state".

1985 - Objectives Resolution was made 'substantive' part of the constitution.

1983 to 1989 - The Council of Islamic Ideology held its sessions in order to survey the Islamic Insurance System.

1992 - The Council of Islamic Ideology submitted its report on Islamic Insurance System.

2000 - The Insurance Ordinance defines the term "Takaful" in Section 2 and provides for establishment of Takaful companies in the country.

September 2005 - Takaful Rules notified.

Takaful Prospects in Pakistan

In a country like Pakistan where 97% population is Muslim, the demand for insurance is increasing with the increase in per capita income. The personal lines insurance business (leasing, health, medicare) is also growing at a higher rate than other conventional classes. The government is also encouraging Islamic banking on sound footing and hence there are great prospects for Takaful in Pakistan.

REFERENCES AND FURTHER READINGS:

Objections to Conventional Insurance - Declaration by Shariah scholars rendering conventional insurance un-Islamic

Fatwa issued in Judicial Conference held in Makkah in Shaban 1398 AH.

Verdict of Supreme Court of Egypt on Dec. 27, 1926.

Unanimous resolutions and fatwa by Ulama in the Muslim League Conference in Cairo in 1965.

Unanimous decision by Muslim Scholars in seminar held in Morocco on May 6, 1972.

Judicial Opinions and Fatwas confirming validity of Takaful

Fatwa issued by Higher Council of Saudi Arabia in 1397 AH.

Fatwa Issued by the Fiqh Council of Muslim World League in 1398 AH.

Fatwa issued by the Fiqh Council of the OIC in 1405 AH.

Approval of the Grand Counsel of Islamic scholars in Makkah, Maja Al - Fiqh, in 1985.

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Saudi Arabian Monetary Agency (SAMA) Regulations of Saudi Arabia - 2004.

Bahrain Monetary Authority (BMA) Rules - 2005.

Takaful Rules - 2005 of Pakistan.

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The Art of Listening

Kavalyn Kreer

Listening is a powerful thing because it makes the person talking to you become more creative. It makes people happy and free when they are listened to. As a listener, people will gravitate towards you because you have the ability to make people feel good about themselves. We all need to feel that we are being heard and understood. It is a basic human need. Listening is an art that when done well delivers tremendous benefits.

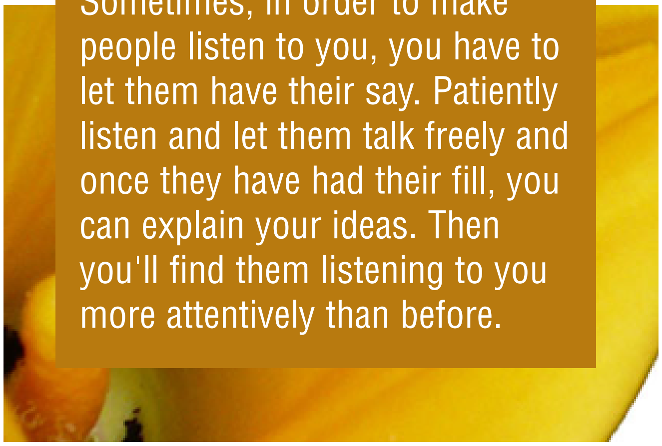
Whom would you go for advice? You would go to the listener who is the kindest, least censorious and bossy because by pouring out your problems, you'll eventually figure out the solution because when someone has listened to you, you go home rested and light-hearted.

When you listen to someone, you give the person a change to talk and allow that creative fountain inside them to flow and cast new thoughts, solutions and ideas.

It is said that women make better listeners. Men, due to their forceful nature, of self-assertion, lose their ability to listen, as they get older. People who do not listen become very lonely people, eventually. This is because they do all the talking and are not interested in listening to what others have to say. Eventually, people move away from these individuals and move towards those who listen.

Don't hang on fiercely and deafly to your own ideas. Be quiet and listen and you'll comprehend a lot more. Not listening is a real tragedy because it seals people off from each other.

Listening is really an art form and is harder than you think. It's a skill that require practice and a lot of patience. Sometimes, in order to make people listen to you, you have to let them have their say. Patiently listen and let them talk freely and once they have had their fill, you can explain your ideas. Then you'll find them listening to you more attentively than before.



Sometimes, in order to make people listen to you, you have to let them have their say. Patiently listen and let them talk freely and once they have had their fill, you can explain your ideas. Then you'll find them listening to you more attentively than before.

Listening is just not hearing what someone is saying. One must really listen. Listening, not talking is a great role. The listener is more magnetic than the talker, more effective and does more good.

Try listening to your wife, your husband, your parents, your children, your colleagues, friends, to those who love and even those who don't, to those who bore you, to your enemies. Listen and you be amazed at what unfolds before you.

The ability and need to communicate touches every area of our lives. Someone who listens well easily establishes rapport with others. Activate your listening skills by asking more questions; indicate to the talker that you are listening by nodding, ask questions to show that you are really listening and make eye contact with the talker.

It is also important to listen with an open mind. Sometimes our experiences and prejudices can be an obstacle to being an effective listener. Ask yourself what it feels like when someone really listens to you. Self-exploration is a good way to improve your listening skills.

Try not to pre-empt the speaker by interrupting with your own thoughts or opinions. Hear everything that is being said and then respond. Show compassion when you are listening. Listening with compassion shows that you have the ability to fully understand and accept another, complete with all their feelings, thoughts and opinions.

While you are listening, observe the speaker's body language, as 75% of all communication is non-verbal. Is the body posture rigid or relaxed, is there eye contact, do the vocals match the words being used, are the movements tense or relaxed? Is the verbal and the non-verbal communication consistent? Observe and listen. Good listeners attract others because they focus on the speaker completely.

Listening not only fosters understanding and appreciation, it also creates an atmosphere of trust, honour and respect. When someone truly listens to you, you feel special. Listeners have a positive energy that makes you want to be in their company.

Listening well is a two-way street, and to be effective communicators, we must all listen well to each other. Listeners are effective in their jobs because by listening they know exactly what needs to be done and how to do it.

To be effective listeners, be physically and mentally present in the moment. Listen by using the ears to hear the message, the eyes to read the body language, and if you cannot see the person, visualize the person speaking and the intuition to determine what the person is actually trying to say. It is also important for the speaker to know that you are listening.

Sadly, over the years listening is slowly becoming a forgotten art. We are so busy making sure that people hear what we have to say that we have forgotten to listen. Learning to listen though difficult is not hard to master. Basically, it's all about practice. Train yourself to keep your mouth shut most of the time and you'll be a good listener.

Listening to others is a strong weapon. People will tell you everything you need to know. You should listen 70% of the time and talk 30% of the time. Once you have learnt to keep yourself from speaking too much, learn to ask effective open-ended questions that cannot be answered with a simple yes or no. The objective is to get the person to talk as much as possible.

And, if all else fails, just remember these words by Epictetus, an ancient Greek philosopher and you are guaranteed to improve your listening skills: "Nature gave us one tongue and two ears so we could hear twice as much as we speak."

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This article was written by Kavalyn Kreer, who writes lifestyle articles for publication on the web and print.

World in Focus

FASB Likely to Approve Mark to Market Rules Change

The Financial Accounting Standards Board's likely approval of changes to “mark-to-market” rules could lead to increases of up to 20 per cent in quarterly profits of large US commercial banks like Citigroup, Bank of America and Wells Fargo who argue that the current regime unfairly magnifies losses by requiring banks to use market prices even though those prices are illiquid and often from fire sales. The changes will make it easier for companies, including banks, to value assets using their own internal models rather than market prices. They will also only have to recognize a part of any impairment in their profits.

The changes have been strongly opposed by investment banks, investors, auditors and analysts. The critics say changing the rules would further undermine investor confidence in the battered banking sector by reducing the transparency of banks' balance sheets.

The rules are also being considered by the International Accounting Standards Board (IASB) which had promised to work with its US counterpart. The IASB softened its own fair value rules last October under pressure from the European Union. Opponents of the change fear Brussels will exert new pressure to get the IASB to follow FASB's lead.

In a letter in Thursday's Financial Times, Dutch securities regulator chief Hans Hoogervorst calls political meddling in accounting a “dangerous development”. If accounting standard-setting is seen as a political process “confidence in the markets will be further undermined”, he said.

Fritz Henderson, New CEO at GM

Frederick (Fritz) A. Henderson, a General Motors has been chosen to replace Richard Wagoner Jr. whose resignation came at the behest of the Obama administration. With the threat of bankruptcy hanging over him, Henderson must execute a plan shaped by the US Treasury Department. Out of the Detroit Three --- Ford, General Motors and Chrysler --- General Motors asked for the most in total federal aid, $26 billion, a figure government officials fear could grow even larger.

Henderson has his work cut out for him. As chief operating officer and Wagoner's heir apparent, Henderson executed several strategies that failed to turn GM around. His restructuring plans were deemed insufficient by the government And like Wagoner, Henderson wouldn't countenance killing any of GM's brands until the government suggested doing so. Wagoner is considered responsible for increasing GM's focus on trucks and SUVs at the expense of the hybrids and fuel efficient cars that have become more popular in the last couple of years.

Toyota Follows Suit; Asks for US$3 b in Emergency Loans

Toyota's financial unit has asked for an emergency loan from the Japan Bank for International Cooperation, a state-backed lender, with reports putting the figure at more than US$3 billion. The world's biggest car maker says the international financial situation is squeezing its business, forcing it to ask for an emergency loan.

It is the first time the state-backed bank has been asked to lend to a Japanese car buyer. The world's biggest auto manufacturer is expecting to report a US$7 billion operating loss later this month.

Books

Breakthrough: How Great Companies Set Outrageous Objectives and Achieve Them

Bill Davidson

Every corporate success story begins with a breakthrough business model that triggers superior performance and rockets a company to a leading position. But unless a company continues to challenge itself to do more and do it better, success can be the beginning of the end for market leaders who rest on their laurels.

Breakthrough is a fact-based, practical guide that helps business leaders keep their success cycles turning with constant business innovation. Based on a landmark ten-year study of more than seventy bold, breakthrough companies-such as IBM, Countrywide, and American Standard - this book shows how the world's best companies stay on top. The secret these high-performing companies share: challenging themselves to achieve goals that seem unreasonable. *Breakthrough* shows business leaders how to develop business goals that seem outrageous, and then foster the cutting-edge thinking, the focused effort, and the teamwork to achieve breakthrough results. Leaders of breakthrough companies do things differently: they develop master plans that integrate every area of the company and they understand their organization's core identity. *Breakthrough* requires more than just good ideas or extra effort-it comes from practical, real-world steps that lead to unbelievable results.

Available at amazon.com
Price: $27.95

The Carrot Principle: How the Best Managers Use Recognition to Engage Their People, Retain Talent, and Accelerate Performance

Adrian Gostick and Chester Elton

Got carrotphobia? Do you think that recognizing your employees will distract you and your team from more serious business, create jealousy, or make you look soft? Think again.

The Carrot Principle reveals the groundbreaking results of one of the most in-depth management studies ever undertaken, showing definitively that the central characteristic of the most successful managers is that they provide their employees with frequent and effective recognition. With independent research from The Jackson Organization and analysis by bestselling leadership experts Adrian Gostick and Chester Elton, this breakthrough study of 200,000 people over ten years found dramatically greater business results when managers offered constructive praise and meaningful rewards in ways that powerfully motivated employees to excel.

Drawing on case studies from leading companies including Disney, DHL, KPMG, and Pepsi Bottling Group, bestselling authors Gostick and Elton show how the transformative power of purpose-based recognition produces astonishing increases in operating results - whether measured by return on equity, return on assets, or operating margin. And they show how great managers lead with carrots, not sticks, and in doing so achieve higher productivity, engagement, retention and customer satisfaction.

Available at amazon.com
Price: $15.61

Shaking the Globe: Courageous Decision-Making in a Changing World

Blythe J. McGarvie

We live in a highly interdependent world where 95 percent of the world's consumers live outside the U.S. Two-thirds of the world's purchasing power is also outside the U.S. Shaking the Globe guides everyone on how to absorb the world's diversity and to build upon his or her global citizenship by using the FISO Factor® skills to transform themselves from a conventional leader into a courageous one.The new dynamics of global leadership - developing different competencies, curiosity and caring - must be learned. *Shaking the Globe* introduces the newly developed FISO Factor® Assessment Tool that can be used to evaluate a leader's ability to both "Fit In and Stand Out" - the ingredients necessary for leaders to make differences in their lives. Globalization is happening with or without you. To be a leader, you must learn how to take advantage of this opportunity.

Available at amazon.com
Price: $14.93

SAFA Students' Conference 2009

2K8: The Year of Changed Realities

The Institute of Chartered Accountants of Pakistan held its 3rd SAFA Students' Conference on March 21, 2009. The theme of this year's conference was **2K8: The Year of Changed Realities.** Mr. Khalid Rahman, CEO and Managing Director Pakistan Petroleum Limited (PPL), was Chief Guest. Mr. Farrukh Junaidy, Vice President South ICAP, Mr. Khalid Rahman, Managing Director PPL, Mr. Sarfaraz Ahmed Rahman, CEO Engro Foods Ltd., Mr. Usman Ghani Akbani, Director Deloitte and Mr. Sirajuddin Aziz, President Bank Alfalah also addressed the Conference.

The Conference revolved around the global economic crises and its repercussions and implications, and was attended by senior students of the Institute. The presenters and panelists were all trainees of CA firms who discussed the root causes of the crisis, ramifications for the South Asian region with specific focus on Pakistan's economy. The Conference concluded on the note that although Pakistan has been insulated from the crisis of global financial institutions but the economy's dependence on imported goods, particularly crude oil, made it difficult to bear the hit due to reduced exports. The participants were of the opinion that there should be integrated efforts to reduce the dependence on imports of this quantum.