WHEN BUSINESS STANDS STILL

SPECIAL REPORT Complete Chronology of GLOBAL CREDIT CRISIS
WHEN BUSINESS STANDS STILL

A Critical Analysis of Accounting Practices Prevailing in the Mutual Funds in Pakistan

Reporting on the Long-Term Sustainability of Public Finances

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A few years ago the US based Financial Executives Research Foundation did a study on what operational people thought about their financial counterparts. More than 50% respondents described their finance managers as 'corporate police'. If the Chief Financial Officer is perceived as a prosecutor would his managers come to him for help?

One of the tenets of the Sarbanes Oxley Act is that boards should have an active role in strategy. Incidentally, most board members come with operational backgrounds. Thus, the CFO needs to bring his strategy to the board in a way that allows the board to align themselves with his strategy.

Traditionally, accountants’ role in strategic planning has been confined to the implementation phases where strategies are converted into budgets. May be that’s because strategic planning requires managers to throw the rule book out the window; something accountants are not programmed to do.

Times are changing, though. Professional accountants are standing up and being counted for as strategic decision makers. Strategic planning defines a business’s mission, evaluates its strengths and weaknesses, identifies opportunities and threats, and realigns resources to achieve the goals of the business. This is where all those advanced quantitative techniques and NPV calculations start to make sense. Add to that an understanding of the profit implications of goodwill, brand recognition and other intangible assets, and you have an accountant who can greatly benefit the planning process.

But if finance managers really want to be seen as strategic business thinkers they must shift their traditional emphasis on compliance to a long term perspective to analyze the performance of their enterprise. They must seek to learn from their operational business partners who possess process knowledge. Whether in manufacturing or in services accountants must participate fully in establishing processes. They must learn to embrace organizational diversity and be willing to take creative risk.

Most important, they must realize that at its core any enterprise is a collection of people and, therefore, business strategy must define the collective intelligence and aspirations of all those people. The relationship between people, process and product must be sustained at all costs.

The game of bridge is often referred to as the game of strategy. It’s part science, part math, part logic. Like business. But bridge is also very human, where instinct matters more than reason. Just as business strategy should be; where business acumen doesn’t override human potential. It develops it.

Adnan Zaman

* The Financial Executives Research Foundation (FERF) was established in 1944 to perform impartial and independent research on financial management and reporting.
WHEN BUSINESS STANDS STILL

During my years with the pharmaceutical industry, the term Big Pharma sounded very intimidating. Big Pharma defines the concentration of the large pharmaceutical companies. In contrast to small and medium sized local companies, these companies coordinate and manage a complex network of alliances and partnerships between them.

Whatever the structure of the pharmaceutical industry in Pakistan, it seems that Big Pharma will have a significant role in determining business practices. The pharmaceutical industry has been one of the most profitable industries for many years and is considered a recession proof industry. Local pharmaceuticals could generate considerable revenue from exports over time if the government provides a business friendly atmosphere to this sector.

Another area where local pharmaceutical companies can compete internationally is outsourcing. China is now being ranked as the number one location for pharmaceutical outsourcing in Asia followed by India, Korea and Taiwan. These countries are emerging not only as low-cost production locations but also as locations with market potential and research and development capacity.

The government needs to devise a strategy for the local pharmaceutical industry to compete and make the most of the opportunities available to Asian countries. This is a critical growth opportunity that this industry can not afford to miss.

Some companies continually face tremendous challenge in creating profitable growth. Then there are other companies that achieve sustained growth in both revenues and profits. Numerous business studies of high growth companies over the years have shown that the difference between high growth and low growth lays in the way these companies approach strategy.

Less successful companies take the beaten path: the conventional model of always staying ahead of the competition. Successful companies on the other hand take the road less traveled: they innovate. They don’t compare themselves to rival companies; they don’t try to match or beat competitors. They don’t allow competitors to set parameters for their success. They use their competitors’ strengths not to identify their own weaknesses, but to build on comparative advantages.

They believe in their core strengths and add value to them. They put aside conventional thinking and deliver a package that their customers would highly value. Successful companies monitor their competitors, but they do not do things in response to what the competition is doing. They do not scramble for incremental share. They aspire to create their unique value in whatever they are doing.

Abdul Rahim Suriya
This issue’s topic is:

**Does IT Matter?**

“The differentiation is not in IT itself which is everywhere and increasingly less expensive these days, but in the new practices it enables.”

Brown & Hagel

As technology diffuses in to every aspect of organizational life, IT is fast becoming a commodity. With more companies investing heavily in IT and with more and more IT products being standardized and their cost falling, should Information Technology be viewed merely as a commodity or as an enabler of new business practices?

**COMMENTS**

I found the topic and its lead answer to be fairly obvious. With the Mcdonald’s like burgers featuring on the cover pages of Pakistan Accountant, I wonder who’s bothered about a vegetable question like this?

Altat Noor Ali
Altat Noor Ali Chartered Accountants
Karachi

It does matter on who is sitting behind the wheel. No doubt, living in this vibrant era without IT is even hard to imagine but making this tool to be used as a best business practices enabler is an art, which practically very few organizations have learnt so far. However, at least through IT’s widespread availability at affordable price this is now not an elite commodity for a few entrepreneurs. Its best business practices features can be utilized by any entrepreneur at his discretion.

Amer Jan
GM Finance (South) PTCL
Karachi

IT is no longer a black box. IT is an integral part of the enterprise functionalities and a board needs to understand the overall architecture of its company’s IT applications portfolio. Having worked for an Institute for Corporate Governance for nearly three years now, this brings me to highlight the importance of IT Governance, the lack of which has led to various IT project failures.

Lack of interest at the Board level in IT related decisions led to the failures resulting in substantial financial loss such as Disney Corporation’s “go.com” project shut down after $878 million in expenditure, Nike’s $400 million investment in software which was subsequently written off as a disaster and the Australian Customs Imports Control System when customs insisted on going live with its own systems, the industry was not ready and the ports effectively closed down for three weeks until the old systems were brought back into action.

Hence IT does matter.

Jahanara Sajjad Ahmad
United Arab Emirates

The Pakistan Accountant  Oct-Dec 2009
IT is definitely not a commodity as commodity is something which is supplied/provided without qualitative differentiation. IT on the other hand can make or break an organization as it has become such an integral part of corporate framework.

**Khwaja Kamran Shah**  
Consolidation Manager Group Corporate Finance  
Dubai

Yes, IT matters a lot. Specifically speaking about the banking industry, technology has the biggest and most critical role not only in innovative product development but also in providing swift customer services. IT has completely changed the thought process of the bankers where every product, process and activity is conceived keeping in view its technological elements and the amount of support it provides from conception to production.

From the simplest of the consumer banking products to the most sophisticated structured products and from archival to audit process, IT has revolutionized everything. Though few would still argue that IT is a luxury and the cost associated is still relatively high. However, in the longer run and in a broader perspective IT has reduced cost considerably with automation of processes.

All in all, IT is an integral element of modern day business and it cannot flourish without IT.

**Syed Raheel Hashmi**  
Head - Quality Assurance | Operational Risk Management  
Noor Islamic Bank

I support the point of view that IT enables business practices. The most relevant example of this is the system of transactions and payments through credit cards. The use of credit cards increases purchasing power resulting in overall increase in business activities, and this system of credit cards was not possible without the help of IT.

**Jamil Ahmed**  
Lahore

Information Technology is already viewed as an enabler of business practices in meeting strategic requirements and sustaining competitive advantage. In current e-business world, information technology is the catalyst for creating entirely new business models. It is not only part of the fabric of the organization, causing companies to restructure business models, but IT has also changed the way they manage customer relationships, work with their business partners, and form strategic alliances with competitors. In this new economy, companies must leverage the enormous opportunities continually created by technological advances to meet the strong demands of complex information networks, an increasingly dynamic global economy, and a ‘never-satisfied’ customer.

**Qaiser Vakani**  
Group Consolidation Manager SThree Management Services

I’ve always considered IT as an enabler of new business practices. Having served in the financial services industry since 2001, I’m confident that the growth of this industry over the past several years has been achieved because of new IT practices across the business either through online account activity, mobile banking, credit or debit card. Going forward, we will see further differentiation in financial products based on IT’s innovations. Soon you will find people managing entire businesses sitting at home, thanks to IT once again. At ABL AMC we believe in the same strategy and think out of the box to design new products based on the latest technology available.

**Faisal Nadeem Mangrola**  
Head of Internal Audit & Compliance  
ABL Asset Management Company Limited  
Karachi

The collapse of geographic boundaries has made the world a global village, thus business must acknowledge the need for Information Technology. IT has challenged the more orthodox ways of business practices. It revolves around the automated processes that require little or no human intervention. This in turn has eliminated repetition of tasks, risks involved due to negligence of timely upgrades and extensive paper-intensive business applications that result in the accumulation of unnecessary bulk. Thus IT cannot be viewed as a mere commodity.

In a nutshell, IT has caught on in the form of a communication revolution for modern day business and revolutionized more or less all business sectors around the globe, thereby changing old business practices.

**Zaryab Hyder**  
Manager | Assurance  
Ernst & Young Ford Rhodes Sidat Hyder  
Karachi

In my opinion how IT is viewed depends a lot on the way it is being implemented by an organization.

Even when an organization merely involves IT for automation of its operation without any business process re-engineering, it is required to mould some of its processes accordingly.

But if IT is implemented in its true spirit it forces organizations to device a number of new business processes, adopt best practices and re-engineer their existing processes. Only in that way can IT act as enabler and not as a commodity.

**Ayesha Ashfaq**  
Assistant Manager Corporate Finance  
Ministry of Petroleum and Natural Resources  
Islamabad

IT does matter but it’s being over-emphasized in current times. So much so that we are more concerned about the left and right margins of a report and less concerned about the message that matters more.

**Saleem Ahmed**  
Senior Manager | Audit & Assurance  
M. Yousuf Adil Saleem & Co. Chartered Accountants

IT is bringing wide ranging and significant changes to business practices. Not only are the traditional operational methods of procurement, manufacturing, distribution and sales being modified to bring in effective and efficient techniques into play, but the back end support systems in an organization including finance, human resource and administration are also evolving to the changing business processes. Be it a market segmentation study or an efficient production process, a balance sheet forecast or employee performance appraisal, IT continues to enable new dynamic practices to the operating business environment.

**Sibtain Shabbir Hussain**  
Manager Treasury | Lakson Tobacco Company Limited  
Karachi
Certainly, the topic is interesting. How could IT be considered as a mere commodity, when businesses all around the globe are GLOBAL today, thanks to the rapid development of IT services. Therefore, IT is a tool for business development and enabler in the true sense of the word.

Abdul Sattar Tabbani
Karachi

The principal role that information technology has performed in the past has been the operational and management support. But recently the use of information systems as competitive weapons is accelerating. Among the classic cases of strategic information systems are the computerized reservation systems of airlines, the cash management system of financial institutions, and the order entry system of the supply chain sector. The companies have now begun using information systems practices strategically to reap significant competitive advantage.

Muhammad Arshad Hasan
Chief Financial Officer Lahore School of Economics
Lahore

Does IT Matter?? implies that IT has dramatically changed the role of business, its leveling effect on competition, and the practical implications for business managers and IT suppliers. The vital role of ERP, other IT solutions and hardware combination also enables businesses to introduce new concepts, new processes, new products and even capture new markets. I believe that a company has to employ IT considering its present and future needs to the extent that they make its operations efficient, deliver a better customer experience and gain a competitive advantage.

Haroon Sulaman
Manager Audit & Systems Sitara Textile Industries Limited
Faisalabad

“The differentiation is not in IT itself which is everywhere and increasingly less expensive these days, but in the new practices it enables.”

This is completely true. IT has permeated all walks of our lives. It has not only changed the way we do business but also the way we operate in society and interact with each other. The advance of social networking and Web 2.0 has completely transformed the concept of human interaction though at the cost of personal privacy.

IT has allowed businesses to break new frontiers in all respects from materials management to marketing. It has made organizations more nimble, flexible, customer focused and highly efficient. It has also questioned whether the profession of accountancy is there for the long haul given the advancements in IT, though this would perhaps be something to be debated separately.

M A Shahk
London

IT has indeed changed the way everything used to be done. What needs our attention though is that we don’t get carried away with the IT drive by adopting IT for the sake of IT. Each step towards automation and IT should be well calculated with clear objectives, modalities and risks in mind. While IT addresses many issues, it brings with it new risks in the areas of systems integration, data migration, disaster management, information security and most importantly, the need for a sense of how IT leverages the overall organizational strategy.

Syed Shahid Abbasi Ritzvl
Mobilink
Islamabad

Nobody can doubt the horizons that IT has opened businesses to. IT usually does not of itself materialize as a product of modern business but it surely leads to differentiation through a competitive edge over rivals. In the last three to four decades IT has transformed from mere data processing to Business Intelligence.

There are many examples of business failure where IT is involved, but fact finding exercises reveal that what was missing was management. It would not be wise to spend millions of rupees to keep abreast of the latest technology. What matters is the alignment of IT Strategy within the Corporate Strategy.

On the other hand IT as a product has put companies like IBM and Microsoft in Fortune 500’s top 50 rankings. In the early nineties, who knew that web based companies like Google, Yahoo etc. would become the big guns of the corporate world.

Imran-ul-Haq
Lahore

IT has changed the way companies carry out many important activities, but it has also led managers to invest cash into risky and misguided initiatives. As IT has become more standardized and more affordable, it has been transformed from a proprietary technology that companies can use to gain an edge over their rivals into an infrastructural technology that is shared by all competitors.

Owais Mukattl
Karachi

A N A L Y S I S

In the year 2000, nearly half of US corporate spending was on Information Technology. Companies were making huge investments, particularly in e-business initiatives, in an attempt to achieve competitive and strategic advantages. However, these projects never produced significant benefits. Indeed, many were never completed. Then there was a significant fall in spending on technology. NASDAQ collapsed and eyebrows were raised and questions were asked whether IT was dead or whether it would continue to be a source of dramatic, even transformational change.

In this backdrop Nicholas G.Carr’s essay “IT Doesn’t Matter” appeared in the May 2003 issue of the Harvard Business Review claiming that “technology’s potential for differentiating one company from the pack – its strategic potential – inexorably diminishes as it becomes accessible and affordable to all.”

The thrust of Carr’s argument was:

- IT has ceased to be a scarce good and can now be acquired from the marketplace like any other commodity.
- Businesses had overestimated the strategic value of IT and in their desire for acquiring business value had significantly overspent on technology.
● Whole industries rather than any one competitor would benefit from these changes.

Based on the above analysis Carr concluded that IT has lost its strategic value and that businesses instead of seeking advantage through technology should manage their IT infrastructures in a way that would reduce capital investment and security of their systems by employing effective risk management techniques.

Not surprisingly, “IT Doesn’t Matter” generated an enormous amount of debate. It drew criticism from Bill Gates and others in the IT industry that had prospered and flourished by marketing the strategic value of technology.

Those who disagree with Carr argue that:

● IT does not matter in isolation. It only matters in the context of a concerted effort to innovate based on new possibilities and opportunities created by the technology:
  ● IT networks and the Internet have made it possible for companies to extend their operations globally. New entrants have joined many industries and have focused on taking strategic advantage of the economics associated with IT.
  ● IT has enabled industry’s transaction costs to decrease continually, making it possible for the firms to make products and services that were not feasible in the past.
  ● The Internet has made the explosive growth of small businesses possible.
  ● The management of information intelligence and collaboration among individuals, groups, and organizations has improved dramatically.

● Unlike commodities like rice and steel, where the processing operations are well understood and the economic advantage lies in being able to source the commodity at lower cost, managerial capabilities are needed to create value with technology.

● On its own IT may not confer strategic differentiation, but it certainly creates opportunities that were not previously economically available. Companies that see and act on these possibilities before others do will continue to differentiate themselves in the marketplace and reap economic rewards. However, the insight required to harness this potential will never be evenly distributed. Therein lays the opportunity for significant strategic advantage.

● To extract value from IT companies need to make innovations in business practices: improving cost savings and efficiencies, making better organizational structures, products and services, creating strategic advantage through partnerships, and providing new IT-based services to extend the customer value propositions.

● IT developments have not reached the saturation point and we would see more and better innovations.

● The need to pay more attention to IT risks is undisputable, but the risks do not exceed the advantages.

The quantum leap promised by those marketing strategic use of technology may not have materialized, however, Information Technology has made it possible for businesses to improve their processes, and has positively affected organizations at the strategic, tactical and operational service delivery levels. The rewards from this transformation have not been evenly distributed; those who had the insight and ability to create economic value have benefited the most.

Furthermore, IT developments have not reached a plateau. We will continue to see better and more innovative software products. However, to gain a significant strategic advantage companies will also have to make innovations in businesses practices.

Ahmed Saeed K|man|l
Karachi

Dear Members
Thank you very much for taking time out to answer our DISCOURSE question.

The number of responses this question has generated proves the significance of Information Systems in providing a competitive advantage.

The crux of this debate is that IT by itself may not provide a business with a strategic advantage, but IT creates possibilities that can only be fully exploited when the business is ready to change its practices. Technology will make a business or a service more efficient only when the right people are continually working to improve the right processes.

Once again you have helped us maintain the vibrancy and decorum of this open discussion forum.

Please continue participating.

Publications Department, ICAP

* The two Harvard Business Review articles that became the basis for this DISCOURSE are:

IT Doesn’t Matter by Nicholas Carr, Editor-at-Large for the Harvard Business Review, HBR, May 2003; and

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In comparison to external factors, internal factors are leading indicators and have more influence on business collapse in general.

Aamir Jan Muhammad, FCA
External economic and other factors are beyond the control of any entrepreneur and generally he cannot help it in overcoming those factors, rather only take internal measures to mitigate the negative influence of these factors to limit the risk of loss to the business at tolerable level. However, certain businesses lose momentum and consistency mainly due to complacency by reaching a certain level and through experimenting new impulsive ideas based on whims without chalking out a proper business plan or taking into account calculated risk associated with the implementation of new ideas.

In the paragraphs that follow we will outline the major internal factors which lead to the demise of profitable business entities:

**NOT ACCEPTING COMPETITIVE CHANGE**

Most enterprises, especially those enjoying monopoly in their products, become the victim of egoistic managerial mindsets and after the emergence of any competition close their eyes to it and gradually lose market share. Contrary to this newcomers act more aggressively with new customer focused ideas and better service providing mindset and gradually capture the market through competitive edge over its monopolistic entrepreneur and in the long run become the true market leader in a competitive economic environment.

Theoretically speaking, it seems obvious that a strong business enterprise with a thorough market share would be in a better position to outclass its new competitor by adopting changed customer focused strategies. However, in practice it does not happen as entrepreneurs who are enjoying guaranteed sale of their products at desired margins fail to accept the reality of competition by assuming that conditions will remain the same whether or not they react in a positive fashion to the changed market conditions. This slackness of entrepreneurs leads to gradual decline of their businesses and in most of the cases, total collapse.

Prime examples in Pakistan are some big business enterprises that either closed down, or lost their market share, or grappled with huge losses. For instance, one of the largest multinational electrical companies operating in Pakistan with a strong brand image and market share in electrical products closed down its manufacturing units and substantially lost its business share to local competition. One of the largest multinational companies dealing in tea lost market share to a local competitor even after merger with another big company, and the monopoly of a multinational dealing in cooking oil and related products market was also captured by new local businesses. On the international front the recent bankruptcy of renowned automobile companies are some examples.

The most common factor amongst major big companies losing market share or giving free space to the new entrants is mainly due to the fact that they were unable to retain their customers by offering them products and services matching changing demands and consequently failed to satisfy their customers. This rule of constant change applies to all facets of life and obviously to businesses as well. Those entrepreneurs who realize this factor and constantly work on continuous improvement to delight customers through their competitive products and services never fall victim to business crisis.

**DECISION MAKING ON IMPULSE**

In the long run only those businesses survive which are managed through defined processes and not by few individuals' whims and impulsive ideas. There is an old saying “if it ain’t broke don’t fix it”. Businesses sometimes become victim of undue influence of high management over decision making. Chief executives are sometimes so obsessed with their own ideas that they are not willing to listen to any arguments against them or take into account risks associated with the project. For example, getting into a totally different line of business with no relation to existing business products and services, business mergers and demergers, discontinuing old product lines and replacing them with new products without market survey, introduction of new product to wrong market segment, overspending on established brands, getting into price wars while compromising the company’s profit margins etc.

**ORGANIZATIONAL STRUCTURE**

People are the key resource of any organization and the key to destroying any business enterprise is to destabilize the organization structure of that company. Though this basic factor is not considered that important in many established business organizations but this is the key for the long term survival and growth of any business entity working in any economy of the world.

Think for a while a company with a defined organogram of all departments with reporting hierarchy, defined cadres, justified pay structure at all levels, job descriptions, key performance indicators (KPIs), assigned SMART targets at all individual levels, succession plans, performance appraisals, reward and
reprimand mechanism and above all proper communication of company’s objectives to all levels from bottom to top.

Under this organized scenario everybody knows their role and would be satisfied with their job at the end of the day by realizing the fact that their performance is being judged and he/she has a defined career path. Contrary to this if these mentioned factors are missing in the organization, no matter how skilled and talented people working with that company are, overwhelmed with work everybody would just be passing the buck around to safeguard their jobs and at the end of the day company objectives would not be achieved.

Another related aspect which has a critical impact on a company’s business is the brain drain of employees through implementation of disorganized Voluntary Separation Schemes (VSS). Downsizing of staff without chalkling out future placement needs in terms of skilled human resource becomes a slow poison for the business and in the long run seriously affects the continuity of the business. In large organizations where VSS are offered those with skills and job opportunities in the market are the first to opt for the scheme as it gives dual benefits to them. Consequently, if general VSS is offered then at the end of the process the company is left with employees less in demand both within and outside the company. Personally speaking, and based on the author’s work experience, most of the VSS schemes, though it is difficult to quantify its intangible consequences, are not well planned and have resulted in a brain drain of key human resource which subsequently affects the company’s performance.

CONCLUSION

In all facets of life basics play the key role. In the current global economic scenario the rule of “survival of the fittest” applies whereby entrepreneurs need to keep their business fit for all environments by bringing innovation to products and services in line with changing market trends.

For the long term survival of business enterprise in the competitive times, regardless of size and nature, entrepreneurs need to implement certain basics to achieve their prime objective i.e. to earn profits from the business on a continuous basis.

Four basic factors must be considered as vital signs for business continuity in the long run:

- Positive financials;
- Customer satisfaction;
- Effective processes; and
- Trained human resource & business infrastructure.

To achieve the business’s financial objectives, entrepreneurs need to have satisfied customers. To retain satisfied customers he needs to device processes which can deliver desired products and services to customers on a continuous basis with a concept of customized products and services. Furthermore, to implement these business processes business need skilled human resource and infrastructure to deliver the desired results.

Conclusively, if we reverse this series of factors in ascending order we come to know that two factors i.e. skilled human resource and business structure, and defined processes are leading factors and if these are effectively in place then the other two factors i.e. customer satisfaction and positive financials are guaranteed.

Business survival is wrapped in this golden strategy of retaining existing customers and attracting new customers without compromising on quality of products and services with an ensured positive bottom line. If these basic factors are properly followed and implemented, rest assured the business will survive and thrive in good times and bad.

Aamir Jan Muhammad
General Manager Finance – South, Pakistan Telecommunications Corporation Limited (PTCL).

To achieve the business's financial objectives, entrepreneurs need to have satisfied customers. To retain satisfied customers he needs to device processes which can deliver desired products and services to customers on a continuous basis with a concept of customized products and services.
Introduction

Recessions are like hurricanes: they hit different areas with different intensities. How a company responds will depend on how sensitive the industry is to the downturn and the strength of its strategic and financial positions. The repercussions of the market meltdown continue to reverberate around the financial services sector. The financial crises around the world in the past two years has been very challenging for everyone and more so for the finance community.

In Pakistan, as well, the past two years have been challenging with deteriorating political, and security conditions and a number of economic challenges like low GDP growth, high inflation, and massive devaluation of the rupee. The purchasing power of the consumer has also deteriorated, thus putting more pressure on companies to operate efficiently and make value offerings. However, currently the GDP growth has started to improve and inflation is more controlled.

Key Learnings

One of the key learnings from the current financial crisis was that there was too much focus on short term revenue generation rather than a more sustainable long term approach to profit and value creation. The CFO can play a critical role in promoting a more balanced approach to risk and reward. This includes strengthening the management and company wide understanding of the risks and funding costs associated with particular products and trading strategies.

New Ways of Working

Businesses need to work differently and find new ways of working. Recession and the turbulent times that follow offer many companies an ideal chance to move ahead of competitors. To seize these opportunities major activities would include clarifying strategies, shifting resources to core activities, aggressively managing costs and cash flows, increasing revenues and margins and preparing bold moves. Not every action will apply to every company. In turbulent times people tend to get very risk averse which sometimes may lead to moving the corporate innovation portfolio exclusively towards short term which is relatively risk free. In such times companies need financial expertise to guide them to rebalance the portfolio, channelling some resources on innovation efforts that have the potential to pay off handsome dividends.

Business Analysis

When the business environment becomes more uncertain there is a greater need to understand how the business is performing and where it is spending the money. A lot more information covering the full range of operations from the organization’s exposure to currency movements, information analysis on the company’s supply chain and logistics operations, risk exposures on investment decisions, the organization’s liquidity position, its net debt position etc. is required.

Also in the current environment there is greater pressure on organizations to produce accurate and timely information that provides an informed view of business performance and expected trading conditions. The accuracy and reliability of business information has become critical and the finance community is seen to drive value through better planning and improving the accuracy of business forecasting. The
need for forward looking information and more refined business forecasting is very essential.

The CFO and finance teams can play a very important role by making sure that correct and timely analysis is done to understand the changing environment and evaluate whether there is a need to review new operating and financial metrics in the light of the environment.

Managing Costs

When profit margins are significant big companies may not be as focused on cost- what they now need is really strong business analysis to reduce the business waste and look for cost efficiencies in controlling costs. In times of stability these companies may not be too concerned about costs because they have more fat in the profit margin. During a recessionary profit there is pressure on the margins.

The consumer is not able to pay such prices. A proper review of supply chain costs and alternative options of resourcing the business should be evaluated. Under such circumstances looking at avenues of cost savings and business efficiencies are also critically important.

Also, in a difficult economic environment, proper forecasting and planning are important. Because of the sharpness with which things decline and depending on how deep the declines were, a lot of companies around the world were forced to make relatively abrupt and drastic moves in order to deal with the loss of sales and loss of volume by reducing the workforce.

Working Capital Management

One of the biggest roles that the finance community can play is the working capital management. As volumes decline, every effort needs to be made to pull working capital out of the system. Through a very systematic month in month out focus on working capital and reviews of orders and inventory levels, the focus should be on the reordering of raw materials. Stronger control and understanding of working capital, better focus and accuracy with cash forecast position, transparency and understanding across the balance sheet, and debt reduction have become critically important to the survival of the organizations.

The financial crisis has created a bottleneck in the banking and cash system and refocused organizations on finance operations. Cash liquidity is the primary reason why many businesses fail in the current environment which explains the refocus on financial operations.

Who is in a position to provide this sort of
guidance to the business? It is the finance community that can with its insights, knowledge and acumen be able to help chalk out a clear direction.

**Empowerment & Challenges**

In many firms the finance teams may lack sufficient licence, willingness and acceptance to challenge business decisions. Encouraging this vital input will require the mandate of the board. Effective transparency, scrutiny and oversight are essential in maintaining the checks and balances needed to safeguard the business and ensure sustainable returns. Empowerment to challenge exposures even if it goes against the prevalent strategic thinking is important.

**Risk Management**

It is the finance community’s responsibility to balance desired profit with acceptable levels of risk. Hence, quantifying the risk and the ability to evaluate and communicate the risk requires developing new processes to mitigate the risk quickly and efficiently. These are areas where the CFO can add value to the business.

**Effective Control**

Effective control demands the ability to cut through the complexity and recognize dangerous exposure and flawed trading strategies. If the finance team has reservations about decisions they should have the necessary mandate, confidence and ear of senior management to challenge them.

**Performance & Reward**

Gearing compensation packages to process improvement and sustainable delivery of goals could accelerate turnaround time and free time for greater strategic input. Finance heads & teams can play a role in the long term development of systems for aligning compensation to risk adjusted measures and longer term value creation to protect shareholder value. They are instrumental in encouraging the right behaviour by developing Balanced Scorecards and monitoring performance. This encourages everyone to pull together and helps to embed a culture of sustainable business growth and profitability.

**Competence/ Challenges**

The recent financial crises have raised questions about whether the finance professionals understand enough about the technicalities and risks associated with today’s complex structured products to provide the necessary advice, oversight and business challenge.

Better understanding would certainly improve the finance team’s ability to recognize threats and identify opportunities while ensuring their input is taken seriously by boards and business teams. There are growing talent shortages and, therefore, it would be unrealistic to expect finance personnel to have comparable technical knowledge to how to front office teams across all business areas. A good CFO should be able to see through the complexity and be willing to challenge trading teams if they believe the company is facing unacceptable risks. This calls for the CFO and his team to have an enquiring mindset and probing analytical skills.

A key consideration is whether some of the complexity that has grown around certain products is necessary let alone beneficial. If a qualified finance professional cannot fathom the intricacies and related jargon surrounding a particular product, then it may not be a safe enough bet anyway. This underlines the importance of finance’s involvement in product development and investment strategies from the outset. A key part of this input should be helping to set key parameters and looking at how to realize sustainable trading profits rather than simply pursuing short term mark to market gains. Hence, in such cases the CFO should hire accounting specialists who are often embedded in trading teams to help structure deals.

**Conclusion**

In summary, the role of the CFO, in addition to finance areas, cuts right across the organization. They are focused on short term survival, navigating the business through economic turmoil, ensuring the organization’s finance operations are strong, and making sure custodial issues- controls framework, protection of business assets, capital structures - are effective. They recognize the growing importance of strong regulatory controls, maintaining investor confidence and relations. They continue to balance these demands while steering organizational strategy and ensuring that the finance teams provide the right analysis and information that the business requires.

Khursheed Kotwal has recently started her own financial and management consultancy.
No Strategy Without Operations:

A Simulated Case Study of Starware International
Rana Mustansir

Operations activities must support corporate strategy if firms aspire to gain competitive advantage

PART I
FACTS OF THE CASE

Starware International is engaged in the manufacturing and sale of a range of good quality household and commercial ceramic ware. In addition to the local market the company exports to customers like Harrods in the United Kingdom, IKEA in the United States, CIS and Central Asia.

The factory handles ceramic production from the initial process of grinding minerals for formulating various color glazes to the final firing with decals decoration.

Starware International has a multi-source, single layer supply chain with a focus on price. Regular raw materials such as clay, grinding minerals, color glazes, decal and packing material are purchased from several independent local suppliers on long term contracts with an agreed price for a minimum period of one year. For import of a specified German chemical product, the company has a long standing relationship with four shortlisted alternate suppliers with C & F price included.

Typical to most developing countries Starware employs intermediate technology with production methods alternating between capital and labor intensive processes.

There is a lot of emphasis at Starware on the integration of quality within the management system, especially in terms of bringing the end product to the customers. However, there are also challenges that the firm faces in the successful implementation of Total Quality Management such as availability of resources, unrealistic business objectives, and establishment of effective supplier channels.

Country factors also affect the plant’s operational capability. Manufacturing is constantly disrupted owing to major power breakdowns, plant breakdown, and labor unrest.

Operational Practices at Starware International

I. THE BULLWHIP EFFECT

One dimension of the supply chain is the Bullwhip Effect which derives its name from the action of a whip where the end moves faster than the handle. It is the repetition of over and under supply of materials down the supply chain causing major problems in coordinating the network.

Starware operations are marred by the Bullwhip Effect owing to:

a) Under supply

Chemical shipments are stuck in customs for weeks. This delays arrival of goods to the manufacturing plant by several days. Frequently, furnished material is out of specification and has to be rejected.

b) Over supply

Master production schedule (MPS) goes off target lowering material consumption, ultimately resulting in excess inventory.

II. PROBLEMS IN PRODUCTION CONTROL

Starware’s production system is one of mass customization, producing low cost, high quality outputs in high variety. The core capabilities of Starware are focused on cutting costs by promoting efficiency and producing high quality product at low unit cost.

Starware’s production control system is material requirements planning (MRP) where work and material are pushed through to
try and pre-empt demand, as opposed to Just-in-Time (JIT) which operates with work instructions deriving from customer demand which pulls material through the system.

The firm is able to customize its product range to suit the needs of different customer groups without a cost penalty. Yet, production at Starware suffered from:

a) Over-production
Production in Starware was for more than what was required (large lot production) and before it was required (push production). Over-production results in higher storage costs, excessive lead times, and makes detecting defects quite difficult.

b) Waiting
The plant experienced waiting when goods were not moving due to poor material flow and long production runs, as when a production order was waiting for machine availability.

c) Unnecessary Inventory
As a direct result of overproduction and waiting, the plant had excessive inventory which led to increased lead times and limited floor space. Batch processing caused inventory influx. The push system left excessive finished goods and work in process, and buffers between unsynchronized production operations.

d) Product Defects
Defects occurred in internal production, in supplier parts/materials, during final testing, and would be discovered by customer after delivery.

PART II
ANALYSIS OF THE CASE

Operations Management is a Strategic Activity

In a 1997 study researchers Sven Horte and Hakan Ylinenpaa found that favorable sales performance resulted when there was a good fit between a firm’s and its customer’s perception of the strengths of a product. Conversely, when firms had high opinions about their competitive strengths but their customers did not share this opinion, sales performance was negative.

That was exactly the case with Starware International. The plant was running under capacity due to tough competition and low market penetration caused by high flow of Chinese finished products at comparatively very low prices. Cost of production at the plant was very high owing to high materials and energy costs, high rupee dollar parity, and import duties and tariffs on raw material. Still the plant continued to manufacture a product that the buyer did not want. Thus, the firm showed great skill in making a product for which there was little demand.

During the 1970s and 1980s, global markets had become so competitive that firms began to reevaluate their manufacturing strategies on the basis of the four competitive priorities: cost; quality; delivery/service; and flexibility. They realized that instead of making tradeoffs on these priorities they could compete on several competencies.

The term ‘world-class’ manufacturing emerged in the 1980s following the 1986 publication of World Class Manufacturing: The Lessons of Simplicity Applied by Richard J. Schonberger. A company was said to be world-class if it had the ability to compete in a global market. At this time Japanese techniques were having a huge impact on manufacturing. The Toyota Production System (TPS) had become the flag bearer of operational efficiency. TPS was established based on two concepts:

i) The first is called jidoka, loosely translated as ‘automation with a human touch’ which means that quality must be built in during the manufacturing process such that when a problem occurs, the equipment stops immediately preventing defective products from being produced.

ii) The second is the concept of Just-in-Time (JIT). Making only what is needed, when it is needed, and in the amount needed so that each process produces only what is needed by the next process in a continuous flow.

Based on the basic philosophies of jidoka and Just-in-Time, Toyota was efficiently and quickly producing vehicles of sound quality, one at a time, to fully satisfy customer requirements.

By 1990, management guru Peter Drucker had postulated that in the modern manufacturing era, world class will be based on Statistical Quality Control, a flexible manufacturing system, an integrated supply chain, and manufacturing economics.

Based on that hypothesis, small and medium sized businesses in developing countries need to acquire additional capabilities in order to compete in the international business arena: managing scarce supply conditions; identifying local supply sources; and training unskilled and semi-skilled workers. Local firms like Starware could become world-class if they understand that what they need is an enduring approach to competition.

However, to become truly world class firms like Starware will have to broaden their capabilities to include such factors as the establishment of strong brands, economies of scale, and market dominance.

The goal of Starware’s manufacturing strategy should not be to make short-term choices between cost, quality and flexibility, but to differentiate itself from its competitors through innovation and building on the firm’s unique skills and capabilities.

That would be possible only when it starts to view operations as a strategic activity. The operations strategy must be designed in such a way that all decisions relevant to system design, planning, control and supervision work to accomplish the manufacturing mission of the company.

As Harvard University researchers Hayes and Pisano say, ‘A company should think of itself as a collection of evolving capabilities, not just as a collection of products and businesses.’

This case study was developed as part of an International Operations Management module for Royal Holloway College, UK. It has been adapted for The Pakistan Accountant.


A C R I T I C A L  A N A L Y S I S  O F
ACCOUNTING PRACTICES
PREVAILING IN THE MUTUAL FUNDS IN PAKISTAN

Muhammad Rashid Zafer, ACA

Introduction
The operational modalities of collective investment schemes more commonly referred to as mutual funds and the presence of some peculiar requirements of the Non Banking Finance Companies and Notified Entities Regulations, 2008 (NBFC Regulations) poses some accounting issues which are normally not encountered in the limited liability companies.

In this article we will try to critically analyze the accounting treatment of the following issues that are prevailing in the mutual funds in Pakistan:

- Element of Income and Capital Gains (specific to open ended funds only)
- Compulsory distribution of ninety percent of the accounting income to the equity participants of the mutual funds (applicable to open ended funds, closed end schemes and investment companies)

**E L E M E N T  O F  I N C O M E  A N D  C A P I T A L  G A I N S**
As most of the readers of this journal are aware that open ended mutual funds continuously offer their units for sale and similarly these units can be redeemed at any time and in this aspect these open ended funds are different from a limited liability company where the share capital once issued is not repayable in the normal course, and the same are traded in the secondary market. This continuous entry and exit of the unit holders poses a unique accounting issue prevailing in the open ended mutual funds in Pakistan i.e. “the recognition of Element of Income and Capital Gains (Element) included in the prices of units issued and redeemed” in the income statement of the open ended mutual funds.

**What is Element?**
Before discussing the prevailing accounting treatment of Element it is necessary to understand the nature of Element. The units of open ended funds are issued and redeemed on the basis of Net Asset Value (NAV) which is computed by dividing the net assets of the open ended fund by the number of outstanding units at any particular time. When a unit holder redeems one unit from an open ended fund the amount he gets represents the current values of the net assets of the open ended fund which also include a portion of income and capital gains that the open ended fund has earned till the time of redemption. Similarly, in order to purchase one unit of open ended fund a person has to pay the current values of the net
assets of the open ended fund which also include a portion of income and capital gains that the open ended fund has earned till the time of purchase of units. This portion of income and capital gains that is paid and received at the time of redemption and purchase of units respectively is termed as Element.

**Current Treatment of Element in the Financial Statements of the Open Ended Funds**
Currently there are two practices that are prevailing regarding the recognition of Element which can be summarized as follows:

**Practice 1**
- The Element on issue of unit is recorded as income with the corresponding effect in unit holders’ fund.
- The Element on redemption of units is recorded as expense with the corresponding impact on unit holders’ fund.

**Why Element is Recognized?**
The Element is recognized in order to prevent the dilution of income and distribution of income already paid out on redemption. To further elaborate this, suppose that on redemption from open ended fund a person gets Rs.101 in which Re.1 represents the income and capital gains earned by the open ended fund. If this Re.1 is not recorded as an expense the income statement will show Re.1 as profit and at the time of distribution it will be distributed to the unit holder despite the fact that this Re.1 has already been paid to the unit holder on redemption. Similarly, a person pays Rs.101 for one unit of the open ended fund in which Re.1 represents the amount of income already earned by the mutual fund. If this Re.1 is not recorded as income in the income statement the amount of profit available for distribution to the existing unit holder will dilute as one additional unit has been issued which will participate in the income of the existing unit holder. The following illustrations will help to understand the impact of Element on the financial statements:

**Example 1 - Without Recognition of Element**

<table>
<thead>
<tr>
<th>Date</th>
<th>Net assets</th>
<th>Units</th>
<th>NAV</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-Jan-09</td>
<td>1,000</td>
<td>10</td>
<td>100</td>
</tr>
<tr>
<td>2-Jan-09</td>
<td>1,010</td>
<td>10</td>
<td>101</td>
</tr>
<tr>
<td>Issuance of Units</td>
<td>202</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Redemption of Units</td>
<td>1,212</td>
<td>12</td>
<td>101</td>
</tr>
<tr>
<td></td>
<td>(1,011)</td>
<td>(1)</td>
<td></td>
</tr>
</tbody>
</table>

**Income Statement**

- Income & Capital Gains 10.00
- Distributable Income Per Unit Before Issuance and Redemption of Units (Rs.10–10) 1
- Distributable Income Per Unit After Issuance but Before Redemption of Units (Rs.10–12) 0.83
- Distributable Income Per Unit After Redemption but Before Issuance of Units (Rs.10–9) 1.11

**Unit Holders’ Fund**

- Opening Net Assets 1,000
- Issuance of Units 202
- Redemption of Units (1,011)

Net Income 10
Net assets 1,111

In the above example, if distribution of profit is made on Jan 02, 2009 before the issuance and redemption of units then Rs.10 will be available for distribution and each unit holder will get Re.1. However, if two units are issued (ignoring the redemption) the...
amount available for distribution on Jan 02, 2009 will be Rs.10 whereas the number of units will have been increased from 10 to 12 as a result the per unit distribution will be Re.0.83 which results in dilution of income available for distribution to the existing unit holders due to issuance of two new units. Similarly, if one unit is redeemed (ignoring the issuance of units) on Jan 02, 2009 the amount available for distribution will be Rs.10 and if distribution is made on Jan 02, 2009 each unit holder will receive Rs.1.11 whereas actually Rs.9.9 should have been distributed to the unit holders i.e. Re.1 per unit as the portion of the income attributable to one unit i.e. Rs.1 has already been paid to the unit holder at the time of redemption.

**EXAMPLE 2 – WITH RECOGNITION OF ELEMENT**

<table>
<thead>
<tr>
<th>Date</th>
<th>Net assets</th>
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<th>NAV</th>
</tr>
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<td>1-Jan-09</td>
<td>1,000</td>
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</tr>
<tr>
<td>2-Jan-09</td>
<td>1,010</td>
<td>10</td>
<td>101</td>
</tr>
<tr>
<td>Issuance of units</td>
<td>202</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,212</td>
<td>12</td>
<td>101</td>
</tr>
<tr>
<td>Redemption of Units</td>
<td>(101)</td>
<td>(1)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,111</td>
<td>11</td>
<td>101</td>
</tr>
</tbody>
</table>

**INCOME STATEMENT**

- Income & Capital Gains 10
- Element of Income on Issuance of Units 2
- Element of Income on Redemption of Units (1)

| Distributable Income per Unit Before Issue and Redemption of Units (Rs.10-10) | 1 |
| Distributable Income per Unit After Issuance but Before Redemption of Units (Rs.12-12) | 1 |
| Distributable Income per Unit After Redemption but Before Issuance of Units (Rs.9-9) | 1 |

**UNIT HOLDERS’ FUND**

- Opening Net Assets 1,000
- Issuance of Units 202
- Redemption of Units (101)
- Element of Income on Issuance of Units 2
- Element of Income on Redemption of Units 1
- Net Income 11
- Net assets 1,111

In the above example, if distribution of profit is made on Jan 02, 2009 before the issuance and redemption of units then Rs.10 will be available for distribution and each unit holder will get Re.1. If two units are issued (ignoring the redemption) the amount available for distribution on Jan 02, 2009 will be Rs.12 whereas the number of units will have been increased from 10 to 12. As a result the per unit distribution will remain same and no dilution will occur in the income available for distribution to the existing unit holders due to issuance of two new units. Similarly, if one unit is redeemed (ignoring the issuance of units) on Jan 02, 2009 the amount available for distribution will be Rs.9 (10-1) and if distribution is made on Jan 02, 2009 each unit holder will get Re.1. As a result the amount paid at redemption will not be distributed again.

It is clear from the above that the recognition of Element is inevitable in order to enable the open ended fund to continuously issue and redeem units without diluting the income available for distribution to the unit holders and to prevent the distribution of income which has been paid to the unit holders at the time of redemption.

**Is the Current Treatment of Element In Accordance with the Financial Reporting Framework Applicable on Open Ended Mutual Funds?**

Paragraph 70 of the "Framework for the Preparation and Presentation of Financial Statements (the Framework) defines income and expenses as follows:

“Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.”

“Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.”

Since the units of open ended funds are classified as equity instruments in accordance with the requirements of International Accounting Standard 32 therefore, in accordance with the definition of income and expense any contribution from or distribution to the equity participants i.e. unit holders cannot be classified as income or expense. If we analyze the examples above it will be clear that the Element is created from the contributions received from the equity participants i.e. the unit holders at the time of issuance of units and distributions made to the equity participants i.e. the unit holders at the time of redemption of units. Therefore, the Element should not be recognized in the income statement as it failed to meet the definition of income and expense.

In addition, paragraph 33 of International Accounting Standard 32 interalia states that “If an entity reacquires its own equity instruments, those instruments (‘treasury shares’) shall be deducted from equity. No gain or loss shall be recognised in profit or loss on the purchase, sale, issue or cancellation of an entity’s own equity Instruments...”

It will be interesting to note that the recognition of Element in the income statement results in two different treatments for the same item i.e. the amount of income paid at the time of redemption (Element) is treated as expense whereas the amount of income distributed as dividend at the time of distribution is treated as appropriation of profits.

Here one argument can be made that since Schedule V to the NBFC Regulations which sets out the disclosure requirements for the financial statements of the open ended mutual funds list ‘element of income and capital gains’ in the disclosure requirements of the income statement therefore, the same should be included in the income statement. The answer to this argument is that Schedule V outlines the disclosure requirements and most readers will agree that disclosure requirements spell out the type and contents of certain information that needs to be disclosed in the financial statements. The disclosure requirements cannot be and should not be construed as accounting treatment of the items of the financial statements. It implies that firstly we have to evaluate whether an item meets the criteria to be included in the income statement or balance sheet as per the applicable financial reporting framework and once it meets the criteria the same...
should be disclosed in accordance with the disclosure requirement. This point is further supported by the fact that in case of prevailing Practice 2 enumerated above a portion of Element is included in the distribution statement despite the fact that as per Schedule V the element is listed in the disclosure requirement of income statement.

In view of the above it can be safely concluded that Element does not meet the definition of income or expense as it results from contributions and distributions to the equity participants i.e. the unit holders of the open ended fund. Therefore, the same should not be recognized as income or expense.

**Suggested Treatment of Element**

As already mentioned above, the recognition of Element is vital for the open ended funds. However, since it does not qualify to be included in the income statement a question now arises as to what should be the correct treatment of Element? The answer to this question is very simple i.e. since the Element is basically contributions from and distributions to the equity participants it should be directly included in the distribution statement or the retained earnings rather than routing through the income statement. The following example will help to illustrate its application:

<table>
<thead>
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<td>12</td>
<td>101</td>
</tr>
<tr>
<td>Redemption of Units</td>
<td>(101)</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>1,111</td>
<td>11</td>
<td>101</td>
</tr>
</tbody>
</table>

**DISTRIBUTION STATEMENT**

| Income & Capital Gains | 10 |
| Element of Income on Issuance of Units | 2 |
| Element of Income on Redemption of Units | (1) |
| Amount Available for Distribution | 11 |
| Distributable Income per Unit Before Issuance and Redemption of Units (Rs.10-10) | 1 |
| Distributable Income per Unit After Issuance but Before Redemption of Units (Rs.12-12) | 1 |
| Distributable Income per Unit After Redemption but Before Issuance of Units (Rs.9-9) | 1 |

**UNIT HOLDERS' FUND**

| Opening Net Assets | 1,000 |
| Issuance of uUnits | 202 |
| Redemption of Units | (1,101) |
| Element of Income on Issuance of Units | (2) |
| Element of Income on Redemption of Units | 1 |
| Undistributed Income | 11 |
| Net assets | 1,111 |

It is clear from the above illustration that the objective of recognition of Element, i.e. to prevent the dilution of income and to prevent the distribution of income already paid to the unit holders at the time of redemption, can be achieved by recognizing it directly in the distribution statement while complying with the requirements of the financial reporting framework applicable on the open ended funds.

**Compulsory Distribution of Profits to the Equity Participants**

Regulation 63 of the NBFC Regulations interalia states that “An Asset Management Company on behalf of a Collective Investment Scheme shall, for every accounting year, distribute by way of dividend to the unit holders, certificate holders or shareholders, as the case may be, not less than ninety per cent of the accounting income of the Collective Investment Scheme received or derived from sources other than unrealized capital gains as reduced by such expenses as are chargeable to a Collective Investment Scheme under these Regulations.”

In order to comply with the above mentioned requirement all the mutual funds distribute ninety percent of the income. However, since the distribution is approved by the board of directors after the year end the same is treated as a non-adjusting event after the balance sheet date in accordance with the requirement of International Accounting Standard 10. However, one thing which is being ignored in this treatment is that the distribution of income is obligatory and not at the discretion of the mutual funds as specified in the above mentioned Regulation. This element of obligation on the mutual funds meets the definition of liability as stipulated in the Framework which defines liability as “A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.” Further, paragraph 60 of the Framework interalia states that “An essential characteristic of a liability is that the entity has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement.”

It is clear from the above that in case of income, compulsory distribution of ninety percent income is a present obligation of the mutual funds enforced on it by the NBFC Regulations and as evident it will result in outflow of resources embodying economic benefits therefore, the same should be accounted for as liability and should not be treated as a non-adjusting event after the balance sheet date.

Further, if we analyze the offering documents of the mutual funds we will note that almost all the mutual funds, in some form or the other, have specifically stated in their offering documents that ninety percent of the income will be distributed to the equity participants in order to avail the benefit of tax exemption available under Clause 99 Part 1 of the Second Schedule to the Income Tax Ordinance 2001, which interalia requires that any income derived by a mutual fund shall be exempt from tax if not less than ninety per cent of its accounting income of that year, as reduced by capital gains whether realized or unrealized, is distributed amongst the equity participants. For the convenience of readers following is an extract from the offering document of a mutual fund:

“Notwithstanding the tax rates stated under Clause XXX above, the accounting income of the Fund will be exempted from tax if not less than 90% of the accounting income of the accounting period is distributed amongst the Unit Holders. The 90% of the accounting income shall be calculated after excluding capital gains whether realised or unrealised. XXX Fund will seek to comply with the requirements of tax exemption and distribute at least 90% of the accounting income, calculated after excluding capital gains to the Unit Holders.”
International Accounting Standard 37 (IAS 37) defines constructive obligation as:

“A constructive obligation is an obligation that derives from an entity’s actions where:

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.”

If we analyze the above statement of the offering document in light with the definition of constructive obligation it will be clear that the above statement creates a constructive obligation on the mutual fund to distribute ninety percent of the accounting income and Para 14 of IAS 37 interalia requires that a provision shall be recognized when an entity has a present obligation (legal or constructive) as a result of a past event.

From the above discussion it is clear that distribution of ninety percent income creates an obligation on the mutual funds which needs to be recognized as a liability or as a provision on the balance sheet however, in case of open ended funds since the units are issued and redeemed on a continuous basis the recognition of compulsory distribution as a liability may create issues in the issuance and redemption of units on the basis of NAV. For example if an open ended fund started its operation from Rs.100 and on the next day it earned Re.1 as profit the NAV on the next day will be Rs.101 (assuming only one unit holder). However, if we record liability for distribution of ninety percent income the NAV will be Rs.100.1 only. If the unit holder redeems his units he will get only Rs.100.1 whereas actually he should receive Rs.101.

In view of the above it is suggested that a joint committee of The Institute of Chartered Accountants of Pakistan and the Mutual Fund Association of Pakistan should be formulated to consider the issue in order to formulate a solution which caters to the operational modalities of the open ended funds while complying with the applicable financial reporting framework.

DISCLAIMER:
The views expressed in this article are solely my personal views and not of the company I represent.

1 For the sake of simplicity the Element of loss and capital loss is not discussed in this article.

Muhammad Rashid Zafer
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Pakistan is one of over 80 countries with plans in place to issue IPSAS (International Public Sector Accounting Standards) or IPSAS-similar financial statements within its public sector. Pakistan is being supported financially by the World Bank as it attempts as a first step to meet the requirements of the cash basis IPSAS before eventually progressing towards producing full accruals based financial statements within its public sector.

Long-term sustainability of public finances
The IPSAS Board is the body responsible for setting accounting standards in the public sector. While it aims for convergence with International Financial Reporting Standards issued by the International Accounting Standards Board, full convergence is impossible because of the unique nature of the public sector.

An example of a difference between public and private sector financial reporting needs can be demonstrated through the recent release of an IPSAS Board consultation paper which looks at “Reporting on the Long-Term Sustainability of Public Finances”.

Inter-generational fairness of fiscal policy
Reporting on the long-term sustainability of public finances involves an examination of the extent to which a government’s policies under its current legal framework can be met in the future, assuming certain fiscal constraints, principally related to levels of taxation. The issues addressed in the paper are becoming increasingly of interest as people become more aware of concepts such as the “inter-generational fairness” of fiscal policy which means that our children and their children will ultimately bear the cost for fiscal decisions taken today.

An example of the inter-generational fairness of fiscal policy involves the costs associated with an ageing population. As life expectancy increases it is becoming increasingly onerous for countries to pay the nationally funded pension benefits and healthcare costs of its ageing population. In response to the costs associated with an ageing population many countries are exploring ideas of delaying the age when its citizens can receive nationally funded pensions in an effort to reduce costs. One can also consider the effects of the recent worldwide credit crisis and the cost incurred by many governments in bailing out their economies, and in particular their banks; who will ultimately bear these costs and when?

Clearly taxpayers and investors have an interest in long-term fiscal sustainability and how it will be funded, as does the IPSAS Board which believes that public sector financial reports should include both historical looking financial statements as well as “prospective financial and other information about the reporting entity’s future service delivery activities and objectives, and the resources necessary to support those activities”.

Benefits of long-term sustainability reporting
Currently many countries issue long-term sustainability predictions looking from 50 to 75 years into the future. Such predictions are typically carried out by economists, statisticians, and budget and policy specialists working in their national Ministries of Finance or Treasuries.

To a large extent long-term sustainability reports should prove to be more interesting to most people than historic looking financial statements. While historic financial statements typically cover a single year and are subject to variations in the short-term economic cycle, forward looking predictions will help smooth out the peaks and troughs of economic cycles. From a fiscal perspective governments can cover short-term fiscal deficits through borrowing, but over the long-term the chances of funding continuous fiscal deficits through borrowing reduces,
and governments must take the unpopular political decision to raise taxation. To be most beneficial long-term sustainability reporting should be based on current government policy; this will allow stakeholders to see the long-term effect of current policies and anticipate what remedial action must be put in place to create a balanced set of accounts in the long-term.

**Practical issues**

There are practical difficulties in producing reliable long-term fiscal sustainability reports, the most obvious being the reliability of estimates that reach well into the future. Even when producing historical looking financial statements a key difficulty is the estimation of provisions where an entity has a present obligation as a result of a past event, such as paying the pensions of currently employed staff. Under long-term sustainability reporting estimates are taken a step further. You must estimate the future costs (e.g. health, welfare, pension) of a population which may not yet be born, and then try to estimate the tax that will be paid by that same hypothetical population.

Although the future is hard, if not impossible, to predict the information to be included in long-term financial sustainability reports must still have the qualitative characteristics necessary to achieve the financial reporting objectives of holding people accountable for decisions made and for making optimal resource allocation, political and social decisions. The IPSAS Board considers the qualitative characteristics of financial reporting to be relevance, faithful representation, timeliness, understandability, comparability and verifiability. It becomes more difficult to attain these characteristics the longer you look into the future.

**Verifying the future**

Just how do you verify what will happen in the distant future? Future government revenues and costs are based on numerous factors revolving around the relationship between labour and capital. In terms of labour, how productive will it be in the future? What will future fertility and mortality look like, will people move to, or leave the country? In terms of capital how productive will it be in the future - how much more technologically advanced will the world become? Then there are other factors which will have an impact on productivity – how much will climate change and what will be its environmental impact upon economic growth?

In the United Kingdom, the Comptroller and Auditor General is required to, “examine and report on conventions and assumptions underlying the Treasury’s fiscal projections that are submitted to me by the Treasury for examination” in the government’s annual budget. This examination includes looking at factors used in estimates such as the trend rate of growth and then concluding on them. At least an independent review and examination gives a little more comfort in the reliability of information presented.

However, in many developing countries issues of verification will prove more difficult to address because future growth patterns may be harder to estimate and the infrastructure required to produce and validate long-term fiscal models may not currently exist.

**Comparing like-with-like**

There are also interesting technical issues that surround the qualitative characteristic of comparability when producing long-term sustainability reports. Many governments produce financial statements which are based on the concept of control. From a financial reporting perspective control requires the demonstration of both the power to govern the financial and operating policies of another entity (at least at the strategic level) and to benefit from the activities of another entity.

**Improved future decision making**

For many people the question of whether long-term sustainability reports should appear together with historical financial statements is probably an irrelevance. Many people and investors, especially in developing countries, would simply like to have access to reliable long-term sustainability projections which will allow them to make better informed personal or business decisions. While historical financial statements are used for accountability purposes, forward looking financial reports have the much more interesting potential to effect the life decisions of individuals.

**Clearly taxpayers and investors have an interest in long-term fiscal sustainability and how it will be funded, as does the IPSAS Board which believes that public sector financial reports should include both historical looking financial statements**

Ian Sanderson
Fellow of the Institute of Chartered Accountants in England and Wales
AUDITOR’S REPORT IN PAKISTAN

Muhammad Asif Iqbal, FCA

1. THE SCOPE OF AN AUDIT OF SEPARATE FINANCIAL STATEMENTS ARISING FROM THE REQUIREMENTS OF COMPANIES ORDINANCE, 1984

Section 255 of the Companies Ordinance, 1984 requires the auditor to make a report on the company’s financial statements to the shareholders that must state whether they have obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purposes of the audit and that whether, in the auditor’s opinion:

- proper books of accounts as required by the Companies Ordinance, 1984 have been kept by the company;
- the financial statements are in agreement with the books of accounts as referred above and have been prepared in accordance with the requirements of the Companies Ordinance, 1984;
- the financial statements give a true and fair view of the company’s state of affairs, its profit or loss and its cash flows and changes in equity in accordance with the approved accounting standards as applicable in Pakistan;
- the expenditure incurred during the year was for the purposes of the business;
- the business conducted, investments made and expenditure incurred during the year were in accordance with the objects of the company; and
- Zakat deductible at source under the Zakat and Usher Ordinance, 1980 (XVIII of 1980), was deducted by the company and deposited in the Central Zakat Fund established under section 7 of that Ordinance.

The Companies Ordinance, 1984 requires the auditor to prepare Auditor’s Report in accordance with Form – 35A which mandates the auditor to conduct the audit in accordance with the requirements of the International Standards on Auditing as applicable in Pakistan.

2. THE REQUIREMENTS OF THE INTERNATIONAL STANDARDS ON AUDITING (ISAS) AND THE ICAP REGARDING CONDUCT OF AUDIT OF THE SEPARATE FINANCIAL STATEMENTS

2.1 Overall objective

In conducting an audit of financial statements, the overall objectives of the auditor is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error in order to express an opinion on the truth and fairness of the financial statements.

2.2 Compliance with ISAs and ICAP Code of Ethics

The auditor is required to comply with:

a. all ISAs and International Auditing Practice Statements (IAPs) that are relevant to the audit; and
b. ICAP Code of Ethics of Chartered Accountants.
c. Other pronouncements issued by ICAP like ATRs etc.

ISAs require the auditor to plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.

ISAs and the Code of Ethics contain basic principles and essential procedures together with related guidance such as the following:

- Planning
- Understanding the company and its environment (including internal controls)
- Identifying and assessing the risks of material misstatement through understanding the company’s internal control system.
- Responding to assessed risks by determining the nature, timing and extent of audit procedures.
- Materiality considerations in planning and performing the audit.

The nature of these Standards requires an auditor to exercise professional judgment in applying them. Moreover, ISAs establish requirements in relation to those areas of the auditor’s work where it is particularly important that the views of auditors and users of financial statements, regarding the nature and extent of work to be performed, are aligned. Such areas include:

- Going concern.
- The auditor’s responsibility to consider fraud in an audit of financial statements.
- Consideration of laws and regulations in an audit of financial statements.
2.3 **Scope of an audit of financial statements**

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

3. **Opinion on the financial statements**

The opinion on the financial statements should be based on a review and assessment of the conclusions drawn on the audit evidence obtained during the audit work.

The audit report as prescribed by ISAs should:

- Contain a clear written expression of opinion on the financial statements taken as a whole.
- Have an appropriate title.
- Be appropriately addressed as required by the circumstances of the engagement and local regulations (if any).
- Identify the financial statements of the entity that have been audited, including the date of and period covered by the financial statements.
- Include a statement that the financial statements are the responsibility of the entity’s management and a statement that the responsibility of the auditor is to express an opinion on the financial statements based on the audit.
- Describe the scope of the audit by stating that the audit was conducted in accordance with ISAs and other relevant local laws.
- Include a statement that the audit was planned and performed to obtain reasonable assurance about whether the financial statements are free of material misstatement.
- Describe the audit as including:
  - Examining, on a test basis, evidence to support the financial statement amounts and disclosures.
  - Assessing the accounting principles used in the preparation of financial statements.
  - Assessing the significant estimates made by management in the preparation of the financial statements.
  - Evaluating the overall financial statement presentation.
  - Include a statement that the audit provides reasonable basis for the opinion.
  - Clearly state in the audit opinion that the financial statements give a true and fair view (or are presented fairly, in all material respects) in accordance with the financial reporting framework and, where appropriate, whether the financial statements comply with statutory requirements.
- The report should be dated as of the completion date of the audit which should not be before the financial statements are approved by the Board of Directors.
- Since auditor’s responsibility is to report on the financial statements as prepared and presented by management, the auditor should not date the report earlier than the date on which the financial statements are signed or approved by management.
- The report should be signed in the name of the firm along with the name of the engagement partner. Additionally, the report should contain the date and place of the signing auditor(s).

3.1 **Unqualified opinion**

An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view (or are fairly presented, in all material respects), in accordance with the identified reporting framework.

3.2 **Modified Opinions**

3.2.1 **Matter of emphasis**

- In certain circumstances, the audit report may be modified by adding an emphasis of matter paragraph to highlight a matter affecting the financial statements which is included in a note to the financial statements that more extensively discusses the matter. The addition of such an emphasis of matter paragraph does not affect the audit opinion. The paragraph would preferably be included after the opinion paragraph and would ordinarily refer to the fact that the audit opinion is not qualified in this respect.
- The addition of a paragraph emphasizing a going concern problem or significant uncertainty is ordinarily adequate to meet the reporting responsibilities regarding such matters. However, in extreme cases, such as situations involving multiple uncertainties that are significant to the financial statements, the auditor may consider it appropriate to express a disclaimer of opinion instead of adding an emphasis of matter paragraph.
- In addition to the use of an emphasis of matter paragraph for matters that affect the financial statements, the auditor may also modify the audit report by using an emphasis of matter paragraph, preferably after the opinion paragraph, to report on matters other than those affecting the financial statements. For example, if an amendment to other information in a document containing audited financial statements is necessary and the entity refuses to make the amendment, the auditor should consider including in the audit report an emphasis of matter paragraph describing the material inconsistency.

3.2.2 **Qualified / Adverse / Disclaimer Opinions**

The auditor may not be able to express an unqualified opinion when either of the following circumstances exists and, in auditor’s judgement, the effect of the matter is or may be material to the financial statements:

- a. there is a limitation on the scope of work; or
- b. there is a disagreement with management regarding the acceptability of the accounting policies selected, the method of their application or the adequacy of financial statement disclosures.
The circumstances described in (a) could lead to a qualified opinion or a disclaimer of opinion. The circumstances described in (b) could lead to a qualified opinion or an adverse opinion.

- A qualified opinion should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but the effect of any disagreement with management, or limitation on scope is not material and pervasive as to require an adverse opinion or disclaimer of opinion. A qualified opinion should be expressed as being “except for” the effects of the matter to which the qualification relates.

- A disclaimer of opinion should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate evidence and accordingly are unable to express an opinion on the financial statements.

- An adverse opinion should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.

- Whenever the auditor expresses an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of possible effect(s) on the financial statements.

- When there is a limitation of scope on the work that requires expression of a qualified opinion or a disclaimer of opinion, the audit report should describe the limitation and indicate the possible adjustments to the financial statements that might have been determined to be necessary had the limitation existed.

- Where the auditor disagrees with management about matters such as the acceptability of accounting policies selected, the method of their application, or the adequacy of disclosures in the financial statements, if such disagreements are material to the financial statements, the auditor should express a qualified or an adverse opinion.

The table below (as given ISA 705-A1) illustrates how the auditor’s judgment about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed.

<table>
<thead>
<tr>
<th>Nature of Matter Giving Rise to the Modification</th>
<th>Auditor’s Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial statements are materially misstated</td>
<td>Material but Not Pervasive: Qualified opinion</td>
</tr>
<tr>
<td>Inability to obtain sufficient appropriate audit evidence</td>
<td>Material and Pervasive: Adverse opinion</td>
</tr>
</tbody>
</table>

### 3.2.3 Going Concern

The report should be modified by adding a paragraph to highlight a material uncertainty regarding going concern of the entity. However, in the following circumstances, the auditor should express a qualified or adverse opinion, as appropriate:

- If adequate disclosure about the going concern uncertainty is not made in the financial statements, the auditor should express a qualified or adverse opinion as appropriate.

- If the auditor concludes that the going concern assumption used in the preparation of the financial statements is inappropriate and therefore the financial statements are misleading, the auditor should express an adverse opinion (ISA 570).

### 4. COMMUNICATING WITH THOSE CHARGED WITH GOVERNANCE

ISA 705 (paragraph 28) requires that when the auditor expects to modify the opinion in the auditor’s report, the auditor shall communicate with those charged with governance (Board of Directors) the circumstances that led to the expected modification and the proposed wording of the modification.

As explained under ISA 705-A25, communicating with those charged with governance the circumstances that lead to an expected modification to the auditor’s opinion and the proposed wording of the modification enables:

a. The auditor to give notice to those charged with governance of the intended modification(s) and the reasons (or circumstances) for the modification(s);

b. The auditor to seek the concurrence of those charged with governance regarding the facts of the matter(s) giving rise to the expected modification(s), or to confirm matters of disagreement with management as such; and

c. Those charged with governance to have opportunity, where appropriate, to provide the auditor with further information and explanations in respect the matter(s) giving rise to the expected modification(s).

### 5. SUMMARY

#### 5.1 Audit Opinion

When the auditor issues an audit opinion, the auditor considers which type of audit opinion is appropriate in a particular situation. The following flow chart endeavors to explain the situations that need to be considered in issuing modified opinion i.e. opinion with emphasis of matter paragraph, qualified opinion, disclaimer of opinion or adverse opinion.

See FLOWCHART 5.1 on Page No. 28

#### 5.2 Matters that do affect audit opinion

When the auditor decides to issue modified opinion other than emphasis of matter paragraph, i.e. qualified opinion, disclaimer of opinion and adverse opinion, the auditor needs to consider the following in each of these modified opinions issued:

- Criteria on which modified audit opinion is issued
- Requirements of qualification paragraph
- Appropriate place of qualification paragraph in audit opinion
- Impact of qualification paragraph on other paragraphs of audit opinion
The above are described in the table below:

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Qualified opinion</th>
<th>Disclaimer of opinion</th>
<th>Adverse opinion</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Disagreement with management re: adequacy of F/S</td>
<td>• Limitation on scope</td>
<td>• Disagreement with management re: acceptance of accounting policies selected</td>
<td>• Effect of disagreement is material and pervasive</td>
</tr>
<tr>
<td>• Method of their application</td>
<td>• Effect of limitation on scope is material and pervasive</td>
<td>• method of their application</td>
<td>• Effect of disagreement is material and pervasive</td>
</tr>
<tr>
<td>• Adequacy of F/S disclosure</td>
<td>• Effect of disagreement or limitation on scope not so material and pervasive</td>
<td>• adequacy of F/S disclosure</td>
<td>• Discloses misleading or incomplete nature of F/S</td>
</tr>
</tbody>
</table>

### 5.3 Going concern

When the auditor concludes that going concern issue exists, the auditor satisfied himself whether emphasis of matter paragraph is sufficient or the auditor needs to issue qualified opinion, disclaimer of opinion or adverse opinion. The decision is based on the situation. The following table lists the criteria, requirements of qualification paragraph, disclosure required in the financial statements, appropriate place of qualification in audit opinion and impact of qualification on other paragraphs of the opinion.

See FLOWCHART 5.3 on Page No. 29

### 5.4 Emphasis of matter paragraph for other than going concern problem

Following table shows the criteria, requirements of qualification paragraph, its appropriate place in the audit opinion and impact on other paragraphs of the opinion.

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Qualification paragraph</th>
<th>Appropriate place</th>
<th>Impact on other paragraphs</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Significant uncertainty exists and whose resolution is dependent upon future events that may affect F/S</td>
<td>• Add “without qualifying our opinion”</td>
<td>• Include after opinion paragraph and before other reporting responsibility</td>
<td>No impact</td>
</tr>
<tr>
<td>• Outcome of uncertainty depends on future actions or events that are not under direct control of the entity but may affect F/S</td>
<td>• Add “without qualifying our opinion”</td>
<td>• Add “without qualifying our opinion”</td>
<td>No impact</td>
</tr>
</tbody>
</table>

## Other than Going Concern Problem

### Emphasis of matter paragraph

- **Criteria**
  - Significant uncertainty exists and whose resolution is dependent upon future events that may affect F/S
  - Outcome of uncertainty depends on future actions or events that are not under direct control of the entity but may affect F/S

- **Qualification paragraph**
  - Add “without qualifying our opinion”
  - Highlight
    - The event; and
    - State ultimate outcome cannot be presently determined
  - No provision for any liability that result has been made in the F/S

- **Appropriate place**
  - Include after opinion paragraph and before other reporting responsibility

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Muhammad Asif Iqbal
Director Technical Services of ICAP

Note:
The author is extremely grateful to Mr. Usman Ghani Akbani for allowing him to reproduce section 5 of the article from his presentation which he delivered at ICAP SMP Workshop on March 14, 2009. Further, the author is also thankful to Mr. Farrukh Rehman, Mr. Arslan Khalid and Ms. Farheen Mirza for their support in finalizing this article.
FLOWCHART 5.3

Going Concern

Issues
- Financial
- Operating
- Others
- Non-compliance
- Pending legal cases
- Government policy

Emphasis of matter paragraph
- Material uncertainty exists regarding going concern but not adequately disclosed in F/S

Qualified opinion
- Going concern assumption inappropriate
- F/S prepared on alternative authoritative basis

Disclaimer of opinion
- Material uncertainty exists regarding going concern significant to F/S (Rare cases)

Adverse opinion
- Material uncertainty exists regarding going concern but not adequately disclosed in F/S
- Going concern assumption is inappropriate and F/S prepared on going concern basis (Disclosure in F/S made or not)

Criteria
- Material uncertainty exists
- Resolution is dependent upon future events and that may affect F/S
- Required disclosure is made in F/S

Qualification paragraph
- Add “without qualifying our opinion”
- Draw attention to the note that discloses the matters
- Highlight the event; and existence of material uncertainty that cast significant doubt to continue as a going concern

Disclosure in F/S
- Principal events and conditions
- Management plans to deal with these events and conditions
- Material uncertainty that cast significant doubt
- Unable to realize assets and discharge liabilities in normal course of business

Appropriate place
- Include after opinion paragraph and before other reporting responsibility

Impact on other paragraphs
- In opinion paragraph include “except for the omission of the information included in the preceding paragraph”

In first paragraph change the words “we have audited” to “we were engaged to audit”
- Omit the sentence stating the responsibility of the auditors
- Scope of audit paragraph omitted or amended
- Add paragraph discussing multiple material uncertainties regarding GC significant to the F/S
- In place of opinion paragraph state “Because of the significance of the matters discussed in the paragraph so and so above, we do not express and opinion on the F/S

In opinion paragraph include“Because of the omission of the information mentioned in the preceding paragraph, the F/S do not give true and fair view of ……….”
Having worked for globally renowned pharmaceutical companies engaged extensively in Research & Development, production of active pharmaceuticals, formulation of pharmaceutical products, and in addition to this deploying their resources in marketing and distribution activities, I have noticed that there is an increasing recognition that ideas, knowledge, know-how, innovations and other intangibles are fundamental sources of value in business. But identifying and measuring that value is a complicated process with numerous non-standard modules and methods currently available to do so. In the case of Intellectual Asset Management, Intellectual Property, a valuable form of intangible to the business and financial communities, there is particular interest in improving the consistency, quality and usefulness of valuations.

Asia, with its conglomerates of the world’s emerging countries, has always been something of an enigma for intellectual property owners. On the one hand, it is one of the most economically dynamic regions of the world, where increasingly prosperous populations have more money to spend than ever before. While on the other hand, it is also a continent in which piracy and counterfeiting are rife, and where, in general, governments, courts and enforcement agencies have been slow to tackle the difficulties rights owners face. The problem, therefore, is a tricky one. Should rights owners fully engage in Asian markets for the potential they offer in terms of increased opportunities, or should they choose to stay out because of the risk that IP thieves could undermine substantial investments, while the authorities stand by and do little to help? One of the other important reasons behind this fiasco in Asia is lack of understanding of the valuation of intellectual assets to a greater extent even with the exponential increase in the impact of market capitalization due to the presence of intangibles.

Valuation of intellectual assets is a matter of immense importance to a large number of professional communities, which include business people, valuation professionals, accountants, academics, consultants, regulators, tax authorities and valuation thought-leaders. But there is no general agreement or consensus among them on how the valuation of intangibles should be conducted. Several attempts have been made in the past decade to develop uniform standards of valuing intangibles but none has had a visible impact on IP valuations or has significantly improved the quality and consistency of IP valuation reports. Why not? What are the major issues that have prevented the development of intellectual assets valuation standards?

Out of the various attempts made previously to harmonize the standard of IP valuations none were successful which can affect their value. With the greater understanding at hand, and given the importance of IP to an increasing number of businesses, it seems it is time to investigate three fundamental questions relating to standardizing IP valuations:

1. Does it make sense to standardize IP valuations?
2. If so, what should be the standard?
3. How valuation standards are formulated and implemented successfully?

The answers to these questions depend on the perspective of the person asked and the professional communities within which they operate. The different, and sometimes narrow, interests and focus of each community have made it impossible for them to agree on any one standard for IP valuation. Further, the tendency of businesses to consider IP valuation mainly within the context of the financial accounting paradigm has been a major obstruction to the development of believable and useful valuation standards.

Although standardization affects assorted communities, the one most directly affected is the IP valuation community itself. For
this reason it seems reasonable to begin an examination of standardization through the eyes of this community. For credible views on the three fundamental questions above, I have reviewed the literature and material printed on this subject by the respected academics and practitioners who have made significant intellectual contributions to the field of intellectual property valuation, both in theory and in practice. This article presents the condensed views of a panel of experts in Intellectual Asset Management. No one from the intellectual community has written all of the ideas in a single paper, although there is a complete consensus on the basics. The consensus is on the need for standardized valuations.

Standards and Standardization

There are two broad types of standards: rule-based standards and principle-based standards (I refer to standards in this context to mean guidelines and definitions, such as ISO9000 for quality systems and ISO14000 for environment). Rule-based standards are often found in environments where there is both a need and a capability to enforce the standard. Principle-based standards are often used in professional environments where definition and understanding of accepted professional behaviour enforcement is the focus.

Traditionally, there has been a periphery between technical standards organizations and professional standards organizations, although the lines between them are beginning to smear. On the technical side, perhaps the premier organization is the International Organization for Standardization (ISO) established to: "Facilitate the international coordination and unification of industrial standards." ISO is made up of member bodies that are "most representative of standardization" in their countries. Only one organization from each country is accepted for membership in the ISO. So, for example, in the United States the member body is the American National Standards Institute (ANSI); in Canada it is the Canadian Standards Council; and in Japan it is the Japanese Standards Association.

The need for an ISO standard is usually expressed by an industry sector, which communicates this need to an ISO national member body. The latter proposes the new standard to the ISO as a whole. Once the need for an international standard has been documented and formally agreed, the first base involves defining the technical scope of the future standard. This phase is usually carried out in working groups of technical experts from countries interested in the subject matter. Although the ISO and its member bodies have typically focused on technical and industrial standards, they have more recently become involved with management systems standards.

In contrast to technical standards organizations, professional standards organizations spotlight the ethics, methods and practices in specific professions. Examples include the accounting profession (in North America they are the US Financial Accounting Standards Board (FASB), the Canadian Institute for Chartered Accountants (CICA) and Mexico’s Instituto de Contadores Publicos); the legal profession - the professional standards committees of the national bar associations; and the medical profession - the professional standards committees of the national medical associations; to name but a few.

Each profession establishes its own standards, some relating to ethics, others to methods of operation and still others to specific practices. Unfortunately there is no specific focus on valuation which is the core issue today. Particularly the recent meltdown in global finance market has authenticated market capitalization directly or inversely related to the presence of intangibles on the balance sheet of the companies.

Is the IP valuation community sufficiently organized and unified to warrant the establishment of either a rule-based or a principle-based set of standards such as those described above? The IP valuation communities have portrayed different arguments, each with its own perspective. It is a scrappy community populated by people trained in accounting, economics and finance; IP valuation has not yet achieved the degree of structure necessary to call itself a profession. A standard for IP valuation developed around the context of any one of its constituents (accounting, economics or finance) could be entirely wrong for the others. Standards are more easily implemented when they are toughened. A good example of underpinning is found in the Canadian accounting profession, which uses four main sets of standards:

1. Financial reporting standards - standards for measurement and disclosure.
2. Auditing standards - dealing with matters concerning the process of auditing.
3. Ethical standards - a code of professional conduct for accountants.
4. Certification standards - defining the body of knowledge and the competencies that accountants are expected to possess.

The first two sets of standards are the responsibility of an independent standards-setting organization and the profession itself manages the latter two. The four different categories of standards are mutually reinforcing. The auditing standards reinforce the financial reporting standards; the ethical and certification standards ensure that accountants are qualified and motivated to live up to the financial and auditing standards since
failure to maintain one’s knowledge or to act ethically can cut a career short. In short, standards of practice or performance may work best when they can be developed in recital with other standards that reinforce the desired conduct.

What is the generic process for valuing intangibles?

Whether projecting price or worth, professionals who seek to value IP follow a nonspecific process. Before doing any calculations they identify the factors that define the context of the valuation at issue. They identify the method that will be used, the key parameters concerned, the data required for the calculation and information about the markets, as well as any external factors deemed to be relevant. Professional valuators recognize that valuation is as much an art as a science, meaning that while there are protocols and accepted procedures (the science), the decisions that precede calculation are perhaps more essential to a successful IP valuation activity than the calculations themselves. Making those judgments (the art) is inherent in the process and must be considered in any standardization procedure.

Factors identified for generic process of valuation are:

1. The purpose of the valuation estimate (e.g. tax, external performance reporting, sale, licensing or litigation) as well as any purposes for which the valuation specifically may not be used.
2. Identification of the beholder, the person from whose perspective the valuation estimate is viewed (e.g. external beholders, such as potential investors, shareholders, prospective purchasers; or internal beholders, such as the CEO, the CFO, chief legal officer, licensing officer, chief R&D officer).
3. The definition of value used; for example, worth - value in use to a specific beholder; or price - a historical or future estimated selling price. Any premises that should be understood to affect value (e.g. whether the business is a going concern, or has filed for bankruptcy and so on).
4. Timeframe of the value estimate (past, current or future).
5. The standard of measurement (market capitalization, value in exchange, value in an accounting framework).
6. The unit of measurement (for example, currency, indices, ratios, vectors).

Why should IP valuations be standardized?

The reasons for standardizing IP valuations depend largely on the perspective of the person asked. People outside the IP valuation community - for example, regulators, tax authorities and accounting standards setters - answer differently from those inside it.

The reasons for standardizing IP valuations depend largely on the perspective of the person asked. People outside the IP valuation community - for example, regulators, tax authorities and accounting standards setters - answer differently from those inside it.

1. The need to create a common language: The terms often used in the valuation of intangibles are not used uniformly. The word value itself is used to mean several different things. A standard should define the relevant terminology in order to provide clarity in communications and minimize the chances of misunderstanding.
2. The need to improve the consistency of valuations and valuation reports: Because there are so many methods and so many IP valuators, with different professional training and levels of understanding, there is little consistency in how valuations are conducted and what IP valuation reports contain. Some include background information, the sources of data used and the details of business judgments. Others provide little more than the type of IP being valued and a value estimate. IP valuation standards could improve consistency by defining what a standard IP valuation report should contain.
3. The need to minimize unethical and incompetent valuations: Professional valuators are implicitly entrusted to use their professional knowledge and skill to provide the best valuation estimate possible. But some intentionally abuse that trust; while others may be well-intentioned but lack knowledge and experience. Standards would help to minimize unethical and incompetent valuations by defining a set of ethical principles and behaviours to which IP valuators are expected to adhere.
4. The need to define required valuator knowledge: People who are new to the field of IP valuation may lack an adequate understanding of the nature of IP - the special considerations related to valuing IP, how IP is used in business and the different kinds of value it can provide. In the absence of standards defining the level of knowledge and know-how necessary for valuing IP, such people blithely enter where others fear to tread. A standard could require or recommend a particular level of knowledge and understanding on the part of the valuator.
5. The need to let clients and users of a valuation know what to expect: Clients and users of valuation results should know something about IP value and valuation, as well as what to expect from the person conducting the valuation. This might include educational information about the value and valuation of intangibles, examples of what a valuation report is expected to contain, information about the level of knowledge required of IP valuators and information about what the profession has codified as its code of ethics.

Experts in the international Intellectual Asset Management arena have laid three major arguments against standardization:

1. The number of factors that are specific to each intangible makes standardizing their valuations impossible.
2. Standardization could oversimplify what is inherently a complex process.

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3. We should avoid arriving at only one view of valuation - one that is North American or European centric, for example. Such a singular view of IP valuation could cause people to make assumptions about the value of IP that are not necessarily valid in all corners of the world.

What can be standardized?

Information material available suggests the following key factors need to be considered while arriving at a consensus for development of standard guidelines in ascertaining uniform practices for establishing IP valuation.

1. Ethical guidelines for valuers: There are currently no generally agreed ethical standards to which valuers in the IP valuation community must adhere. There are individual professional groups within the IP community that have developed standards of behaviour for their members, but these are neither accepted nor necessarily practiced beyond the borders of the groups’ membership lists.

2. Terminology: Too frequently, valuation reports contain terms and phrases that are undefined, ambiguous or unique to an industry or area of business. A glossary or dictionary of commonly used terms would minimize misunderstandings.

3. The identification of elements that constitute the context of the valuation: It is now common wisdom in the IP management community that IP (and other intangibles) are operationally passive, having no value by themselves. It is only when these intangible assets are teamed with other (often tangible) assets, operational capabilities or uses that their value can be realized. The context within which an IP asset is used defines the nature and amount of value it can provide to a specific owner or user. Although our understanding of context is still evolving, the panel provided an understanding of the elements that currently appear to define it (Standards could require that the context of an IP valuation be included in any valuation report).

4. The content of a valuation report: Clients often complain that IP valuations are inconsistent. In part, this is true because there is no broad agreement on the appropriate or necessary content. An IP valuation standard could list appropriate and desirable content categories with examples.

How should valuation standards be created and implemented successfully? Several items are deemed to be particularly important in developing IP valuation standards that are viewed as credible by professionals within and outside the IP field. These are: oversight of the standards development process; broad-based professional participation; and an understanding of the steps to be followed during the standards development process.

How to organize: Although the large number of concerned stakeholders in this effort creates the possibility for an unwieldy organization, the panel did not provide specifics on how the effort might be organized. The panel agreed that a steering group should guide the process, though it did not agree on its make-up. One view was that the steering group should comprise only members of the IP valuation community, working closely with a more widely constituted working group made up of members of stakeholder organizations. The counter-view was that the steering group should include both IP valuation community members and other stakeholder representatives.

Summing up: The valuation of intellectual property is more complex than valuation of real or tangible property. Numerous business, academic, regulatory and professional bodies and individuals have a stake in the valuation of IP. They view it through lenses that are polarized by the needs of their own community. Developing any standard from the collective perspective of such a broad field of interested entities and individuals will be difficult. One practical alternative appears to be the potential development of IP valuation standards from the perspective of the IP valuation community, the group most directly concerned with the quality and consistency of valuation results. Other interested groups, individuals and organizations might adapt that standard to meet the needs of their own communities.

Although there are several conclusions one may draw from the preceding discussion, two are unequivocal:

1. IP valuation standards would be useful, particularly if they were focused on principles rather than on detailed rules.

2. At a minimum, such standards should focus on improving both the quality and the consistency of IP valuations and valuation reports.

On the question of how such standards might be developed and implemented, however, there is not yet a clear path. There is not yet an IP valuation profession, or even a common understanding of what or who constitutes the IP valuation community. Still, it appears that business and regulatory communities have a need and a desire for some sort of standard for valuation activity and performance. Perhaps it is time to discuss whether to formalize an IP community (as distinct from the broader valuation and assessment community) as a step towards the ultimate development of an IP valuation profession.

Because there is no single organization capable of credibly and effectively sponsoring an IP valuation standardization effort, a consortium of several potential sponsoring bodies could be created to provide the necessary oversight. Although today the IP valuation community is a community in name only, the importance of IP valuations and the concomitant desirability of an IP valuation profession mean that the development of an IP profession should be a topic for future discussion.

As Vice President of the Institute of Cost & Management Accountants of Pakistan, and as member and advisor on the board of the South Asian Federation of Accountants the author strongly recommends that the SAFA board should take up this issue as a challenge and acclimatize member countries with this valuable subject.

Reference material from the works of:

1. Dr. Daan Andriessen, Professor of Intellectual Capital at In Holland University and author of Weightless Wealth
2. Dr. Baruch Lev, Professor of Accounting and Finance at New York University; author of two books and many articles on intangibles and their value
3. Rob McLean, President of Matrix Links, author of Re-Discovering Measurement, and adviser to the Canadian accounting profession on intellectual capital and value measurement
4. Russell Parr, President of Intellectual Property Research Associates Inc (IPRA); author and co-author of 10 books on intangibles and valuation
5. Gordon Smith, Chairman AUS, Inc., author and co-author of several books on IP valuation; Adjunct Professor and director of IP Institute at Pierce Law
6. Dr. Alexander Wurzer, Managing Director of PATEV, Director of the Institute for Intellectual Property Management at Steinbeis University, and author of several books and articles on IP valuation

Mohammed Hanif Ajari
Vice President of the Institute of Cost & Management Accountants of Pakistan and Director Strategic Development with Getz Pharma (Pvt.) Limited
Advanced Fee Fraud is a criminal offence. The ‘scam’, as it is now widely known, is initiated by syndicates with members in different parts of the world strategically located to implement their different tasks to ensure the success of the deals. As the name of the crime implies, the fraudsters through deception obtain money or goods from the victims in advance in lure of promised financial benefits accruable to the victims after the conclusion of the ‘deal’.

We should also note here that the deals are usually not legal; there are always indications of bribes to be paid to some government or bank officials, evasion of official tax and other illegal activities to ensure the success of the deal. What usually attracts the victims to co-operate with the fraudsters are the attractive financial benefits they hope to gain at the end of the deal, thus in the real sense both the fraudsters and the victims have wrong motives.

The scam is initiated with the fraudster contacting a targeted victim, either by fax, phone or e-mail and a proposal or request made with the fraudster posing as senior government officials, a victim or dependant of government’s abuse of human rights. They claim that they are in possession of a large amount of money. The proposal usually involves the transfer of the money to a bank account outside of Nigeria, to that of the targeted victim. A plausible or sympathetic explanation is usually given for the transfer, although they basically appeal to the intended victim’s greed usually with a promise of a sizeable percentage of the money transferred, as a commission for the use of the bank account.

If the intended victim is interested in the deal, they are requested to forward a variety of paperwork which generally includes blank company letterheads which are duly signed, blank invoices, telephone and fax numbers, and especially bank account details; these being required to effect the transfer of the money into the bank account.

**FEATURES OF THE SCAM LETTERS**

- **Urgency:** The letter will stress the urgency of the matter.
- **Confidentiality:** The confidential nature of the transaction is always stressed.
- **Forged Documents:** Many forged official-looking documents.
- **Strong Ties:** Claims are made that the other parties are employed in, or have strong ties with the government, the Central Bank of the country, or dependants of a dead or living victim of the government’s human rights abuse.
- **Huge Sums of Money:** The deal always involves the transfer of huge sums of money usually in dollars either kept in a secret vault or account known only to the fraudster.
- **No Risk:** The victims are usually told that there is no risk involved.
- **Bank Details:** The bank details of the victim are requested and some personal documents.
- **Advance Fee:** Finally an advance fee is usually required to either pay for some legal fees, transfer fees, or to bribe government or bank officials.

The Internet has not only brought about development in communications and commerce and all other facets of human endeavors, but it has also provided a platform for criminals to take advantage of unsuspecting members of the public using a faster and cheaper means of communication. Unlike other criminal activities, crime on the Internet has no boundaries. Hence, a scam letter can be sent from any country to any part of the world, posing challenges to law enforcement agencies all over the world.
AUDIT FILE

Sadia Kaleem, ACA

A. Please see that followings are in your Audit Files:

1. Engagement letter
2. Evidence of audit planning
3. Audit program relating to the Profit and Loss account items
4. Documentation of internal control and risk assessment procedures.
5. Extract of minutes of Board of Directors meetings relating to Fixed Assets.
6. Letter of representation
7. A copy of financial statements approved by Board of Directors
8. Direct confirmations for finance lease, trade debtors & trade creditors.
9. Evidence in respect of advances, stock in trade and debtors.
10. Bank confirmation letters
11. Confirmation from tax advisor
12. Reconciliations of figures sent to which party does not agree.
13. List of banks and legal advisors from its client.
14. Confirmation from legal advisors.
15. Disclosure checklist
16. Supervisor has initials on the working papers.
17. Going concern and Subsequent review checklists are reviewed by a supervisor.
18. The basis of conclusion on which the auditor issued an emphasis para on going concern is documented.
19. Exceptions noted during audit are properly disposed off.
20. Number of employees is disclosed.
21. The amount of deferred tax is provided and the related reasoning
22. Policy regarding staff retirement benefits
23. Working papers reflect the conclusions drawn from the audit evidence.
24. Working papers are properly referenced or cross referenced
25. Verified existence of all motor vehicles & original documents
26. Certified & updated copy of Memorandum and Articles is on the permanent file.
27. Cash flow statement is signed by the Board of Directors.
28. Sales and purchase cut off tests are applied by the auditors.
29. Contribution to Provident Fund by the company
30. Management letter is sent by the auditors.
31. Evidence is documented in the working papers indicating the weaknesses in the accounting and internal control systems.
32. The letter of representation is dated.
33. Disclosure requirements with regards to the date of authorisation of financial statements
34. Tax deducted at source is separately disclosed.
35. Note on the status of tax assessments is disclosed.
36. Work is performed by the auditors to review any impairment of assets.
37. Working papers for :
38. Provision for taxation
39. Cash flow statement
40. Statement of Changes in Equity
41. Audit evidence exists for comparison of cost and Net Realisable Value of stock in trade.
42. Stock in trade is distinguished as Raw Material, Finished Goods and Work in Progress.
43. Audit program for stock in trade and P&L items. Evidence of audit working paper reference or any conclusions drawn by auditor.
44. Work is performed for verification of valuation of stock based on lower of cost or NRV and evidenced.
45. Valuation sheets of stock in trade mentions the rates at which the valuation was made.
46. Physical count papers of stock in trade and stores are available.
47. The auditor attended the physical stock count or an alternative procedures was carried out.
48. Information is provided of Financial Instruments as per IAS 32.
49. The financial statements include the statement of compliance with IAS as applicable in Pakistan as required by para 91a and 94 of IAS 1.
50. Corporate Governance Compliance review checklist or evidence of work done in this respect.
51. Details of disposal of fixed assets and names of persons to whom disposals were made, is provided in the financial statements.
52. Fraud and Error review checklist
53. Sales and purchases were only traced to the sales tax challans. On a working paper, the auditor observed that sales vouchers (supports) are not available.
54. Notes to the accounts are signed by the Board of Directors.
55. Sales tax payable is not merged with other liabilities.
56. Audit ticks and work done is documented on working papers.
57. Audit evidence exists for creditors, other income, financial changes, and administrative and selling expenses.
58. Work to prove that auditors performed procedures to verify existence and valuation of stock. Working papers are not with an expert partner who has left the firm because of dispute.
59. Surplus on revaluation of fixed assets is recorded properly.
60. An engagement letter is issued for first time audit.
61. Knowledge of the company or its operations is documented.
62. Preliminary judgement for materiality levels is considered.
63. Audit programs
64. Evidence of review of work or conclusions drawn.
65. Letter of representation
66. Subsequent events review checklist is available.
67. Lease agreements
68. No work for Corporate Governance compliance.
69. Letter of representation is not signed only by Chief Financial Officer.
70. Letter of representation was signed five days before the date of the audit report.
71. Letter of representation was signed by one director and was dated a day before the date of the audit report.
72. Material variances in analytical review is recorded or discussed.
73. Last page of the notes to the financial statements of the approved copy is signed by the Chief Executive and Director.
74. Audit Report is dated before Letter of Representation.
75. Audit evidence is in file regarding staff retirement gratuity, amount payable to associated undertakings.
76. Break down is available for long-term deposits.
77. Donations are disclosed separately as required by Companies Ordinance, 1984.
78. Audit sampling techniques are adopted even if extensive testing on random basis was performed.
79. Unrecognised deferred tax liability is disclosed as required by Companies Ordinance, 1984.
80. Current maturity of long term deposits is disclosed as current liability.
81. Auditors issued the Review Report to the members on Statement of Compliance with Practice of Code of Corporate Governance.
82. Related parties are identified.
83. Sufficient and adequate audit evidence is available in respect of Capital Work in Progress.
84. Auditor has documented the reasons for classifying Advance against repurchase of land amounting to Rs. 25m outstanding for three years as an advance rather than classifying it as a fixed asset.
85. The maximum amount outstanding as receivable at the end of any month during the year is disclosed.
86. Movement of accumulated depreciation is disclosed as required by IS –16 Property, Plant and Equipment.
87. Depreciation methods used are disclosed.
88. Depreciation is charged at revalued amounts.
89. Auditor’s judgement on the change rate of depreciation is documented in the working papers.
90. Sales tax payable and other statutory dues are disclosed separately.
91. Movement in the provision for doubtful debt balance is disclosed.
92. Note relating to transactions with associated undertakings / related parties is disclosed.
93. Sufficient and appropriate audit evidence exists in respect of Director’s Loan account & direct confirmation is obtained.
94. Extracts of the minutes of the Board of Directors meetings are in file.
95. Working for deferred taxation was not available in the working papers.
96. Letter of representation is dated. It is on the company’s letterhead.
97. Note on status of pending / disputed tax assessments is disclosed as required by Companies Ordinance, 1984.
98. Advance tax deductions are shown as a separate line item rather than under receivables.
99. Some confirmation letters received from third parties were not specifically addressed to the firm.
100. Letter of representation was dated 18.07.03, whereas the audit report was signed on 09.10.03. It was signed only by the General Manager Finance.
101. Auditor’s report is addressed to the shareholders of the company.
102. Evidence of physical verification of share certificates of short term investments
103. Advance to directors shown as part of Current Assets.
104. Subsequent events review was performed on 14.08.03, whereas audit report was signed on 22.08.03.
105. Direct confirmations are received in respect of Advances- Capital Work in Progress.
106. Sufficient and adequate audit evidence in respect of provision for slow moving and obsolete spares.

B. Please see that following checklist/details or workings are in Audit File:
1. Knowledge about client business
2. Directors meeting relating to Fixed Assets.
3. Physical cash counts are done.
5. Analytical review procedures at the planning stage.
6. Audit sampling techniques are adopted while selecting items for testing.
7. Audit report is in accordance with Form 35-A.
8. Preliminary judgement relating to materiality level for audit purposes is considered.
9. Work is performed for valuation of stock in trade.
10. EPS is disclosed in Profit & loss Account.
11. Letter of representation is not signed only by Chief Executive.
12. Unclaimed dividend is not disclosed as unpaid dividend.
13. The original copy of accounts is not on the auditor’s letterhead.
14. Balance Confirmations are addressed to the firm, not to entity.
15. Working papers are reviewed.
16. Extent of verification performed is documented in it.
17. From banks if some securities are not disclosed, reason must be documented.
19. Procedures are performed to ascertain the going concern assertion.
20. Working paper on going concern review are developed and auditors’ judgement regarding appropriateness of going concern assumption is documented.
21. Following items are classified as required by the Companies Ordinance 1984:  
   · Land - Freehold / Leasehold  
   · Buildings - Freehold / Leasehold  
22. Disclosure are made for  
   · Trade Debtors (considered good/ doubtful)  
   · Advances (considered good/ doubtful).
2003 The Beginning of the End

It all started in June 2003 when US Federal Reserve Chairman Alan Greenspan lowered the Fed’s key rate to 1%, the lowest in 45 years. In the same month the US unemployment rate reached a then cyclical peak of 6.3% and held there until June 2004.

US monetary policy was intentionally eased between 2001 and 2004. The Federal Reserve believed that monetary policy should respond aggressively to pre-empt the threat of consumer price deflation. Monetary policy in Australia, Canada and much of Europe was also easy at this time.

However, according to Dr. Stephen Kirchner, a Research fellow at the Center for Independent Studies, unintentionally this policy prompted the US government to subsidize financial risk-taking by home-buyers and financial institutions. As housing prices stopped rising and low introductory mortgage rates ended, buyers began defaulting on their loans. Many of the loans backed bonds that were sold to investors around the world.

By 2006 lenders had already made $640 billion in subprime loans. By the summer of 2007, the first signs of the subprime crisis had started to appear. By late August of the same year defaults on subprime mortgages had started to occur, much earlier in the mortgage process.

The signs of a weakening mortgage credit market were rapidly emerging.
January 3, 2007

Ownit Mortgage Solutions Inc., which owed Merrill Lynch around $93 million, files for Chapter 11 bankruptcy.

February 7, 2007

HSBC, London releases a statement about a slump in its Mortgage Services operations owing to increased delinquencies of US subprime mortgages. HSBC is Europe’s largest bank.

The bank is unable to refinance because of falling equity prices.

February 10, 2007

G7 Finance Ministers meet in Essen, Germany. On top of their agenda is the lack of regulation of hedge funds.

April 3, 2007

New Century Financial Corp. defaults on $8.4 billion in loan repayments and files for Chapter 11.

New Century had made $51.6 billion in subprime loans in 2006 making it the 2nd largest subprime lender in the US.

Goldman Sachs, Morgan Stanley, and Bank of America all backed New Century Financial Corp. which originated more than $75 billion in high-cost loans between 2005 and 2007.

May 2007

At the peak of the bull market in May 2007, Royal Bank of Scotland teamed up with Fortis and Santander to launch a €71 billion hostile bid for ABN Amro. The deal brought RBS to its knees and became a symbol of the credit crisis. Fred Goodwin, CEO of RBS, was blamed for his role in leading the UK to economic disaster.

June 27, 2007

US Securities & Exchange Commission Chairman, Christopher Cox, testifies to Congress that the SEC has opened 12 enforcement investigations into collateralized debt obligation (CDO) practices.

CDO is an investment-grade security backed by a pool of bonds, loans and other assets. CDOs are unique in that they represent different types of debt and credit risk often referred to as ‘tranches’ or ‘slices’. Each slice has a different maturity and risk associated with it. The higher the risk, the more the CDO pays.

July 9, 2007

Private equity firms* start raising money to buy bad mortgage debt at deeply discounted rates.

Credit Suisse releases a report stating CDO losses could total up to $52 billion. However, analysts say that did not pose any systematic risk to banks.

* Apollo, Blackstone, and TPG, Marathon Asset Management, GSC Group, Pimco, and Fortress Investment Group are some of those active in the market.

July 17, 2007

In a letter to investors, two Bear Stearns hedge funds specializing in subprime debt announce that each fund has lost at least 90% of its value. The two funds had $1.6 billion in investor capital.

Both funds had used ‘AAA’ rated tranches of subprime, mortgage-backed securities.

Typically, hedge fund managers are compensated with management fees of 1-2% on assets and incentive fees of 20% of all profits. This entices them to leverage more and more. During the credit crisis they used this leverage to buy more CDOs than they could pay for with capital alone.

July 18, 2007

US Federal Reserve Chairman Ben Bernanke acknowledges that the Fed and other regulators had failed to control aggressive mortgage lenders.

Bernanke estimates that the fallout from the US subprime crisis could be up to $100 billion.

July 24, 2007

Countrywide Financial, America’s biggest subprime mortgage lender, says the problems with subprime mortgages were starting to spread to conventional home loans.

The company lost $704 million in 2007 and another $893 million during the first quarter of 2008.

July 31, 2007

“The worst thing that ever happened to Bear Stearns.”

The two Bear Stearns hedge funds that had reported losses on July 17 file for Chapter 15 bankruptcy. Bear Stearns winds down the funds and liquidates all of their holdings.

August 1, 2007

Two civil lawsuits are filed against Bear Stearns for misleading investors about the extent of exposure of the two hedge funds to subprime debt.

August 3, 2007

The Germans get dragged in

A German government-led bailout of IKB Deutsche Industriebank results in state-owned KfW assuming up to €1 billion in losses.

KfW and other banks agree to guarantee up to €8.1 billion in liquidity to cover the loss in value of Industriebank’s subprime US investments.

August 9, 2007

... and then the French

BNP Paribas SA, France’s largest bank, freezes assets on three investment funds with €1.6 billion in capital. The assets could not be fairly valued due to their exposure to the US subprime market.

In its biggest intervention in overnight rates since September 11, 2001, the European Central Bank injects €95 billion into the Eurozone banking system.

August 10, 2007

Central banks in Europe, Asia, and the Americas inject $300 billion over 2 days to prevent a credit market seizure.

The US Federal Reserve injects $38 billion into the banking system, and the European Central Bank injects over €150 billion in an attempt to steady the Eurozone credit markets.

August 16, 2007

Countrywide Financial Group loses more than half its stock value and borrows $11.5 billion to avoid bankruptcy.
Fitch drops Countrywide’s credit rating to BBB+ and Moody’s to Baa3.

The Group announces 90% of new loans would meet Fannie Mae and Freddie Mac standards.

US mortgage lenders Fannie Mae and Freddie Mac were ‘government sponsored’ private companies set up to help segments of the mortgage market run smoothly.

August 24, 2007
In an attempt to restore investor confidence Bank of America buys $2 billion in preferred shares of Countrywide Financial.

August 26, 2007
Sachsen Landesbank emerges as the second German bank needing a bailout.

German public sector bank Landesbank Baden-Württemberg (LBBW) agrees to buy Sachsen for €250 million.

September 14, 2007
Rumors about a larger bank purchasing giant British mortgage lender Northern Rock are afloat.

The Bank of England extends emergency funding to Northern Rock after investors withdraw their support.

September 15, 2007
Lehman Brothers collapses in the world’s biggest bankruptcy.

As banks around the world struggle to issue debt, several emergency rescue mergers are struck. Bank of America spends $44.4 billion on Merrill Lynch. In the UK, Lloyds TSB takes over HBOS for $21.9 billion, and the British government takes over 70% control of RBS.

September 26, 2007
In its attempt to inject liquidity in the banking system the Bank of England announces an auction of £10 billion of emergency three-month funds at 6.75% and agrees to accept bank mortgages as collateral.

No bids are received.

October 1, 2007
Swiss bank UBS announces a $3.7 billion writedown.

October 16, 2007
Owing to writedowns linked to subprime mortgages, Citigroup’s profits drop 57% from the same quarter in 2006.

Around the same time in October record levels of foreclosures are expected in the US with $350 billion in adjustable-rate mortgages (ARMs) in the marketplace. A worldwide freeze in credit market activities is evident.

Approximately 80% of U.S. mortgages issued to subprime borrowers were adjustable-rate mortgages. ARM is a type of mortgage in which the interest rate paid by the borrower is based on a benchmark plus an additional spread.

October 25, 2007
Merrill Lynch announces a $2.24 billion third quarter loss.

Merrill Lynch has written down $7.9 billion on CDOs and subprime mortgages, the largest writedown in the crisis so far.

On October 31, Merrill Lynch CEO Stan O’Neal resigns with a severance package of $160 million.

October 26, 2007
Countrywide Financial announces a $1.2 billion third quarter loss, its first loss in 25 years.

Countrywide has written down about $1 billion.

November 12, 2007
Three major US banks, Citigroup, Bank of America, and JP Morgan Chase, agree to buy $75 billion in weak debt as purchaser of last resort.

Citigroup is the largest bank in the US.

November 13, 2007
Bank of America says it will have to writeoff $3 billion in bad debt. The bank also says it will spend $600 million supporting some of its funds because of possible liquidity problems.

November 15, 2007
Barclays confirms a $1.6 billion writedown on their subprime holdings and warns of more writedowns.

November 21, 2007
Freddie Mac announces a $2 billion loss in mortgage defaults and credit losses.

Following this announcement, shares in Freddie Mac and Fannie Mae drop 28.7% and 24.8% respectively.

November 23, 2007
Two French banks pledge $1.5 billion to bailout French bond insurer CIFG, on the verge of losing its AAA rating.

November 27, 2007
The Abu Dhabi Investment Authority purchases $7.5 billion worth of convertible securities with an 11% coupon from Citigroup.

Freddie Mac announces a $6 billion share issue to cover more losses from mortgages.

German state-owned KfW doubles its balance sheet risk provisions from their bailout of IKB to €4.8 billion in expected losses.

KfW says IKB’s subprime portfolio had significantly deteriorated since the bailout in August. KfW had initially assumed €1 billion in losses from its bailout of IKB.

November 29, 2007
Slowdown in UK housing market
Bank of England releases data showing mortgage approvals have fallen to their lowest level since 2005.

Slowdown begins in the UK housing market. UK housing prices have fallen by 0.8% in November, the largest drop in 12 years.

United States lowers its growth forecast for 2008 from 3.1% to 2.7% owing to the housing and credit markets decline combined with high oil prices.

Total job cuts at Bear Stearns come to around 1500 which is more than 10% of its workforce.

December 3, 2007
Moody’s announces ratings cut on debt of up to $116 billion.

Much of this debt was on account of structured investment vehicles (SIVs) that relied heavily on the subprime market.

December 6, 2007
George W. Bush announces plans to help homeowners in trouble by freezing
interest rates on subprime loans for five years.

Royal Bank of Scotland (RBS) announces it expects to write down £1.25 billion due to exposure to the US subprime market.

December 10, 2007

UBS announces $10 billion more in writedowns associated with their subprime holdings and a capital injection of $11.5 billion from the Singapore government and an unnamed Middle East investor.

December 12, 2007

In order to provide more liquidity to the credit markets, the US Federal Reserve creates a Term Auction Facility (TAF) designed to allow banks to get Fed funds by pledging all sorts of collateral. TAF is open to all depository institutions believed to be financially sound.

The Federal Open Market Committee also approves swap agreements to provide $20 billion to the European Central Bank and $4 billion to the Swiss National Bank.

Swap agreements are reciprocal currency arrangements approved for up to six months.

December 18, 2007

The European Central Bank allocates $502 billion to banks at a below market interest rate to cut the cost of lending between commercial and retail banks.

The ECB was one of five central banks to inject liquidity into the market.

December 19, 2007

Morgan Stanley announces $9.4 billion in writedowns from subprime losses and receives a capital injection of $5 billion from a Chinese sovereign wealth fund to cover them.

December 20, 2007

For the first time in its 84 year history Bear Stearns reports a quarterly loss of $854 million with a fourth quarter writedown of $1.9 billion on its mortgage holdings.

CEO Jimmy Cayne and other top executives do not receive a bonus for 2007. This makes headline news.

December 21, 2007

After a run on assets, Friends Provident, a UK commercial property fund with £1.2 billion, freezes withdrawals and tells investors it could take up to six months to get their money out.

This is the first property fund to freeze withdrawals since the last UK property crash 15 years ago.

January 8, 2008

Jimmy Cayne retires as CEO of Bear Stearns and President Alan Schwartz takes over as CEO.

January 9, 2008

World Bank releases its Global Economic Prospects study forecasting worldwide economic growth at 3.3% in 2008. The study says strong growth in emerging markets will help to turn around the effects of the global credit crisis.

MBIA, the world's largest bond insurer, slashes its dividend by more than 60% and announces plans to raise $1 billion in debt to raise liquidity.

Monoline insurers such as MBIA and AMBAC write a single type of insurance contract, usually for bonds or asset-backed securities. Since these insurers have AAA debt ratings, the bonds also have a AAA debt rating, regardless of the financial health of the borrower.

January 11, 2008

Merrill Lynch and Citigroup announce plans to seek additional capital from sovereign wealth funds.

Citi looks to go back to the Abu Dhabi Investment Authority while Merrill eyes the Kuwait Investment Authority.

January 15, 2008

Citigroup reports a $9.83 billion loss in the fourth quarter resulting from an $18.1 billion writedown on its subprime mortgage-related exposure.

Citi also announces it would raise $12.5 billion in new capital to shore up its balance sheet; $6.88 billion of which will come from the Government of Singapore Investment Corporation.

January 16, 2008

JP Morgan Chase says it has cut its investments in the US subprime market by $1.3 billion.

Wells Fargo reports a 37% loss in net income for its fourth quarter.

January 17, 2008

Lehman Brothers announces plans to cut another 1,300 jobs in its domestic mortgage division in addition to the 2,500 lost already.

Moody's Investor Services hints large bond insurers could lose their AAA ratings.

Ambac is the world's second largest monoline insurer.

Merrill Lynch reveals a net loss of $7.8 billion for 2007 compared to a $7.5 billion net profit in 2006.

Merrill's had a $14.1 billion writedown on investments related to subprime mortgages.

January 18, 2008

After a run on assets, Scottish Aegon becomes the second property fund forced to freeze withdrawals and announce investors may have to wait up to a year to get their money back.

January 19, 2008

Fitch downgrades Ambac from AAA to AA.

A ratings downgrade could mean billions of dollars in writedowns on Ambac guaranteed securities and force banks to cough up more capital to cover the increased risks.

January 21, 2008

Ambac's downgrade has huge implications

As a result global stock markets in London and Europe suffer the biggest one day loss since September 11, 2001.

FTSE 100 index falls 5.5% wiping out £76 billion in market value as investors sell...
January 30, 2008
Role of credit rating agencies comes in to question

European leaders meet in London for a credit crunch summit. They ask credit rating agencies and big audit firms to help restore confidence in financial markets.

Credit ratings are widely used in Basel II capital requirements and in assessment of acceptable collateral in liquidity operations by central banks.

January 22, 2008
Panic sets in global credit markets

The US Federal Reserve cuts interest rates by 75 basis points which is the largest cut in over two decades.

Owing to $5.21 billion in writedowns on subprime mortgage guarantees Ambac Financial reports a record loss of $3.26 billion.

January 24, 2008
The United States Congress agrees on a $150 billion economic stimulus package to save the US economy from slipping into recession.

The package includes tax refunds of $300 to $1,200 to over 117 million American families.

Congress also raises the mortgage purchase limit for Fannie Mae and Freddie Mac from $417,000 to $625,000.

January 26, 2008
Financial Times announces that Bank of America (BoFA) and Countrywide are in merger talks to create the largest mortgage lending group in the US.

Analysts say the acquisition of Countrywide could cost BoFA $30 billion in addition to the $2 billion it invested in Countrywide’s preferred shares in August, 2007.

January 29, 2008
In a joint investigation of accounting fraud and insider trading, the US Securities & Exchange Commission and the Federal Bureau of Investigation (FBI) crack down on fourteen lenders and investment banks.

January 30, 2008
Role of credit rating agencies comes in to question

European leaders meet in London for a credit crunch summit. They ask credit rating agencies and big audit firms to help restore confidence in financial markets.

Credit ratings are widely used in Basel II capital requirements and in assessment of acceptable collateral in liquidity operations by central banks.

February 3, 2008
The auction-rate security market starts faltering as dealers stop taking unsold securities in auctions.

Financial regulators from the world’s leading economies meet in Amsterdam to discuss markets’ dependence on credit ratings.

G-7 finance ministers agree on a more universal enforcement of Basel II

February 7, 2008
Regulatory pressure builds up on the agencies

In response to regulatory pressure Standard & Poor’s releases a reform plan focusing on four main areas: governance reforms to address conflicts of interest; examining the accuracy of credit ratings; increased ratings transparency; and more information to investors.

February 8, 2008

CEO Josef Ackermann says he did not expect any more writedowns from subprime portfolios, after the third quarter €2.2 billion including leveraged loans, but says the bank still had exposure to leveraged loans.

February 11, 2008
G-7 Finance Ministers meet in Tokyo to determine that write-off losses on US subprime mortgages could reach up to $400 billion. The ministers ask banks to provide full disclosure on the losses.

February 12, 2008
Billionaire Warren Buffett offers to take more than $800 billion of municipal bonds backed by three monolines: Ambac, MBIA, and Financial Guarantee Insurance Company (FGIC).

This is in response to a possible credit rating downgrade of the monolines that insure the bonds. Ambac declines the offer.

Credit Suisse announces its writedowns on subprime mortgage exposure totaled 2 billion Swiss francs for 2007.

February 13, 2008
Data from Japanese financial watchdog, Financial Services Agency (FSA), shows Japanese subprime writedowns reached $5.6 billion in 2007.

February 14, 2008
Commerzbank, Germany’s second largest bank, announces record profits in 2007 despite $1.1 billion in subprime writedowns.

Swiss bank UBS confirms a $4 billion loss in 2007 on $18.4 billion in subprime writedowns as well as $26.6 billion in exposure to risky mortgages.

February 15, 2008
Moody’s pulls its AAA rating from Financial Guarantee Insurance Company.

February 17, 2008
Nationalization of Northern Rock

British government takes over the beleaguered Northern Rock, UK’s fifth largest mortgage lender, after two private sector bids fail — one from Northern Rock’s management, the other from Richard Branson’s Virgin consortium.

UK Chancellor of the Exchequer Alistair Darling says the two private offers to buy out the bank are insufficient to ensure pay back of loans.


The inter-bank lending market was the main source for Northern Rock’s liquidity before the US subprime mortgage fallout which deteriorated credit conditions and investor confidence.

February 18, 2008
Loans given by the US Federal Reserve through the Term Auction Facility reach $50 billion in one-month funds raising
fears that the collateral given for these loans was increasing the Fed’s exposure to the credit crisis.

The Fed views Term Auction Facility as a means to channel liquidity instead of the discount window which could trigger investor concern.

February 23, 2008
Citigroup, Wachovia, Barclays, Royal Bank of Scotland, Societe Generale, BNP Paribas, UBS, and Dresdner are in talks to inject $2 to $3 billion in Ambac to avoid a ratings downgrade.

The European Commission and the International Monetary fund prepare to introduce voluntary guidelines for governance and transparency in sovereign wealth funds (SWFs).

Several SWFs invested heavily in banks during the credit crisis raising fears their motivations were more strategic than commercial.*

* According to IMF estimates, state owned funds control about $1,900 to $2,900 billion in global funds.

February 28, 2008
AIG announces a $5.2 billion fourth quarter loss in 2007, its second consecutive quarter of losses.

Most of these losses are a result of AIG’s $11.12 billion (pretax) in writedowns. AIG has written $78 billion in credit default swaps (CDS). CDS is like an insurance contract where a company promises to cover certain securities in the event of default.

March 3, 2008
HSBC reports a $17.2 billion loss on writedowns of its US mortgage portfolio.

March 5, 2008
France’s largest retail bank, Credit Agricole, announces a €857 million loss after writedowns of €3.3 billion on its exposure to the credit crisis. The loss is much worse than Agricole’s forecast in December 2007.

March 10, 2008
Bear Stearns stocks drop amid rumors of liquidity problems.

Lehman Brothers cuts 5% of its workforce across all lines of business. Total job loss at Lehman comes to 5,425 employees.

In response to its AAA downgrading by Moody’s and S&P, Ambac announces plans to issue $1.25 billion in new shares and $250 million in equity-linked instruments. A consortium of large banks will purchase most of these shares.

FGIC sues German bank IKB on charges of providing misleading information that exposed FGIC to $1.9 billion in liabilities and a ratings downgrade.

March 11, 2008
The Federal Reserve offers primary dealers up to $200 billion in treasury securities for 28 days in return for AAA rated private mortgage backed securities (MBSs) as collateral.

The loans are implemented through a new Term Securities Lending Facility for investment banks.

As on February 18, 2008 the move underscores that the collateral would increase the Fed’s exposure to the credit crisis; defaults on the MBS would ultimately be borne by taxpayers.

March 12, 2008
In an interview with CNBC, Bear Stearns CEO Alan Schwartz denies rumors about the hedge fund’s liquidity position and blames stock variability of the last few days on market speculation.

March 13, 2008
Bear Stearns reports a $2 billion drop in liquid assets among rumors of illiquidity, reflecting a loss of $15 billion in cash and cash equivalents in two days.

A $22 billion mortgage-backed hedge fund run by Carlyle Capital Corporation collapses. Remaining assets would be taken up by banks for repayment of debts. The fund was slightly leveraged with $31 in debt per every $1 in equity.

March 14, 2008
Bear Stearns and JP Morgan Chase discuss permanent financing agreement. Bear Stearns shares trade at $30.

March 16, 2008
The collapse of Bear Stearns, once one of the biggest investment banks on Wall Street.

JP Morgan Chase announces it will acquire Bear Stearns for $2 per share, a fraction of what the bank was once worth.

To avoid a fire sale the Federal Reserve Bank agrees to fund up to $30 billion of Bear’s long-term assets.

The Bear Stearns collapse raises concerns about the instability of the credit default swap market. In mid-2007, the CDS market was worth $45 trillion, more than twice the size of the US stock market. Commercial banks were most active in the CDS market with the top 25 banks holding more than $13 trillion.

March 17, 2008
UBS reduces its balance sheet by $520 billion after adjusting the Bear Stearns sale price.

March 18, 2008
Lehman Brothers and Goldman Sachs announce profits for the first quarter better than what analysts had expected.

March 24, 2008
Morgan Chase raises its price on Bear Stearns to $10 per share after the original merger at $2 per share falls through by opposition of Bear Stearns shareholders.

March 26, 2008
It transpires that of all the Asian banks the Bank of China has the largest exposure to subprime mortgages. The Bank announces increased growth in securitization holdings despite a $1.3 billion writedown.

March 27, 2008
Moody’s announces it would hold back ratings unless mortgage lenders provided more transparent borrower information such as borrower income, employment and occupancy, and property value.

UK Financial Services Authority releases an internal report highlighting oversight failures of Northern Rock. FSA announces beefing up capacity to oversee the complex financial models banks use to assess risk.

The main errors highlighted in the report were: extraordinarily high turnover of FSA staff directly supervising Northern Rock; inadequate numbers of staff assigned to Northern Rock; and very limited direct contact with Rock executives.
March 31, 2008

US Treasury Secretary Henry Paulson announces a blueprint on a long term regulatory model with a three tier regulatory framework:

One focused on market stability across the entire financial sector; one focused on safety and soundness of institutions supported by a federal guarantee; and one focused on protecting consumers and investors.

Gordon Brown and George W. Bush announce plans to establish a UK-US working group to enhance cooperation between US and UK regulators.

A month after being nationalized Northern Rock announces plans to repay £23 billion in loans to the Bank of England by laying off one-third of its staff, halving its balance sheet, and shedding 60% of its mortgage holders.

April 1, 2008

Banks improve balance sheets by selling off leveraged loans and ridding themselves off mortgage backed securities

UBS announces a $19 billion first quarter writedown on its US holdings, and a rights offering of $13.1 billion to help offset the writedown.

UBS shares fell 83% in 2007 following $18 billion in writedowns.

Deutsche Bank announces a $3.9 billion first quarter writedown linked to its leveraged loan portfolio which including exposure to commercial real estate, half of it in the United States.

April 2, 2008

EU proposes changes to Basel II capital requirements including rules to limit the risk stemming from large bank exposures, harmonization of definitions of hybrid capital, capital requirements for default risks in banks’ trading books, and technical changes to the securitization framework.

Bank for International Settlements releases a report saying complex debt securities used to repackage asset-backed bonds will likely disappear as a result of the credit crisis.

The report further says that issuances of collateralized debt obligations of asset-backed securities (ABS) had been running at $70-$100 billion a quarter from 2005 to 2007.

The securities backing ABS are assets such as auto loans, leases, credit card debt, a company’s receivables, royalties and so on, and not mortgage-based securities.

April 7, 2008

The Concise Oxford English Dictionary adds ‘subprime’ and ‘credit crunch’ to the new words included in its next edition.

Credit crunch is defined as ‘a severe shortage of money or credit’.

Subprime is defined as ‘a credit or loan arrangement for borrowers with a poor credit history, typically having unfavourable conditions such as high interest rates’.

April 8, 2008

The International Monetary Fund releases its Global Stability Report which projects the new estimate on credit crunch losses upwards of $945 billion.

The Financial Times reports that Citigroup is in negotiations with private equity firms to sell $12 billion in loans to shrink its balance sheet and exposure to the subprime crisis.

April 9, 2008

Washington Mutual, the largest savings and loans bank in the US, announces it will raise $7 billion from outside investors to cover losses arising from its subprime mortgages.

The investors are led by private equity group, TPG, which will provide $2 billion. The investment will come in the form of an additional 176 million of new shares of stock.

April 11, 2008

The Council for Mortgage Lenders (CML) warns that mortgage lending in the UK could go down by 50% if fresh liquidity is not injected into the market.

April 14, 2008

Wachovia announces plans to raise $7 billion in capital after reporting a first quarter loss of $393 million.

The $7 billion would come from an offering of common stock and convertible preferred shares. Wachovia also announces a dividend slash of 41% and 500 job cuts.

April 17, 2008

Merrill Lynch reveals first quarter losses of $1.96 billion compared to a $2.1 billion profit in 2007. The bank says it plans to cut 4,000 jobs worldwide.

Merrill’s writedowns from subprime mortgages in first quarter of 2008 amount to $4.5 billion, added to $24 billion in writedowns from 2007.

April 18, 2008

Citigroup, the largest US bank, reports a first quarter $5.11 billion loss off a $12 billion write down on subprime loans. The bank announces another 9,000 job cuts.

April 22, 2008

In a move to unblock interbank lending Bank of England offers to acquire UK banks’ mortgage-backed securities for up to three years in return for treasury bills.

Royal Bank of Scotland announces a deeply discounted £12 billion rights issue in attempt to raise capital to cover £5.9 billion in writedowns on its April-June investments.

The rights issue is the largest in UK corporate history and the writedowns are the largest yet for a British bank.

April 23, 2008

In the US writedowns across the financial system from subprime related assets exceed $200 billion and are set to rise.

Big US financial groups raise more than $28 billion in capital markets. The 20 largest US banks have raised in excess of $80 billion in capital since October 2007.

US Securities & Exchange Commission draws up rules to govern credit rating agencies.

Wall Street bankers say the worst of the crisis is over.

April 24, 2008

With $5 billion in US leveraged loans, Deutsche Bank prepares another multibillion dollar sale making it the
third big sale in April after Citibank led the way with a $12 billion sale.

**Banks are trying to sell a backlog of about $100 billion in leveraged loans they’re holding.**

**May 1, 2008**

Credit markets are deteriorating fast. Increasing cost of credit is making it difficult to do business. US home prices drop 15.8%.

Citigroup raises $4.5 billion in equity offering. The Article lists capital raisings.

**May 6, 2008**

Swiss Reinsurance Co., the world’s biggest reinsurer, announces writedowns of $782 million while restructuring credit default swaps.

UBS sells $15 billion of subprime mortgage debt to US asset manager BlackRock at a 25% discount from its face value of $20 billion.

BlackRock, 49.8% owned by Merrill Lynch, manages about $1,360 billion in assets including $29 billion from the Bear Stearns bailout.

The deal signifies that private investors are willing to place bets on subprime debt to gain when the market turns around. These investors are betting that the valuation techniques are valuing the debt below what it is worth.

**May 9, 2008**

Owing to a writedown of $9.11 billion on the revaluation of its credit default swap portfolio, AIG reports first quarter net loss of $7.81 billion. AIG Holding Company is downgraded to AA-. AIG also announces it will raise $12.5 billion in capital through a stock offering to generate liquidity.

**May 12, 2008**

HSBC reports $3.2 billion in subprime writeoffs in the first three months of 2008.

HSBC now ranks fourth among big banks with total writedowns behind Citibank, UBS, and Merrill Lynch.

**May 13, 2008**

The Financial Times releases a table of writedowns showing worldwide bank writeoff totaling almost $450 billion since January 2007.

The table breaks down the total for each of the world’s major banks.

MBIA announces a $2.4 billion loss as a result of write downs on CDS, more than twice that of analyst estimates. MBIA stock lost more than 80% of its value in 2007.

**May 14, 2008**

Freddie and Fannie: “thinly capitalized, highly leveraged, and a systemic risk to taxpayers”

Freddie Mac announces it will raise $5.5 billion in capital.

In its first offer to help Freddie Mac and Fannie Mae the US Office of Federal Housing Enterprise Oversight lowers surcharges on Freddie Mac’s regulatory capital requirements. Freddie Mac’s shares rise 9% with the announcement.

A report by Fitch Ratings says banks have written off 80% of their subprime losses. The report estimates total losses on subprime mortgages and CDOs could reach $400 billion.

**May 15, 2008**

Barclays UK announces a £1 billion credit writedown and confirms its first quarter profits would be lower than in 2007.

**May 21, 2008**

A Financial Times investigation uncovers that owing to a computer coding error, Moody’s had awarded an incorrect AAA rating to billions of dollars of complex debt products.

Top Moody executives were aware of the problem in early 2007 but did nothing until January 2008.

The glitch was significant because most high powered investors require 2 AAA ratings before investing and Moody’s provided the second rating after Standard and Poor’s.

Moody’s Investors Service downgrades French bond insurer CIFG from A1 to Ba2 due to its increased writedowns on CDOs backed by risky mortgages. This downgrade could put CIFG in violation of its regulatory capital requirements, potentially leading to insolvency.

**May 22, 2008**

Following investigation, Moody’s declares that faulty computer models had incorrectly rated up to $4 billion of complex debt products as AAA. Moody’s stock price falls 16%.

The Institute of International Finance* proposes that banks that have not written off their bad debts be allowed to: use historical rather than market prices; and sell assets after two years instead of holding until maturity.

FASB and IASB do not support this proposal saying it would be dangerous to change the rules at a time when transparency was imperative.

The Financial Services Authority, UK announces it will factor in banker pay structures when considering overall risk to a financial institution.

The Basel II Accord enables regulators to impose additional capital charges for incentive structures that promote risky behavior.

To cover $19 billion in first quarter writedowns UBS offers stockholders deeply discounted rights issue to raise $15.5 billion.

* The Institute of International Finance is an alliance of 300-plus companies including banks.

**May 25, 2008**

The International Accounting Standards Board invites bankers and regulators to form a new working group to look in to the problems of valuing securities in an illiquid market.

The current model of ‘fair value’ accounting has caused banks to write off more than $300 billion in bad debt. Critics of fair value believe the debt will be written back up when markets rebound and this swing is contributing to the lack of confidence in financial markets.

**May 29, 2008**

After a final price of $10 per share JP Morgan Chase completes its acquisition of Bear Stearns.
June 6, 2008

The credit crisis has exposed over reliance on credit ratings for evaluating securities. Rating agencies published higher ratings for complex financial products.

Standard & Poor’s downgrades MBIA and Ambac, the two largest bond insurers, from AAA to AA owing to further deterioration of US mortgage markets and the CDOs insured by the monolines.

This downgrade could cause further writedowns of up to $10 billion for banks like Citigroup, Merrill Lynch and UBS with the most exposure to these monolines.


June 13, 2008

Following an inquiry by the SEC, Standard & Poor’s also announces errors in rating models, but says the glitch did not affect the ratings of the debt.

June 16, 2008

US SEC announces plans to overhaul regulation governing credit rating agencies by disallowing them to rate the securities that they help design, and increasing disclosure requirements for these agencies such as requiring them to flag complex securities which could be risky for investors.

Incidentally, the SEC itself relies on credit ratings with explicit references to ratings in its market rules which assume that securities with high credit ratings are liquid and have lower price volatility.

Lehman Brothers reports a $2.8 billion second quarter loss. President Joe Gregory and CFO Erin Callan resign.

June 19, 2008

For the love of money!

In the first criminal charges brought about in the credit crisis, Ralph Ciofi and Matthew Tannin, two former Bear Stearns hedge fund managers, are arrested for securities fraud and insider trading. The two funds had collapsed in July 2007.

The US Federal Bureau of Investigation (FBI) cracks down with its ‘Operation Malicious Mortgage’ on anyone involved in suspect mortgage practices that caused roughly $1 billion in losses. The Operation yields 406 defendants in 144 cases.

June 25, 2008

Barclays announces a £4.5 billion shares issue to boost its capital ratios which are some of the lowest in Europe. Qatar Investment Authority, an SWF, and chairman of Qatar Holding finance half of the offering.

Countrywide shareholders vote to approve the attempted takeover by Bank of America.

July 1, 2008

A government bailout of Freddie Mac and Fannie Mae is imminent. Federal researchers say the bailout could cost American taxpayers up to $25 billion. July turns out to be the worst month for mortgage-backed bonds since the beginning of the subprime crisis.

UK Treasury announces new guarantee scheme raising deposits covered from £35,000 to £50,000 hoping to prevent any runs on the banks.

July 4, 2008

US private equity group TPG pulls out of a deal to invest £179 million in UK mortgage lender Bradford & Bingley after Moody’s accords B&B one of the lowest ratings of any of the large European banks.

July 8, 2008

Shares in Fannie Mae and Freddie Mac plunge around 20% as investors sell off their shares after a Lehman Brothers report that accounting changes proposed by the FASB could force Freddie and Fannie to bring securitized mortgages back onto their balance sheets resulting in a total of $75 billion in regulatory capital charges.

July 10, 2008

Barrat Developments, one of the UK’s largest house builders, warns job cuts in the house building sector could reach 60,000 of the 300,000 employees employed directly or indirectly.

July 12, 2008

US bank IndyMac, with assets of $32 billion, closes down after being unable to meet withdrawal demands by customers. The bank’s rescue is estimated to cost between $4 and $8 billion.

The bank’s main regulator is the US Office of Thrift Supervision which failed to recognize IndyMac’s risky lending practices.

July 13, 2008

US Treasury concedes a large injection of public funds to save Freddie Mac and Fannie Mae from insolvency.

Investors, including large hedge funds, employ the take-under strategy in the belief that the government will bail them out to protect the financial market.

Take-under strategy means to short sell the stock causing share price to fall further, and then investing the proceeds in the company’s debt.

July 14, 2008

US Treasury Secretary Henry Paulson outlines a three point plan to save Freddie Mac and Fannie Mae:

i) the Treasury will be authorized to increase the current $2.25 billion lines of credit to Freddie and Fannie;

ii) the Treasury will have the power to purchase equity in the companies if necessary; and

iii) the entities will have access to borrowing from the Fed’s discount window.

July 16, 2008

Wells Fargo, the fifth largest US bank, reports better than expected second quarter earnings with $1.51 billion in writeoffs and a 10% increase in dividends.

Martinsa-Fadesa, one of Spain’s largest property companies, files for bankruptcy after failing to raise equity to complete a €4 billion debt refinancing with banks.

La Caixa, the largest Spanish bank, announces a €700 million loan exposure.

July 17, 2008

Richard Holbrooke, a director at the American International Group (AIG), resigns after two straight quarters of financial losses.

Merrill Lynch announces writedowns of $9.4 billion primarily on its mortgage related assets and hedges with troubled bond insurers.

Merrill has posted a loss of almost $19 billion in the last four quarters. Merrill
also announces a selloff of $8 billion in assets to raise much needed capital.

JP Morgan Chase posts a net income of $2 billion despite $2.4 billion in writedowns in the second quarter of 2008.

Goldman Sachs announces earnings of $2.1 billion.

**July 19, 2008**

Citigroup announces losses of $2.5 billion after second quarter write downs of $7.2 billion in bad debt.

This is significantly better than the $3.67 billion in losses predicted by analysts. Citigroup shares jump 7.7% on the news.

**July 21, 2008**

Bank of America (BofA) announces better than expected second quarter earnings of 72 cents a share with writeoffs totaling $3.6 billion.

**July 22, 2008**

US Congressional Budget Office says the US Treasury would have to cover $100 billion in losses if the mortgage market keeps getting worse. US mortgage rates reach their highest levels in a year.

Wachovia declares an $8.9 billion dollar second quarter loss, the largest in the company’s history.

**July 23, 2008**

US House of Representatives passes a rescue plan for Freddie Mac and Fannie Mae allowing the government to guarantee up to $300 billion in mortgages refinanced through the Federal Housing Administration.

The Basel Committee on Banking Supervision proposes incremental risk charge (IRC) which would make it more costly for banks to hold structured debt products that helped exacerbate the credit crisis.

IRC would also apply to investment banks.

**July 24, 2008**

New York State Attorney General Andrew Cuomo files charges against UBS executives for selling more than $21 million of their personal holdings of auction-rate securities and falsely marketing them as safe and liquid.

**July 29, 2008**

Trade partners of SCA, an insolvent bond insurer, agree to drop their claims in exchange for cash to allow the monoline to avoid being taken over by the US insurance regulator. The trade partners include Merrill Lynch and 13 other banks.

**July 30, 2008**

US SEC extends its ban on ‘naked short-selling’ on Fannie Mae, Freddie Mac and 17 large bank stocks.

**Naked short-selling allowed investors to bet on a stock falling without having to pay interest leading to increased speculation.**

**July 31, 2008**

Deutsche Bank reveals total writedowns of $7.8 billion for 2008. Without figuring in the write downs Deutsche would have an income 16% less than the second quarter of 2007.

The European Commission outlines a plan to subject credit rating agencies to a single supervisory regime in order to operate in Europe.

In an 80 page complaint Massachusetts’ Secretary of State, William Galvin, accuses Merrill Lynch of fraud in their selling techniques of auction-rate securities (ARS) by avoiding to warn investors of the risks of ARS.

**ARS are long-term debts issued by municipalities and others whose interest rates are set at bank-backed auctions.**

**August 4, 2008**

The credit crisis extends to Asia

HSBC, UK cautions that the credit crisis is starting to leak over into Asia with signs of slowdown in India and Vietnam.

David Aufhauser resigns as general counsel to UBS’s investment banking division after Andrew Cuomo had accused him along with other top level UBS officials for selling their personal holdings in auction rate securities on insider information.

**August 5, 2008**

Northern Rock, the British nationalized mortgage lender, expects to report first half losses of $500 million tied to bad debts in mortgage.

**August 7, 2008**

AIG shares drop 19.1%, its biggest daily drop in 39 years, after announcement of a higher than expected $5.4 billion second quarter loss.

Barclays offloads £6.3 billion in troubled loans and securities in a move to transfer the risk of the credit crunch off its balance sheet.

**Investors were still willing to buy debt assets affected by the credit crunch.**

**August 8, 2008**

Fannie Mae announces a $2.3 billion second quarter loss and slashes its dividend.

Citigroup and Merrill Lynch agree to buy up to $20 billion in auction-rate securities (ARS) after pressure from regulators claiming banks had continued to sell ARS as liquid instruments.

Royal Bank of Scotland announces a £691 million loss, the third largest in UK banking history with £5.9 billion in write downs.

**August 9, 2008**

UBS reaches an agreement with regulators to repurchase $19 billion in ARS debt. The agreement also settles the civil lawsuits brought by Andrew Cuomo against UBS.

**August 10, 2008**

Financial Times reports that the Royal Bank of Scotland is involved in a sale of $8 billion in loans from their balance sheet. The buyout is led by private equity firms Apollo, Blackstone, and TPG.

Buyers are expected to make up to 30% on the deeply discounted loans.

**These deals are structured in such a way that the private equity companies are at risk for the first losses of up to 20 cents on the dollar, but then any additional losses are shared with the banks.**
August 11, 2008
A Moody’s report shows the default rate on UK subprime mortgages increased from 7.3% in the second quarter of 2007 to 10% in the second quarter of 2008.

UK mortgage lenders predict a 20% drop in housing prices by the end of 2009. Data from the UK Building Societies Association shows that mortgage repayments outstripped new loans by £700 million in June bringing net lending in the mortgage market in the negative.

August 13, 2008
UK inflation rate exceeds bank interest rate for the first time in twenty seven years.

Bank of England is expected to respond by raising interest rates to control inflation instead of lowering them further to ease the credit crunch.

August 27, 2008
Bloomberg reports total losses related to the failure of the US subprime mortgage market have topped $500 billion, with banks raising $352.6 billion to cover their writedowns.

September 7, 2008
Subprime mortgage collapse wipes out more than $17 trillion in global equity value.

US government takes control of Freddie Mac and Fannie Mae by injecting $100 billion to ensure the troubled mortgage lenders would be able to meet their debts.

The government also says it would buy mortgage bonds backed by the companies starting with $5 billion and provide unlimited liquidity until the end of 2009.

Current shareholders face the prospect of massive dilution. Freddie and Fannie have $5,400 billion in outstanding liabilities and guarantee three-quarters of all new US mortgages.

September 11, 2008
Lehman Brothers announces plans to sell off its asset management unit and spinning-off $30 billion of troubled property assets after Lehman reported its worse loss ever of $3.9 billion for the third quarter spurred by $7.8 billion in credit related writedowns.

September 13, 2008

The US Treasury and Federal Reserve refuse to use public funds to close a rescue for Lehman Brothers, as opposed to the government bailout of Bear Stearns.

Analysts highlight three important differences between Lehman and Bear Stearns:

i) business mix differs from Bear’s, ii) less systematic risk with Lehman’s failure; and iii) Fed’s emergency liquidity facility to allow Lehman to wind down business in a way that will not cause shocks to the markets.

September 14, 2008
Merrill Lynch is in talks to be acquired by Bank of America after BoF removed itself from the bidding for Lehman Brothers.

American International Group (AIG) seeks to raise $10-20 billion in equity from private investors to shore up its balance sheet.

AIG also petitions the Fed to borrow from its discount window after ratings agencies threaten to downgrade AIG.

September 15, 2008
AIG, the world’s largest insurance company, goes bankrupt. Lehman files for bankruptcy.

Lehman Brothers files for Chapter 11 bankruptcy after acquisition talks with Bank of America break down.

Ten* of the world’s largest banks agree to pool $70 billion in a liquidity fund to mitigate the expected failure of Lehman Brothers.

*Bank of America, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, JP Morgan Chase, Merrill Lynch, Morgan Stanley, and UBS.

Bank of America agrees to acquire Merrill Lynch for $50 billion. The all stock transaction signals that investment banks were scrambling to find partners after the fall of Lehman.

European Central Bank (ECB) allots €30 billion in one-day liquidity to counter the effects of Lehman Brothers bankruptcy. Bank of England says it would offer £5 billion of extra reserves to help stabilize the markets.

A deal between AIG and New York insurance regulators allows the insurance company to access $20 billion of assets from its subsidiaries in an attempt to add liquidity and prevent a credit downgrade.

Yet, all the major rating agencies downgrade AIG’s long term debt triggering billions of dollars in collateral payments on its derivative trades, in addition to the billions AIG owed to its trading partners. AIG is bankrupt.

AIG’s largest trading partner was Goldman Sachs. The minute AIG went bankrupt, Goldman Sachs lost $20 billion in CDS exposure to AIG.

September 16, 2008
US Federal Reserve announces it will lend AIG $85 billion in emergency funds with a 79.9% government stake in the company to prevent existing shareholders from benefiting from the bailout.

AIG executives would be replaced and the $85 billion bridge loan would be repaid by selling off assets.

Russian central bank injects $14.16 billion in emergency one-day funds in an effort to stabilize the money market, after a 20% drop in trading on its two stock exchanges Micex and RTS.

September 17, 2008
The first time since 1994 the net asset value of a money market fund managed by US Reserve Management Corporation drops to 97 cents, i.e. below $1 per share.

RMC had written down $785 million held in Lehman Brothers debt to zero.

Financial Services Authority and UK government agree to waive competition rules to allow a £12 billion takeover of HBOS, UK’s largest savings institution, by Lloyds TSB.

The merged bank would have around 28% of the mortgage loan market and 50% of the savings market.

September 18, 2008
Following the AIG bailout, Interbank lending in the US and UK falls.
Central banks from around the world announce $180 billion in emergency liquidity.

**September 19, 2008**

In response to the Russian government’s pledge to pump $100 billion in liquidity the Russian stock market gains 30% after suspension of trading for two days.

Standard & Poor’s downgrades Russia’s economic outlook from positive to stable.

Financial Services Authority approves ban on short-selling of financial stocks in the UK until January 16, 2009.

US Treasury announces it will provide up to $50 billion from the Exchange Stabilization Fund to insure money market mutual funds in an attempt to prevent a run on the funds. Money market funds hold more than $3.4 billion in investor funds.

Treasurer Secretary Henry Paulson urges Congress to pass legislation to allow the government to buy up to $700 billion worth of toxic mortgage securities from the banks.

**September 21, 2008**

Russian finance ministry announces $24.21 billion in additional funds to the banking system in the form of three month bonds. More Russian banks are given access to budget funding.

**September 22, 2008**

Australia, Taiwan, and the Netherlands announce ban on short-selling.

US Federal Reserve approves Goldman Sachs and Morgan Stanley as bank holding companies, subjecting them to the Fed’s capital requirements. These were the last two large standalone investment banks.

**September 24, 2008**

Goldman Sachs announces it will receive a $5 billion capital infusion from Warren Buffett’s Berkshire Hathaway, and raise an additional $2.5 billion from public sale of common shares.

Rumors about insufficient liquidity at the Bank of East Asia, Hong Kong causes a run on the bank. BEA denies the rumors.

**September 25, 2008**

In a televised address US President George W. Bush pleads with the US public to support the $700 billion government bailout plan, or risk a long and painful recession.

**September 26, 2008**

**WaMu becomes the biggest bank failure in US history**

US regulators seize the assets of Washington Mutual (WaMu), the sixth largest US bank, which had lost a quarter of its share value the day before.

WaMu had failed to auction itself to potential buyers becoming the biggest bank failure in US history.

**September 28, 2008**

After WaMu’s seizure, its leftover holding company, Washington Mutual Inc., files for Chapter 11 bankruptcy listing more than $8 billion in total debts.

At the World Economic Forum in Tianjin, China policymakers discuss the need for a set of international accounting standards, policing of the CDS market, and greater international cooperation between regulators.

**September 29, 2008**

**Known as the ‘bailout bill’, the Emergency Economic Stabilization Act was put to the US House of Representatives. The Act allowed the Treasury to spend up to $700 billion on the Troubled Assets Relief Program (TARP) to buy and hold troubled loan-based assets, many of which are tied to slumping home prices in the US.**

The US House of Representatives votes against the $700 billion bailout bill proposed by the Treasury.

In response, the S&P 500 Index falls 8.8%, its worst drop since 1987 and the Dow Jones Industrial Average falls 778 points—it’s worst points decline ever. Citigroup agrees to buy the banking operations of Wachovia, the sixth largest lender in the US for $2.2 billion. The takeover will turn Citi into the largest retail bank in the US with more than $600 billion in deposits and more than 4,300 branches.

FDIC agrees to provide a cap on losses of Wachovia’s $312 billion mortgage portfolio. In return FDIC will receive a $12 billion stake in Citi in the form of warrants and preferred shares. Citi will be responsible for the first $42 billion in losses with the FDIC covering any additional losses.

US Federal Reserve more than doubles its swap lines with the European Central Bank and other central banks from $290 billion to $620 billion.

The European Central Bank along with the governments of the Netherlands, Belgium, and Luxembourg agree to pitch in €11.2 billion to nationalize Fortis, the European banking and insurance giant.

Hypo Real Estate, one of Germany’s biggest lenders, is rescued by the German government and other banks after a €50 billion liquidity crisis. HRE sells off €15 billion of assets to help cover the liquidity shortfall.

The government of Iceland takes control of Glitnir, the country’s third largest bank. The government had injected €600 million of equity into the bank.

Neuberger Berman, the asset management arm of Lehman Brothers Holdings, is sold to Bain Capital and Hellman & Friedman for $2.15 billion.

**A month before Lehman’s collapse, Carlyle was prepared to pay $7 billion for Neuberger which would have allowed Lehman to buy back the asset.**

**September 30, 2008**

Ireland guarantees around €400 billion of liabilities and €100,000 of individual deposits of six of its largest banks.

Dexia, a Franco-Belgian bank specializing in local authority finance, gets a €6.4 billion capital injection from various European governments including €3 billion from Belgium, €3 billion from France, and €376 million from Luxembourg.

The governments contend Dexia’s failure would have caused unacceptable systemic risk to their financial systems.
October 1, 2008

End of an era: Structured Investment vehicles (SIVs) are the latest casualty of the credit crisis

With $27 billion in managed funds, Sigma Finance in the US becomes the last of the structured investment vehicles (SIV) to be liquidated after JPMorgan cuts its last funding line.

SIVs are debt funds that borrow short-term commercial paper and lend long at a higher interest rate; the credit crunch prevented financing of long-term debt. The SIV industry had once controlled over $400 billion.

MBIA files a lawsuit charging Countrywide Financial (which has been acquired by Bank of America) for fraudulently inducing MBIA to guarantee billions of dollars in its mortgage bonds.

October 3, 2008

The revised bailout plan passes through the US House of Representatives and is signed into law by President Bush. Amendments in the bill include an increase in the FDIC insurance on bank deposits.

October 4, 2008

Wells Fargo announces it will pay $15.1 billion in an all-share offer to purchase Wachovia after the $2.2 billion government engineered deal with Citigroup falls through.

Citigroup says it plans to file for an injunction to prevent the deal or substantial damages from Wells Fargo.

October 6, 2008

French President, Nicolas Sarkozy, hosts an emergency summit on the global financial crisis in Paris where leaders of France, Germany, UK, and Italy agree that Europe will not allow any bank to fail.

Bank of America agrees to settle claim of predatory lending charges against recently acquired Countrywide Financial. BofA says around 400,000 borrowers will benefit from the deal.

Danish government announces plan to guarantee all banking deposits and some inter-bank loans, in return for which the country’s banks must establish a rescue fund of $6.5 billion. Iceland passes legislation allowing government to nationalize, merge, or force ailing banks into bankruptcy, and to take over housing loans held by banks and put them into a government housing fund.

BNP Paribas takes over Fortis from the Belgian government for €14.5 billion making BNP the largest bank in the Eurozone.

US Federal Reserve is in the process of creating a central clearing house for credit default swaps.

October 7, 2008

Dow Jones Industrial Average falls below 10,000 for the first time since 2004.

Iceland nationalizes Landsbanki, the second largest bank in the country and turns to Russia for a €4 billion loan to help stabilize its financial situation.

Spain announces the formation of a €30-50 billion emergency fund to provide liquidity by buying Spanish bank assets. Spanish government announces it will increase its guarantees for bank deposits from €20,000 to €100,000.

Russia injects $37 billion in long-term subordinated loans into state controlled banks through Russia’s two largest state banks, VTB and Sberbank.

October 8, 2008

For the first time since September 11, 2001 the European Central Bank and the US Federal Reserve work together to bring a half-point rate cut to stop the damage from the credit crisis.

UK government launches a £400 billion rescue plan to help restore confidence in the financial markets by investing £50 billion in the banking industry, guaranteeing £250 billion of new bank debt, and adding £100 billion to the existing Bank of England short-term loan scheme.

UK government declares it will sue Iceland to recover all UK customer deposits in Icesave, the failed internet bank that was nationalized. Icesave has about 300,000 UK customers.

The Swedish division of Iceland’s largest bank, Kaupthing, receives a SK5 billion loan from Sweden’s central bank.

October 10, 2008

Spillover effects are felt in Asia. South Korean banks are seen as the most vulnerable in Asia due to their dependence on foreign funding. US

Federal Reserve extends $740 billion via dollar swap lines to 14 central banks, including those in South Korea and Singapore.

The credit crisis begins to dig its claws into Japan as Yamato Life files for bankruptcy becoming the first direct Japanese victim of subprime. Yamato Life had $2.7 billion in liabilities at the time of the filing.

October 11, 2008

Dow Jones Industrial Average caps its worst week ever with the highest volatility day in its 112 year history. Paper losses on US stocks total $8.4 trillion from the market highs in 2007.

October 13, 2008

French president, Nicolas Sarkozy, pledges €360 billion in liquidity to French banks including €320 billion in guarantees for new bank debt and a €40 billion fund for recapitalizing lenders.

Spain announces up to €100 billion of guarantees for new debt issued by commercial banks in 2008.

UK government starts its nationalization process by injecting £37 billion in the nation’s three largest banks by owning a majority share in RBS and over a 40% share in Lloyds and HBOS.

In a coordinated move the US Federal Reserve, European Central Bank, the Bank of England and Swiss National Bank announce they will provide unlimited liquidity at a pre-fixed interest rate for dollars over periods of seven days, one month, and 84 days.

Bank of Italy announces it will provide €40 billion in treasury bills to banks to refinance inferior assets that can not be currently used as collateral.

Germany approves a plan to inject €500 billion into credit markets, and the Dutch government announces it will guarantee interbank lending up to €200 billion.

October 14, 2008

The US taps in to its $700 billion bailout fund to inject $250 billion of public money into the US banking system by taking an equity position in banks that choose to participate in the program in exchange for certain restrictions such as executive compensation.

Bank of America, JPMorgan Chase, Wells
Fargo, Citigroup, Merrill Lynch, Goldman Sachs, Morgan Stanley, Bank of New York Mellon and State Street agree to participate to receive half of the total funds.

The plan also allows the FDIC to temporarily guarantee the senior debt of all FDIC-insured institutions and increase access to funding for businesses by announcing further details of the commercial paper funding facility.

United Arab Emirates’ ministry of finance adds a $19 billion in liquidity to domestic banks bringing the total to $32.7 billion.

Japan announces a plan to help steady the Japanese market by lifting restrictions on companies buying back their shares, strengthening disclosure on short selling, and temporary suspension of the sale of government-owned stocks.

The Australian government unveils a $10.4 billion stimulus package to help pensioners, low and middle income families, and first time home buyers withstand the economic slowdown.

**October 15, 2008**

Greece announces a €28 billion package to support the banking sector including guarantees for up to €15 billion of medium-term lending and €8 billion of special government bond issues.

**October 16, 2008**

Citigroup announces a third quarter loss of $2.8 billion after receiving a $25 billion injection from the US government.

Switzerland agrees to fund a vehicle designed to hold up to $60 billion of toxic debt held by UBS, and also injects €3.9 billion to help recapitalize UBS. The Swiss government will own almost 10% of UBS.

Credit Suisse declines government assistance to turn to private equity to raise SFr10 billion, making it the best capitalized financial institution in Europe.

**October 17, 2008**

European Union leaders sign off on a joint $2.7 trillion bank bailout plan after a 2-day summit in Brussels. New international supervisory boards for at least 30 of the world’s largest banks are considered.

The won and Seoul stock market fall prompting South Korea to announce plans to raise spending and cut taxes to stabilize its economy.

Singapore and Malaysia both announce blanket guarantees on bank deposits until December 2010.

**October 19, 2008**

South Korean government announces a $130 billion rescue package for its banks and companies. The government will inject $750 million into the Industrial Bank of Korea to help enhance its capital base.

**October 20, 2008**

The €500 billion German bank rescue fund is up and running but a €10 billion limit may be set for a single bank along with a €5 billion maximum value of assets per bank.

Iceland seeks a €6 billion rescue package from the International Monetary Fund to help stabilize its economy.

The French government announces it will inject €10.5 billion into France’s six largest banks Credit Agricole, BNP Paribas, Societe Generale, Credit Mutuel, Caisse d’Epargne, and Banque Populaire.

Sweden announces a $205 billion program to stabilize its financial system and boost liquidity.

**October 21, 2008**

US Federal Reserve announces it will spend $540 billion to purchase short-term debt from money market mutual funds to help unfreeze the credit markets making it easier for businesses and banks to obtain loans.

UK announces plans for a £3 billion loan to the government of Iceland to help unfreeze the assets of over 300,000 British savers who had deposits with Icesave.

**October 22, 2008**

Wachovia announces third quarter losses of $23.9 billion.

The run on the bank before its sale to Wells Fargo included depositor’s withdrawal of more than $26 billion or 24% of their deposits, the biggest loss any bank has impaired since the beginning of the credit crisis.

**October 24, 2008**

AIG has borrowed a total of $90.3 billion of the $123 billion rescue fund set up by the government. The money has been used to pay off bad debts incurred by AIG’s CDSs.

**October 26, 2008**

International Monetary Fund announces a proposed $16.5 billion loan to Ukraine to mitigate the effects of the global credit crisis.

Kuwait guarantees all local bank deposits and suspends trading in Gulf Bank, the nation’s second largest bank, after some clients dealing in derivatives refused to honor their commitments. This action was the first of its kind in Kuwait.

**October 27, 2008**

Bank of Korea cuts interest rates by 75 basis points and says it would buy up to $7 billion of bank bonds to provide more liquidity.

The central bank agrees to allow exporters to borrow dollars to pay for foreign exchange losses and small companies to roll over foreign-currency debt for one year.

**October 28, 2008**

According to Bank of England estimates the world’s financial firms have now lost $2.8 trillion as a result of the global credit crisis.

Chairman Gulf Bank resigns over derivative losses and a run on Kuwait’s second largest bank, which is the first publicly known bank run in the Middle East.

World Bank, IMF and the European Union agree to provide Hungary $1.3 billion, $15.7 billion, and $8.1 billion respectively. This is the largest international rescue package for one country and the first for an EU member country since the crisis began. The Hungarian economy was heavily dependant on foreign financing.

US Federal Reserve announces a temporary reciprocal currency arrangement with the Reserve Bank of New Zealand. The swap agreement will help ease pressures in the US dollar short-term funding markets.

**October 29, 2008**

The Fed, the Banco Central de Brazil, the Banco de Mexico, the Bank of Korea,
and the Monetary Authority of Singapore announce a temporary swap line between the banks.

Kuwaiti parliament votes to guarantee around $86 billion all bank deposits of all local and foreign banks.

October 31, 2008

As a corollary to the subprime, global credit card revenues decline 40% as rising unemployment and job cuts force borrowers to default

Citigroup announces a $1.4 billion loss on securitized credit card loans in the third quarter of 2008.

Credit card loans were largely securitized in the same way mortgages had been.

Back-door Bailout for Big Banks

Flashback November 2008

The New York Federal Reserve bought out, for about $30 billion, credit default swaps that AIG had sold on toxic debt securities to banks including Goldman Sachs Group, Merrill Lynch & Co., Societe Generale and Deutsche Bank.

Fast Forward February 2010

The US Congressional Committee on Oversight and Government Reform is currently hearing the case of AIG's bailout, which involved a secretive group deploying billions of dollars to favored banks operating with little public or government oversight.

November 1, 2008

J.P. Morgan Chase announces a plan to restructure $70 billion in mortgages for an estimated 400,000 borrowers defaulting on payments.

November 3, 2008

South Korea announces plans to pump an extra $11 billion into their economy in 2009. Economic growth in the country has fallen to its lowest level in a decade.

HBOS, UK’s largest mortgage lender, reveals writedowns of £5.18 billion for the nine months ending in September including £457 million on HBOS’s exposure to Lehman Brothers and Washington Mutual.

November 4, 2008

Generally considered immune to the credit crisis, Latin American banks suffer from sharp currency declines

Two of Brazil’s largest banks agree to merge. Itaú Holding Financeira SA, Brazil’s second largest non-state bank, will purchase its smaller rival, Unibanco, to create Latin America’s largest bank. Contrary to analysts’ expectations, Swiss Re, one of the world’s largest reinsurers, announces a $263 million loss with a 289 million Swiss francs writedown on its credit default swap portfolio during the quarter.

November 5, 2008

Expecting to earn up to $550 billion by end 2008, the US Treasury offers its first “bailout bond” which will reach maturity in three years at a fixed rate of interest every six months.

Bond insurers MBIA and Ambac announce losses of $806.5 million and $2.43 billion leading to a likely credit rating downgrade. There is speculation on whether the two would be able to get anything from the $700 billion TARP.

November 9, 2008

AIG receives a revised $150 billion government bailout plan to reduce its interest payments and give it more time to sell assets. The total rescue package given to AIG now amounts to $150 billion.

November 10, 2008

Eastern Europe is most affected by the crisis because of large current account deficits and external financing needs

Fitch downgrades emerging markets of Bulgaria, Hungary, Kazakhstan, and Romania.

Fitch also revises long-term foreign currency ratings for South Korea, Mexico, Russia, and South Africa from stable to negative.

November 11, 2008

With little presence in retail banking, American Express converts to a bank holding company which would give it permanent access to low-cost Federal Reserve funds, but stricter regulatory and capital requirements.

Out of total assets of $127 billion, AmEx has only $7.2 billion in retail deposits.

November 12, 2008

US Treasury Secretary Henry Paulson abandons plan to buy toxic assets with the $410 billion remaining in the $700 billion TARP.

Instead, the Treasury evaluates a recapitalization scheme to provide a match of public funds to any funds financial institutions are able to raise from private investors.

November 14, 2008

S&P downgrades Turkey’s sovereign credit outlook from stable to negative. Turkey’s request for IMF assistance seems inevitable.

After announcing a quarterly loss of $25.3 billion, Freddie Mac asks the US government for access to $13.8 billion from the $200 billion facility created at the time of nationalization of Freddie and Fannie.

Fannie Mae reports a $29 billion quarterly loss and asks for more than $100 billion to stay afloat.

November 15, 2008

G20 meets in Washington DC to focus on five policy measures: i) strengthen transparency and accountability; ii) improve regulation; iii) promote market integrity, iv) reinforce cooperation; and v) reform international institutions.

November 17, 2008

In the second round of TARP disbursements, US Treasury gives out $33.6 billion to 21 banks bringing total payout so far to $158.56 billion.

November 24, 2008

Total capital infusion in to Citigroup comes to $45 billion

US Federal Reserve, Treasury and Federal Deposit Insurance Corporation agree to cover remaining losses for Citigroup after the bank agrees to absorb the first $29 billion of a pool of $306 billion identified toxic assets held by it.

November 25, 2008

US Federal Reserve pledges $800 billion more

$600 billion will be used to buy mortgage bonds issued or guaranteed by Fannie Mae, Freddie Mac, Fannie Mae and Ginnie Mae, and the Federal Home Loan Banks.

The other $200 billion will be used to fund the term asset-backed securities
loans. credit card loans, and small business loans are backed by student loans, auto loans, and acquisitions are down 29% from 2007 owing to lack in financing, valuation fluctuation, and widespread risk aversion.

China cuts interest rates to 5.31%, its fifth cut in the last three months. In an effort to restore China's high growth rate People's Bank of China reduces its capital reserve requirement by 50 basis points.

December 22, 2008
Worldwide M&As suffer
At $3,280 billion, worldwide mergers and acquisitions are down 29% from 2007 owing to lack in financing, valuation fluctuation, and widespread risk aversion.

January-March 2009
Credit Crisis Continues to Take Root in Asia.
Central banks around the world cut interest rates to record lows — near zero in the US and Japan while pumping trillions of dollars, known as quantitative easing, into the banking system to help restore credit flows.

In January the IMF warned that “the world economy is facing a deep recession.” Towards the end of January, IMF announced a significant downward adjustment in its forecasts for global economic growth. By now, the IMF had contributed $50 billion to member countries in response to the global financial crisis.

In the first quarter of 2009 US GDP sank 6.4%. Unemployment in the United States jumped to 7.2%, its highest in 16 years. Jobs were being lost at a pace of 700,000 per month. Eurozone saw a 2.5% slide in GDP, a potential 10 percent annualized drop in the first quarter, the worst on record.

Japan's economy was falling at a rate of 14.2%. The Bank of Japan reduced economic forecasts for the next two years admitting it could face deflation.

The bank also planned to inject capital into the markets by buying corporate debt to allow businesses to raise money. Japan announces a $16.7 billion stimulus package. China announced the slowest growth of 7.7% in seven years, and South Korea reported the first decline in quarterly economic growth since the Asian financial crisis.

A study by the Boston Consulting Group showed market value of the world’s banks has depleted by $5.5 trillion equivalent to 10% of the world’s GDP.

US Treasury Secretary Timothy Geithner introduced his $2 trillion Financial Stability Plan in an attempt to clean up the US financial system. US Treasury also announced details of its Capital Assistance Program (CAP) that included running stress tests on banks to determine if they will require additional capital.

UK government announced its Asset Protection Scheme (APS) to insure $712 billion of banks’ toxic assets. APS aims to increase lending without having to fully nationalize the banking system. Royal Bank of Scotland reported a £24.1 billion loss for 2008, the largest corporate loss in Britain's history. UK government released plans to inject £25.5 billion into RBS, and to absorb £325 billion of its toxic assets into the Asset Protection Scheme.

An Asian development Bank study showed the value of global financial assets tumbled $50 trillion in 2008. The African Development Bank (AfDB) set up a $1.5 billion emergency bailout fund to help alleviate the impact of the global financial crisis in Africa.

April-June 2009
A modest second half comeback in most of the world
G20 leaders pledge $1.1 trillion to fight the global financial crisis with $750 billion in additional funding for the IMF, $250 billion for world trade financing, and $100 billion for multilateral development banks.

The Financial Accounting Standards Board (FASB) announced a relaxation in mark-to-market rules. The changes will allow companies more discretion in accounting for toxic assets allowing banks to value their distressed assets.
higher. The mark-to-market rule had been blamed by many to have exacerbated the credit crisis by forcing banks to write down their assets.

IMF’s Financial Stability Report projected total writedowns on US originated assets to reach $4 trillion. US car maker Chrysler filed for Chapter 11 bankruptcy and announced partnership with Italy’s Fiat marking Fiat’s reentrance into the US car market.

Stress test results for the 19 largest U.S. banks are released. Nine banks including JP Morgan Chase, Goldman Sachs and MetLife, are found to be adequately capitalized. Of the 10 most vulnerable banks GMAC, Wells Fargo, Bank of America and Citigroup, as well as several large regional banks like KeyCorp and SunTrust Banks lack capital to withstand the worst-case scenario simulations. These banks are asked to prepare capital-raising plans by June 8 which will be implemented by November 9.

Under worst-case assumptions, experts put potential losses at $600 billion and the likely mortgage failure rate at 1 in 10.

Since its March 2009 low, the MSCI emerging markets index gained 68 percent compared with a 43 percent gain in the developed markets index though there are still significant reductions in capital flow, export demand, and foreign investment.

In the largest manufacturing bankruptcy in American history, US automaker General Motors filed for Chapter 11 bankruptcy.

Eurozone GDP saw a 2.5% overall decline. German economy contracted 4%. This was the worst recession in Europe since World War II. Industrial production was down 21.6%. Eurozone banks needed to writedown $283 billion more by end 2010. Rising corporate default and falling property prices were cause for concern.

Ten US banks are allowed to exit the TARP including American Express, Goldman Sachs, Morgan Stanley and JP Morgan Chase. Altogether they will return $68.3 billion, more than a quarter of the federal bailout money issued by TARP since October 2008. Chinese leaders proposed expanding IMF Special Drawing Rights for use as international reserve currency to counter the role of the dollar. The European Central Bank lent a record $622 billion to Eurozone banks at the current key rate of 1 percent which reflected continued funding problems in Eurozone banks amid expectations that the region’s economy will begin recovering in 2009.

**July-September 2009**

US economy expanded at a 2.2% pace in the third quarter after four quarters of contraction. Japan grew at a more moderate pace of 1.3% in July to September. Eurozone saw a sluggish 0.4% growth over the quarter after five quarters of contraction. China saw a slowdown but avoided recession. Built on stimulus cash and bank lending, China’s third quarter growth was 8.9%.

Common problems arising from the credit crisis are identified as ineffective integration of risk into decision making, a lack of alignment between companies’ strategies and appetites for risk, and a lack of timely data. According to Accenture’s 2009 Global Risk Management Survey 85% of corporate executives believed their companies needed to overhaul their approaches to managing risk.

**October-December 2009**

In October the IMF projected global growth at 3.1% in 2010, after an estimated 1.1% global contraction in 2009. Economists said whatever bad assets have been resolved have almost entirely been placed on the books of governments and central banks in places like Dubai, Mexico, Spain, Greece, the UK and the Baltic states, even at state level in the US. Japan announced its worst performance in 30 years as its economy shrank by 3.3% in the fourth quarter.

By November the impact of the financial crisis had its most severe impact on countries where the pre-crisis excesses had been greatest, i.e. the US and the UK among the G7 countries. According to the IMF the levels of GDP and fiscal revenue in these countries will not return to the previous path. In the case of UK, the IMF forecasts that the crisis will raise the ratio of net public debt to GDP by close to 50 percentage points between 2007 and 2014.

In the context of the global credit crisis, the role of credit ratings agencies has also come under a lot of fire. The three biggest ratings agencies — Moody’s, Standard & Poor’s and Fitch — control over 90% of the market. These agencies have been blamed for awarding excessively high ratings on mortgage-backed bonds that turned out to be almost worthless. These agencies make money by charging the bond issuers to evaluate the risks of their debt offerings, which in the aftermath of the credit crisis, has been criticized as a potential conflict of interest.

The US Securities & Exchange Commission approves a ratings agency as a Nationally Recognized Statistical Rating Organization (NRSRO) which signifies that a ratings agency is credible and reliable. European securities regulators and bankers have long pressured the SEC to break up the three agencies’ monopoly, or make them more accountable for issuing bogus ratings.

Entries for Living In a Bubble have been drawn from news reports, press releases and statements from the following sources:

- www.associatedpress.com
- www.news.bbc.co.uk
- www.bloomberg.com
- www.businessweek.com
- www.money.cnn.com
- www.europa.eu/rapid
- www.imf.org/external/pubs
- www.financialstability.gov/latest
- www.ft.com
- www.nytimes.com
- www.reuters.com
- www.marketwatch.com
- www.cnbc.com
- www.ustreas.gov/press/releases/reports
- www.time.com
- www.guardian.co.uk

Living In a Bubble: The Credit Crisis at Your Fingertips

This Special Report provides a chronology of events leading up to, and culminating in, the recent global credit crisis.

Due care has been taken to ensure accuracy of dates, events, and analysis.
In researching her forthcoming book *Top Talent: Keeping Performance Up When Business Is Down*, author Sylvia Ann Hewlett, an economist and founding president of the Center for Work-Life Policy, found that in the wake of last year’s financial crash, high-powered women were more than twice as likely as men — 84 percent compared with 40 percent — to be seriously thinking about leaving their jobs.

Research shows that the presence of women in senior positions in any organization translates into higher productivity, higher return on investment, and greater resilience to downturns. A recent study from London Business School shows that when work teams are split 50-50 between men and women, productivity goes up.

Women are better lateral thinkers, and they bring compassion and idealism to the workplace. Summarizing how valuable women are to business, *The Economist* recently wrote:

“The recent financial crisis proved that the sorts of qualities that men pride themselves on, such as risk-taking and bare-knuckle competition, can lead to disaster. Lehman Brothers would never have happened had it been Lehman Sisters.”

Intel created career development workshops aimed squarely at retaining one of its most at-risk populations: mid-level female engineers. Data collected from exit interviews had revealed that many of these talented technologists were leaving not to spend time with their family but because they no longer felt challenged by or passionate about their work.

According to Hewlett, talented people, both men and women are looking for intellectually and professionally challenging careers instead of a traditional vertical career path. “When they don’t know how to articulate those desires or think they won’t be satisfied by their current employer, they’ll look elsewhere.”

In 1991, Deloitte & Touche got a wake-up call about its efforts to retain women professionals. While it was recruiting almost as many women as men, the company had a much higher turnover rate for women. When they looked harder, they found that most women weren’t leaving to raise families; they were leaving after having weighed their unpromising career options in Deloitte’s male-dominated culture.

CEO Mike Cook made a business case for change. Deloitte held mandatory, two-day, intensive workshops for its 5,000 US managers to deliberate on what was discouraging high-performing women from staying. Deloitte’s gender gap in turnover has now nearly vanished, and the number of women partners and directors is the highest among the Big Five. Gender and cultural diversity have enabled Deloitte to grow faster than any of its competitors.

Myth Busted!

Most women who leave their jobs do not leave to spend time with their family, but because they no longer feel challenged by or passionate about their work.

*Source: Harvard Business online*
State Bank of Pakistan announced its monetary policy on January 30 keeping its benchmark interest rate unchanged for the next two months as inflation soars due to higher power tariffs and delay in receiving aid from Friends of Pakistan. The domestic inflationary cycle is expected to hike over the next three months with the increase in utility rates. State Bank of Pakistan maintained its discount rate at 12.5 percent.

SBP projected CPI inflation for the current fiscal between 11 and 12 per cent, compared to 20.5 per cent last year. Rise in cotton production and growth in textile sector have led to increased exports. Large-scale manufacturing sector grew by 0.7 per cent in November, compared to minus 20 per cent in March.

Overall balance of payments has posted a surplus of $1.4 billion during the first half of the current fiscal, compared to a deficit of $4.8 billion during the same period last year.

Sustained improvement in the balance of payments would depend significantly on the timing and scale of projected foreign inflows, especially the officials flows pledged in Tokyo by Friends of Pakistan.

SBP Governor Salim Raza said monetary growth was expected to be around 14.5 per cent for the current financial year. The governor dismissed worries about the decline in rupee’s value vis-à-vis the dollar, saying 3.5 per cent depreciation was not very significant, considering that all major currencies had seen a fall in their value against the dollar.
DP World to Open Port Qasim

DP World will be opening Port Qasim in Karachi this year. DP CEO Mohammad Sharaf has declined to say what the added capacity would be. As part of its international strategy DP World, one of the world’s largest port operators, is focusing on emerging markets which have remained more resilient to the global downturn.

In the last 12 months DP World has opened new terminals in Djibouti and Vietnam and has seen added capacity from port expansion in Kochi and Peru.

Pakistani Businesses Pledge Projects at FoDP

Led by Foreign Minister Shah Mahmoud Quraishi, a delegation of Pakistani businessmen has pledged to offer private-public sector projects to international investors in Dubai. The UAE hosted the Public-Private Partnership conference in Dubai under the aegis of Friends of Democratic Pakistan (FoDP). The conference is expected to provide an excellent opportunity to local businesses and foreign investors to directly obtain and provide information.

Real Estate Speculation Raises Bubble Fears in China

China’s property prices rose at the fastest pace in 18 months in December with residential and commercial real estate prices in 70 cities climbing up to 7.8 percent from a year earlier signaling the risk of asset bubbles. Home prices have become excessive in some coastal cities with newly built apartments in Shanghai climbing 9.2 percent.

As a crackdown measure on speculation, Chinese Premier Wen Jiabao pledged to stabilize property prices and keep housing affordable through taxation, differentiated interest rates and land regulations.

Analysts say the tightening focus will be on the luxury housing segment and speculative buying, not on so called ‘ordinary’ housing. If the market cools to the extent that no one’s buying then the 2010 economic growth target will be jeopardized. Real estate investment is equivalent to almost 10 percent of China’s economic output.

Ben Bernanke Appointed Federal Reserve Chairman for Another Term

The US Senate backed Ben Bernanke for a second four year term as Chairman of the Federal Reserve, but he continues to face significant challenges. Bernanke’s political standing has taken a beating during the past several weeks, which might make it more difficult for him to defend the central bank and maintain its independence.

Obama ‘Crisis Tax’ Threatens Recovery of European Banks

A ‘crisis tax’ proposed by the Obama administration would cut substantially into bank earnings across Europe and could sidetrack the sector’s recovery according to analysts and industry officials.

Under the new tax proposals, financial institutions with balance sheets above $50 billion would be assessed a fee equal to 0.15 percent of certain assets. About 15 international firms fall under that umbrella.

Europe’s three biggest economies were quick to distance themselves from the proposal given that the European banks which would be affected by this levy did not get bailouts in the United States and lack many of the guarantees their U.S. competitors received.

German Chancellor Angela Merkel said she favored a financial transaction tax, Britain said the problems in the United States were uniquely its own, and France said a tax on bonuses was the most efficient response to it.

Deutsche Bank was named as likely to be one of the European banks most affected, given its U.S. exposure.

Break Up the Banks, Says Nouriel Roubini

Nouriel Roubini, the economist credited with predicting the financial meltdown well before others, says big banks must be split up.

The New York University economist told business and political leaders at the World Economic Forum in Davos, that the Obama administration’s planned reforms of banks is a good first step, and it should lead to the separation of commercial banking from investment banking around the world.

Emerging Markets To Be Hit As Foreign Investors Pull Out

Foreign investors withdrew nearly $1 billion from emerging market stock funds in the week ended February 3, the most in over a year, according to global fund tracker EPFR Global. This included $516 million from Asian equities including Japan.

Worsening public debt concerns in Europe and doubts of a US recovery are driving foreign investors away from risky equities forcing them to pull out funds from emerging markets such as India where their portfolio holdings total almost $73 billion. Greece, Spain and Portugal are among the three European countries where there is mounting public pressure and threats of social unrest driven by risks of a sovereign default.

Meanwhile, India’s $1.3 trillion economy is being strongly driven ahead by domestic demand and investment. Morgan Stanley has raised its forecast for India’s economic growth to 8.5 percent in 2010-2011 from 8 percent earlier.
What the CEO Wants You to Know: How Your Company Really Works
Ram Charan

What the CEO Wants You to Know captures these insights and explains in clear, simple language how to do what great CEOs do instinctively and persistently: Understand the basic building blocks of a business and use them to figure out how your company makes money and operates as a total business. Then decide what to do despite the clutter of day-to-day business and the complexity of the real world. Many people spend more than a hundred thousand dollars on an MBA without learning to pull these pieces of the puzzle together. Many others lack a formal business education and feel shut out from the executive suite. What the CEO Wants You to Know takes the mystery out of business and shows the secrets of success used by business legends like Jack Welch of GE.

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The Return of Depression Economics and the Crisis of 2008
Paul Krugman

In 1999, in The Return of Depression Economics, Paul Krugman surveyed the economic crises that had swept across Asia and Latin America, and pointed out that those crises were a warning for all of us: like diseases that have become resistant to antibiotics, the economic maladies that caused the Great Depression were making a comeback. In the years that followed, as Wall Street boomed and financial wheeler-dealers made vast profits, the international crises of the 1990s faded from memory. But now depression economics has come to America: when the great housing bubble of the mid-2000s burst, the U.S. financial system proved as vulnerable as those of developing countries caught up in earlier crises and a replay of the 1930s seems all too possible.

In this new, greatly updated edition of The Return of Depression Economics, Krugman shows how the failure of regulation to keep pace with an increasingly out-of-control financial system set the United States, and the world as a whole, up for the greatest financial crisis since the 1930s. He also lays out the steps that must be taken to contain the crisis, and turn around a world economy sliding into a deep recession.

The book is crafted in Krugman’s trademark style – lucid, lively, and informed – this new edition of The Return of Depression Economics sets the debate over how to respond to the crisis.

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The Flight of the Creative Class: The New Global Competition for Talent
Richard Florida

For the first time ever, the United States is truly in danger of losing its most crucial economic advantage – its status as the world’s greatest talent magnet – argues best-selling author and economist Richard Florida. Where America was once the first destination for foreign students and the last stop for scientists, engineers, musicians, and entrepreneurs wishing to engage in the most robust and creative economy on the planet, it has now become only one place among many where cutting-edge innovation occurs.

Burgeoning global technology hotspots. The outsourcing of ingenuity. Rising intolerance. A faltering education system. Cities torn by inequality. Disconnected political leadership. According to Florida, they all point to the looming creativity crisis that is causing the decline of American economic might.

In the groundbreaking The Rise of the Creative Class, Florida introduced the United States to the rules of engagement in the creative age. Florida’s 3 Ts of economic development – Technology, Talent, and Tolerance – took him around the world and back again, sparking an international debate over the causes and effects of long-term prosperity, development, and innovation.

The Flight of the Creative Class takes Florida’s arguments to the next level, explaining how the same conditions that affect regional economic development, talent exchange, and the unleashing of human creativity play out on the world stage.

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Nouriel Roubini, the economist credited with predicting the financial meltdown well before others, says big banks must be split up. Roubini expects the Obama administration’s planned reforms of banks to lead to the separation of commercial banking from investment banking around the globe.

The Obama administration is getting tough with the six largest US banks with total assets worth more than 60 percent of GDP. The existing business model encourages excessive risk taking by banks. Former Federal Reserve Chairman Paul Volcker has proposed restrictions on banks similar to those contained in the Glass-Steagall Act of 1933.

The Glass-Steagall Act separated commercial and investment banking. The Act was repealed in 1999 allowing institutions such as Goldman Sachs and Morgan Stanley to transform into bank holding companies from securities firms to get cheap funding from the US Federal Reserve’s TARP program during the recent financial crisis. Additionally, if Glass-Steagall had not been repealed Bank of America would not have been able to acquire Merrill Lynch.

Policymakers are now calling for a prohibition on proprietary trading by commercial banks. They are also calling for an increase in banks’ capital requirements so that the banks hold at least 20 to 25 percent of assets in core capital. In the US there are calls to amend the Riegle-Neal Interstate Banking Act of 1994 which set a size cap so that no bank could have more than 10 percent retail deposits.

The US House of Representatives is planning to reinstate Glass-Steagall. Critics of Glass-Steagall say it would be impractical to roll back the evolution of many financial institutions into global trading and banking giants over the past decade, with Goldman Sachs’ finance chief David Viniar saying, “Glass-Steagall went away a long time ago.” Whether it’s coming back remains to be seen.