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Editorial Office
Chartered Accountants Avenue, Clifton,
Karachi-75600 (Pakistan)
Phone: 99251636-39 Fax: 99251626
E-mail: asad.shahzad@icap.org.pk
Website: www.icap.org.pk

Editor's Letter

For ages Corporates have been infamously known for their stone heartedness and ruthless behavior, however slowly the perception is being changed, primarily due to the Corporate and the public both understanding and accepting each others jurisdiction.

With financial scandals rocking the comfortable sailing and jolting the public out of their reverie, calls for better reporting and better management compelled the Corporates to rethink their game plan. Being Accountants our premier interest lies in the reporting, as our profession binds us to protect and safeguard accountability and transparency. The recent trend of accounting for future is a welcome move as it enables the stakeholders to access complete information and make informed decisions.

The content of a corporate report enables the stakeholder to assimilate data elements from disparate source systems that together should provide a clear picture of the company's ability to execute its strategy. The quality of a corporate report is judged by how well the end user draws out the rational inferences. If the content is limited to the extent that the end user is only able to view discrete data elements without seeing those data elements in context, then the value of the content is dubious. Likewise, if the content of the report fails to combine both financial and nonfinancial data it is quite likely that the end user may be misled by the corporate report.

We accountants have to broaden our horizons and adapt to the changes in the financial and corporate world. As more and more accounting functions become automated, accountants and financial analysts who can add value to the business they serve by way of being business managers and able to think strategically will have much better prospects than those who stick to keeping the books.

The Pakistan Accountant is a medium through which we grow together and a regular feature of the journal, "join the discourse" thrives on our contribution and provides an opportunity for us to voice our opinion as well as be more aware of the perceptions of the society we live in. We look forward to hearing from you in future.

Adnan Zaman

President's Page

Change is imminent when the mindset of the people changes. Throughout the history of our profession we have witnessed numerous changes, some catering to our needs, some in response to changing times and some in response to the public's demand.

An example is when in the nineteenth century the public interest in the corporate sector led to its reinvention and concentrating more on transparency, accountability as well as being socially accountable. During the century the corporate sector, developed and created the need and framework for proper reporting and transparency to ensure public confidence. The idea of being accountable with greater emphasis given on the relevancy, timeliness and reliability of data settled in with the passage of the century making it a regular norm.

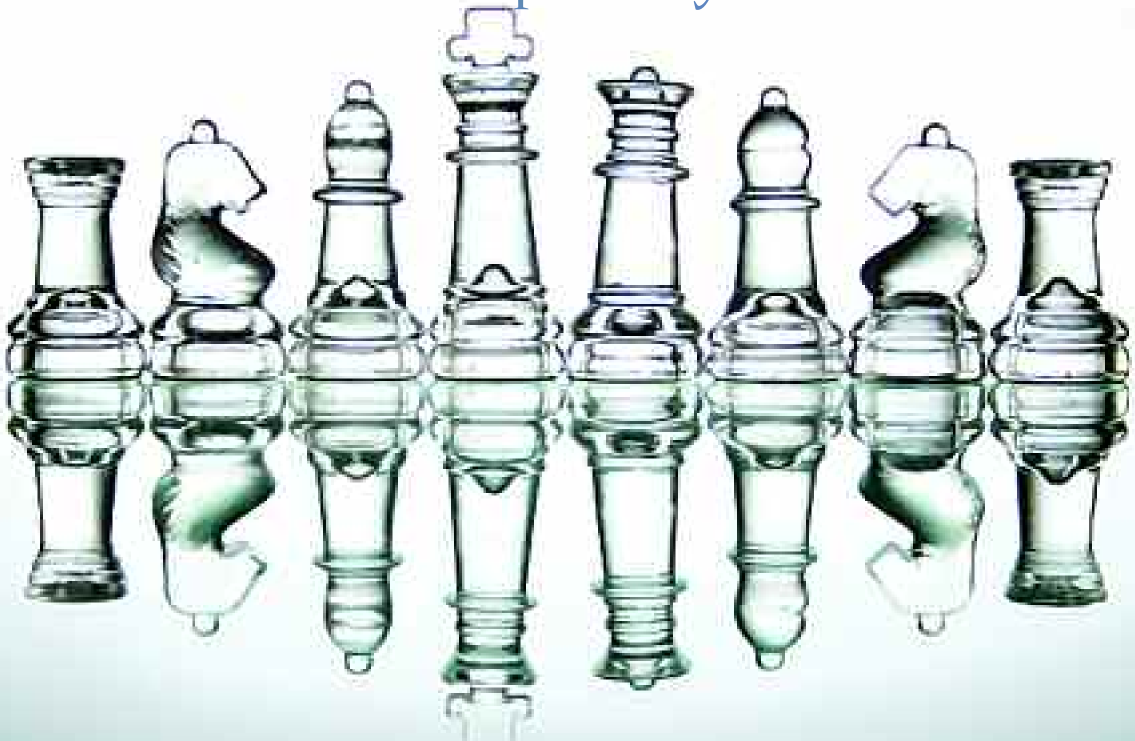
Today globally, the corporate have changed their game, the idea of being responsible to the stakeholders and the public in general has gradually sunk in. Corporates are willingly sharing more information with stakeholders. As accountants we must appreciate that information shared should be meaningful, timely and clearly communicate the complete picture to the stakeholders. In just over ten years, corporate sustainability reporting has shifted from voluntary to the vital. Sustainability reports, often called corporate social responsibility or even integrated reports, now contain more detailed performance metrics and reflect the priority companies have given to measuring and managing the impact of their operations. Global standards have also played an important role in the development of sustainability reporting and performance management.

We at ICAP remain committed towards enhancing and providing avenues for our professionals to develop their competencies at the same time realise the need of initiating the process change a fine example is the Best Corporate &Sustainability Reports Awards, through the decade the awards have managed to inspire and inculcate within the Corporates to improve upon financial reporting and becoming more transparent.

Rashid Rahman

ANNUAL REPORT

A Means for Corporate Governance and Transparency



Abdul Rahim Suriya, FCA
Haroon Tabraze, FCA

Corporate Governance

The corporate sector in Pakistan has had its fair share of corporate failures, scams and scandals - Taj Company, Mehran Bank , Islamic Investment Bank various Housing Cooperative Societies Schemes, and other numerous finance companies have deprived thousands of small investors of their life-savings. In the not so distant past, nationalized banks have written off billions of rupees by way of bad loans. These scams bear similarity to those happening across borders; with the largest occurring in USA. The victim in most cases being the general public, leads to a hue and cry over regulating the companies. After ENRON and other similar cases, financial experts from world over sat together to formulate a strategy and came to a conclusion which the medical profession discovered decades ago: "prevention is better than cure". Thus the concept of corporate governance was born.

HISTORY

At independence, Pakistan inherited the political heritage of the United India including the Indian Companies Consolidation Act, 1913, which was duly adopted. The Act remained in force till 1984 when the Companies Ordinance 1984 was promulgated. It is still remains in force, although amendments are usual and regular feature.

The corporate sector in Pakistan is primarily regulated by the Securities and Exchange Commission of Pakistan (SECP) through the Companies Ordinance, 1984. Various specific laws to regulate specialized corporate entities are in place i.e. Modaraba Companies and Modarabas (Floatation and Control) Ordinance, 1980, State Bank of Pakistan Act 1956, the Insurance Ordinance, 2000 etc.

ICAP'S ROLE

One of the main developments in corporate governance in Pakistan has been the formulation of a Code of Corporate Governance (CCG). The Code was developed on the initiative of the Institute of Chartered Accountants of Pakistan (ICAP) after the members passed a resolution in the Fifth All Pakistan Chartered Accountants' Conference held in December 1998. A committee was later formed which included representatives from various stakeholders i.e. KSE, SECP etc and a set of recommendations were formulated. These recommendations after being exposed to members of ICAP and the general public in 2001 were taken up by SECP for processing and made part of the respective listing regulations of the three stock exchanges. In 2004, Pakistan Institute of Corporate Governance (PICG) was established with the objective to provide enabling environment for the implementation of CCG issued by the SECP. ICAP was one of the founding members along with SECP, SBP, stock exchanges in Pakistan, banking and insurance associations, apex bodies of the corporate businesses, FPCCI, Institute of Corporate Secretaries and Non-Bank Financial Institutions (NBFIs) and the leading business educational institutions like LUMS and IBA.

In 2008 ICAP developed a Guide (MIES-19) in Partnership with the Center for International Private Enterprise (CIPE), and PICG. The Guide establishes principles and practices aimed at helping directors of family owned companies in improving governance.

Annual Report and Good Corporate Governance

TRANSPARENCY

The buzz word in today's business is transparency. Illustratively, standing outside a window would provide you with a view of what is in the room. A transparent window will give you a complete and detailed view, while a window with dark tinted glass might not show you the dirt and grime inside. Using the analogy, a financial report should be such that the reader can see inside-out of the company.

The publication of timely annual report which fulfils the requirement of Companies Ordinance is an important tool for promoting accountability and transparency in the Corporate Reporting. Of course transparency is important only when shareholders are diverse and widespread i.e. in listed entities. Detailed information is not expected from closely held or family owned companies. The last decade has witnessed the financial disclosures increasingly getting improved through international accounting standards and IFRSs to achieve the transparency desired by the readers. However the numbers are only quantitative; they lack the description of qualitative factors. The operational management for their decision making still prepare a different set of management accounts. However Management Commentary along with financial numbers is necessary for a better understanding of the operating results and financial/investing activities of the business

ROLE OF PROFESSIONAL INSTITUTES

For the last 11 years the Joint Committee of ICAP and ICMAP has been organizing the Best Annual Repot Competition with the objectives:

- to encourage and give recognition to excellence in annual corporate reporting; and
- to promote corporate accountability and transparency through the publication of :
  - timely;
  - factual information; and
  - reader friendly information.

It is interesting to note that there although is no specific law requiring an entity to produce and publish annual report there are various statutes that require the contents embodied in it. According to the International Standard on Auditing # 720 the Annual Report is defined as "An entity ordinarily issues on an annual basis a document which includes its audited financial statements together with the auditor's report thereon. This document is frequently referred to as the **"annual report".**

However in order to encourage transparency and better and relevant reporting from companies through additional disclosures, ICAP and ICMAP launched the Best Corporate Reporting Awards. The awards are given to companies as an acknowledgement for voluntarily providing relevant and timely information to the stakeholders to help them make economic decisions. An elaborate 'Criteria' which has evolved over the years, is used as a basis to evaluate best reports. The criteria for 2011 includes certain information in addition to the disclosures required by corporate laws in practice, such as:

Ref.	Criteria
2.0	Disclosures of information required by the IFAC Management Commentary
2.1	Description of nature of business including a macro-level (e.g. industry, main markets, and legal environment) and a micro-level (e.g. business model, product portfolio) discussion.
2.2	Explanation of management's objectives and its strategies for meeting those objectives including priorities for action and addressing threats and opportunities of market trends.
2.3	Description of the entity's most significant:
2.4	Resources, including an analysis of liquidity, cash flows, financing arrangements, human capital and capital structure, including any inadequacies in the capital structure and plans to address such inadequacies;

a) Risks, including strategic, commercial operational and financial risks; and
b) Relationships, which are likely to affect performance and value of the entity
c) Description of the entity's financial and non-financial performance (results) and the future prospects, including whether the performance may be indicative of the future performance.
d) Description of critical performance measures and indicators which management uses to measure performance of the entity against stated objectives of the entity and whether the indicators used currently will continue to be relevant in the future.

2.6 Market share information preferably from an independent source

4.2 Summary of the Cash Flow Statement for 6 years

4.4 Vertical and Horizontal analysis of Balance Sheet and Profit and Loss Account for 6 years

4.5 Statement of Value Added and how distributed

4.6 Investors' Relations section on the corporate website

5.4 Comprehensiveness of corporate information

5.6 Definition and glossary of terms / Calendar of major events during the year

6.3 Board structure and its committees

6.4 Chairman of the Board other than the CEO

6.5 Information on other Board Committees, their terms of reference and the number of meetings

6.6 Salient features of the Audit Committee Charter/Terms of Reference

6.7 Name of independent directors / non-executive directors

6.8 Profile of each director including engagement in other entities

6.9 Non- executive directors on the Audit Committee

6.10 Organization Chart

6.11 Disclosure of criteria to evaluate Board's performance

6.12 CEO performance review

It is pertinent to note here that the 'Criteria' not only comprises of mandatory requirement of Companies Ordinance 1984, and the code of corporate governance, it also encourages adopting international best practices. The Joint Committee of ICAP and ICMAP always looks out for new trends in information sharing and one item that stands out is the concept of 'Management Commentary'.

Management Commentary

Management Commentary is a narrative report accompanying, but not part of, the financial statements. It tells the story about the company's performance and financial conditions as seen through the eyes of the management. The commentary describes both financial and non-financial information, and is a basis of understanding for the reader by providing a context to interpret the financial position, operating environment, and key indicators of the company.

The International Accounting Standards Board (IASB) which is the independent standard-setting body of the IFRS Foundation, had set up a project team comprising representatives from the national standard setters in Germany, New Zealand, United Kingdom, and from Canadian Institute of Chartered Accountants, to examine the potential for issuing a formal guidance on management commentary.

Subsequently, a practice statement was issued on 8th December 2010. Sir David Tweedie, Chairman of the IASB, said on the occasion:

> *"Management commentary is one of the most interesting parts of the annual report. It provides management with an opportunity to add context to the published financial information, and to explain their future strategy and objectives. It is also becoming increasingly important in the reporting of non-financial metrics such as sustainability and environmental reporting.*
>
> *The publication of this Practice Statement will benefit both users and preparers by enhancing the international consistency of this important source of information".*

The Practice Statement applies only to management commentary and not to other information presented in either the financial statements or the broader financial reports. It should be applied by entities that present management commentary which relate to financial statements prepared in accordance with IFRSs.

A good management commentary should provide managements view not only on what has happened, but also management;s reasoning of its occurrence, , as well as an estimate of future, based on the past events.

A good commentary should not repeat what is in the financial statements, rather should clarify and describe the implications.

PURPOSE

The IFRS Practice Statement Management Commentary provides a broad, non-binding framework for the presentation of management commentary that relates to financial statements that have been prepared in accordance with International Financial Reporting Standards (IFRSs).

The Practice Statement is not an IFRS. Consequently, entities applying IFRSs are not required to comply with the Practice Statement, unless specifically required by their jurisdiction. Furthermore, non-compliance with the Practice Statement will not prevent an entity's financial statements from complying with IFRSs, if they otherwise do so.

Futuristic information

Management commentary should communicate management's perspective about entity's direction. It should include forward looking information when it is aware of trends, uncertainties or other factors that might affect the entity's liquidity, capital resources, revenues and results.

Management should also disclose the assumptions used in providing forward looking information as well as the Management's assessment of the entity's prospects in the light of current period results.

VARIANCES WITH PREVIOUS YEAR TARGETS

Management should explain how and why the performance of the entity is short of, meets or exceeds forward-looking disclosures made in the prior period management commentary. For example, if management stated targets for future performance in previous reporting periods, it should report the entity's actual performance in the current reporting period and analyze and explain significant variances from its previously stated target as well as the implications of those variances for management's expectations for the entity's future performance.

WHAT DOES MANAGEMENT COMMENTARY INCLUDE

Focus of the management commentary depends on the facts and circumstances of the entity. It generally includes:

1. **Nature of Business:**
   a. The knowledge of the business in which a company is engaged, its external environment including a discussion of the industry sector to which company belongs.
   b. A discussion of primary and secondary markets and company's position in the market
   c. The legal, regulatory and economic environment that may have an influence on the company as well as on the market in which the company operates.
   d. The company's structure, organization, products, services, business processes and distribution channels.

2. **Objectives and Strategies:**
   a. A discussion on strategies adopted by the company, and their respective results
   b. Likelihood of continuing these strategies and estimated results in future

3. **Resources:**
   a. The most important resources available to company including human, and capital resources
   b. The company's ability to sustain and maintain these resources in future
   c. A discussion on company's strategy on how to generate resources in future

4. **Relationships**
   a. Significant relationships of the company with stakeholders
   b. How these relationships effect the performance and value of the company
   c. How these relationships are managed and strengthened

5. **Risks:**
   a. A discussion on the risk identification process adopted by the management.
   b. Plans and strategies of how to mitigate material risks and uncertainties
   c. Negative consequences and potential opportunities related to material risks

6. **Results and prospects**
   a. A clear description of the entity's financial and non-financial performance
   b. Management's assessment of entity's prospects
   c. Analysis of the managements objectives and strategies with the entity's result
   d. Comparison of current performance with prior periods to help understand the extent to which past performance may be indicative of the future prospects

7. **Performance measures and indicators**
   a. Narrative description of the effects of key financial indicators
   b. Explanation of why and how past performance differs with current performance
   c. Explanation of any change in the relevance of performance measurement indicators

MANAGEMENT COMMENTARY VERSUS DIRECTORS REPORT:

The difference: In this context it is important to note that "management here means the people responsible for decision making and oversight of the entity. They may include executive employees, key management personnel and members of a governing body.

Management commentary is not directors' report, although it is usually assumed to be so. Management commentary is recommendatory but not mandatory. After all it is not IFRS.

The Directors' report generally consists of review and trend analysis of the performance of the company over a period of time. It covers the performance limited to the earnings and distributions over the period. In contrast the Management Commentary is aimed at providing the users information regarding strategies established to achieve the targets. Furthermore it also requires management to provide an analysis of any shortcomings in the achievements with reference to these strategies followed by the management. In fact the management commentary requires such information for the users to analyze the sustainable growth of the entity including information related to the available resources and future strategy to maintain and or enhance according to the needs in future.

information which is now addressed by the Management Commentary:

- Explanation of strategies for meeting management's objectives e.g. threats and opportunities of market trends.
- Analysis of liquidity, cash flows, financing arrangements, human capital and capital structure and the company's ability to maintain these resources and strategy on how to generate resources in future.
- Description of the entity's most significant relationships, which are likely to affect performance and value of the entity and how these relationships are managed and strengthened.
- Description of the entity's most significant risks and related consequences and opportunities and plans and strategies to mitigate material risks and uncertainties.
- Description of critical performance measures and indicators which management uses to measure performance of the entity against stated objectives of the entity.
- Narrative description of the effects of key financial indicators.
- Explanation of why and how past performance differs with current performance

There are few areas of Management Commentary which

GAP with BCR Criteria

are neither part of Companies Ordinance / Code of Corporate Governance nor in the Criteria for Best Corporate Report for 2011. Management should disclose in order to bring more transparency:

- The information that is important to management in managing the business
- Perspective of the entity's direction
- Forward looking information when management is aware of trends, uncertainties or other factors that could affect the entity's liquidity, capital resources, revenues and the results of its operations. Forward looking information may be narrative explanations or quantitative including projections or forecasts.
- How and why the performance of the entity is short, meets or exceeds forward looking disclosures made in the prior periods.
- Significant changes in an entity's objectives and strategies from the previous period or periods.
- Risk plans and strategies for bearing risk or mitigating risks and effectiveness of these strategies. Principal risks facing the entity should cover both exposures to negative consequences and potential opportunities.
- The significant relationships that the entity has with stakeholders, how those relationships are likely to affect the performance and value of the entity, and how those relationships are managed.
- The relationship between the entity's results, management's objectives and management's strategies for achieving those objectives.
- Significant changes in financial position, liquidity and performance compared with those of the previous period or periods.
- Analysis of the prospects of the entity which may include targets for financial and non-financial measures. For targets, if quantified, management should explain the risks and assumptions necessary for users to assess the likely hood of achieving those targets
- Why the results from performance measures have changed over the period or how the indicators have changed.

About the Authors:

Abdul Rahim Suriya is a fellow member of ICAP and ICMAP. He is past President of ICAP and presently a council member. He has over 27 years experience in Accounting, Auditing, Corporate Finance and Operational Management. He is a professional trainer on the subject of “Finance for Non Finance Executives” and has recently authored a book on “A guide to Business Decision Making”. He is a practicing CA and runs his firm "A.R.Suriya and Co, Chartered Accountants ". For details visit www.arsuriya.com

Haroon Taberez is a fellow member of the Institute of Chartered Accountants of Pakistan (ICAP) and Director of Technical Services at the Institute.

Facilitating Corporate Amalgamations & Mergers

Qaisar Mufti

Merchant Banks' functioning is multi-dimensional. They cater un-bridged gap between supply and demand of investible funds. The banks help enterprises in raising funds and investors to invest their money. In new securities offerings and managing funds, merchant banks play an important role. These are also referred as investments banks. Role of a merchant banker is dynamic in the wake of diverse nature of services offerings. A merchant banker has to devise instruments of financing for commercial propositions in accordance with requirements of his customers. Merchant banks do not accept deposits from public like ordinary commercial banks.

Role of merchant banks in equities and debt instruments' private placements, market making, mergers, acquisitions and corporate structuring is pervasive. Also acting as underwriters of both listed and non-listed securities, the banks assist individuals, companies, institutions and governments in raising funds. Sales force of the banks call on high-net-worth investors to suggest trading ideas. To fit specific requirements, trading desks in merchant banks price and execute trade, structure new products.

Merchant banks operations extend beyond issue management to project and corporate counseling, portfolio management, consultancy on sick units, providing and procuring venture capital, leasing financing, trusteeship for instruments of redeemable capital, arranging international finances etc. At times, as divisions of commercial banks, non-banking financial institutions, financial and corporate consultants, merchant banking activities thrive.

A Merchant Bank in USA is subject to Securities & Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA) regulations. In Pakistan they are under the discipline of Securities & Exchange Commission of Pakistan (SECP) in terms of Non-Banking Financial Companies Rules and Regulations (NBFIs Rules). In India, Securities & Exchange Board of India (SEBI) regulates these banks. UK has the Securities & Investment Board (SIB), under Financial Services Act, 1986, with wide powers to put in place fair practices on the part of all those engaged in investment or merchant banking business like stock brokers, jobbers, unit trust managers, life insurance agents, pension funds managers and financial consultancy.

In common day to day reference, terms like 'takeovers', 'mergers', 'amalgamations', 'acquisitions' etc. are considered synonyms exchange. Acquisitions and Mergers (AM) involve transfer of an entire undertaking for shares of the transferee company-given in exchange to subsisting shareholders in the ratio of their holding. AM are strategic decisions that can introduce a paradigm shift of business. On rejuvenations of enterprises AM have volumes to tell. They help usher rejuvenation at a pace and volume internal developments would normally not. Of the activities merchant banks get into AM is a core activity.

In the melee, as a mater of course, AM appear great on paper. However, real test is after these are put in place, when people from different organizations collaborate to turn the plans into action and finally into results. Value is not created until after the combinations. Due to this, despite pressure for a quick secretive go that surrounds almost all AM decisions, managers of the game, which include consultants and advisers of the exercise, do not make their decisions lightly.

FINANCIAL STATEMENTS PROVIDE KICK START

Financial statements present condensed position of a date and summarized operating results for a period. Personal judgment is enshrined in financial statements with conventions in deciding:

- a particular method or combination of methods to estimate depreciation, depletion, amortization or provision for receivables no longer collectible.
- compile merchandise inventory figures.
- choose the method of inventory valuation for purposes of charge to cost.
- record certain expenditure as capital instead of revenue and vice versa.

Operations presented by financial statements are historical in nature which can hardly be used for analysis of segments and phases of business during the operating period. For an AM exercise relatively deeper information and segmental data, both with regard to financial position and operations would be called for. Financial Ratios are used to compare return relationships. Through these, risk and returns of different entities can be compared by investors and creditors. A merchant bank needs these to make intelligent investment and credit decisions. To gauge feasibility or efficacy of a proposition, merchant banks engrossed in AM exercises apply many tests, based on techniques drawn from different disciplines.

ROLE FINANCIAL RATIOS PLAY

Analysis of financial ratios would always be there. The ratios categorized from different angles provide profile of a company's economic properties, its strength and its operating, financial and investment characteristics. These normally are:

1. Activity analysis.
2. Liquidity analysis.
3. Term-debt and solvency analysis.
4. Profitability analysis.

Knowledge gained through accounting ratios is used to the end of:

- testing efficiency of operations,
- determining investment value of the enterprise concerned, and
- deciding whether financial and operating policies, methods or practices should be continued or altered.

INFLEXIBLE ARITHMETICAL EXERCISES

The process of evaluation can not possibly be reduced to inflexible arithmetical exercises. Too much reliance on mechanical means may not be good. All ratios or indicators have their limitations. Ratios do not always have something definite to say. Technical analysis may not be effective where capital is small.

Accounting ratios and equations do not have to be used in isolation. Judgment will have to be based on judicious discretion taking into account all the relevant factors. Such factors would include quality and integrity of the management, present and prospective competition and yield on a scrip comparable with share of the company being analyzed. Not to be overlooked will be the possibilities of 'window dressing' of accounts being examined.

DOSE FOR CHANGE

Going into financial ratios by merchant banks would also be with the view point of exploring their alteration given the identified 'dose of change' after AM. For example, the doers of an AM exercise would consider steps which go to alter the gross profit margin. They could look into reducing the operating profit percentage through pegging-up percentage allocations for marketing overheads by pushing-up incentives for the marketing force. This process may be to target increase in volume of operating profit.

An expert assisting an AM exercise can not afford to ignore state of:

- production and marketing strategies,
- changing price levels and
- fixed and variable costs complexions

on profitability and financial health of the enterprise. He can not be oblivious of similar ratios obtaining in other (competitive) business concerns. It is study on this pattern which decides whether sales should be augmented, production pattern reshuffled and capacity should be increased to bring down cost, particularly fixed component of cost, and whether outside financing would be required to push-up level of operations.

In the planning process prices and / or sorts of costs are projected at the desired points with a view to put in place machinery to achieve the targets.

Hereinafter are cited some ratios, projection of change in which may be in pursuance with an AM plan. What follows is neither a scientific outline for ratios modification nor enumerated are all the steps under each head. Engaging attention of the AM team, this is listing of ideas for probe under each heading.

This scribe is aware that information on a number of points hereinabelow, the AM team may not eventually be able to have.

GROSS PROFIT TO SALES

- whether service industry, industrial or commercial activity.
- graph of market share enjoyed by the entity.
- effect of changes in duties and taxes on gross profit margin.
- competitive strength of the company and obsolescence.
- stability of the company - % decline in sales to erode gross profit.
- reliance on associated / group companies for business.
- prospects of increase in gross profit margin.
- depreciation, depletion and amortization methodology.
- weightage and segment to sales and gross profit.
- sensitivity associated with governmental policies.
- strategic depth of sales revenue.
- cyclical trends associated with business of the entity.

OPERATING PROFIT TO SALES

- sensitivity of marketing overheads in relation to sales.
- efficacy of subsisting marketing related incentives.
- trends of administration & marketing overheads ratio to sales.
- factors leading to variation in marketing expenses, fixed & variable components of marketing expenses.

NET PROFIT TO SALES

- spread between operating and net profit margins.
- percentages of cash and credit sales in total sales and terms for credit sales.
- impact of increase or decrease of days allowed to pay for sale on credit.
- amount of interest against short term borrowing charged to operations.
- net profit if there were no financial overheads.

FINANCIAL OVERHEADS AS % SALES AND CAPITALIZATION

- purposes for which term loans utilized and such loans in the pipeline.
- term loans as percentage of fixed assets, cushion existing for further borrowing and impact of such borrowing on profitability.
- possibilities of utilization of short-term loans as term loans and vice versa.
- impact of cash dividend in view of the related tax shield missing, particularly when the funds are borrowed for such payment
- chances of swapping between types / forms of financing.
- implications of further issue of instruments of redeemable capital / debentures.
- evaluating impact of:
  = decrease in credit sales.
  = increase in credit sales
  on financial overheads, cash flows and profit.

PROFIT AFTER TAX PROFIT TO EQUITY

- characteristics of shares and instruments of redeemable capital issued:

  (a) for consideration other than cash, wholly or partly.
  (b) traded at a premium or discount.
  (c) option for conversion or otherwise.

- tax concessions available or existing and time frame for such availability.
- post re-organizations, reconstructions, amalgamations or changes otherwise in capital structure.
- current and previous liabilities included in tax computations and tax related contingences.
- impact of tax in relation to segment-wise profit.
- profit arising from normal operations and tax shields associated with different income categories.
- possible changes in accounting policies and their effect on profitability.
- tax holidays existing or possible and other tax incentives.
- deferred tax / tax rebates available and availed.
- claims on equity e.g. conversion of redeemable or preferred capital into ordinary shares, stock options to employees and right options released or to be released to shareholders.
- prospects for reduction in tax with change in corporate structure or presentation of tax information.

EARNING PER SHARE

- past years' trend.
- past years' trend of other companies in the same business.
- EPS of companies in general.
- EPS with all financial overheads written back.
- EPS with cost of long term borrowings written back.
- major shareholders of the company, nature of their business and support flowing from them to the company.
- sensitivities associated with earnings – comparison with industry averages and impediment with removal of which earning could improve.
- effective rate of the company's EPS in view of right issues made and stock dividends declared.
- high & low stock market quotations for shares & debentures of the company and their average prices during last six months.
- management's perception of risk factors.
- material contracts in force and in offing.
- review of capital available – additions or surplusage.

DEBT EQUITY RATIO

- industry relevance:
  = conventional or non-conventional industry.
  = consumption goods or capital good relevance.
  = production or service industry, fragility associated with production and delivery.
  = whether licence required for setting-up a project likewise and effective cost of licence.
- total loans in relation with total assets and assets under lenders' lien.

- sale prospects of assets and their estimated (sale) value in relation with the investment proposed.
- soundness of lenders, prospects of postponement / rescheduling / restructuring of debts.
- status of debt servicing.
- debt service coverage computation and determining debt servicing capacity.

BREAK EVEN

- break even point in units and value AM.
- break even point as % of enterprise's capacity subsisting and capacity utilized.
- investment required to lower the fixed cost per unit by:
  = increasing capacity operations.
  = up-gradation etc. of production process.

CURRENT ASSETS

- complexion of current assets.
- characteristics associated with inventories forming current assets of the business:
  = seasonal availability.
  = perishability.
  = obsolescence.
  = price variation associated with purchase timings.
  = storage cost and delicacies associated with storage.
  = stocks consumption as % of cost & cost as % of sales.
  = do the stocks consist of items of daily use? Whether the stocks are commonly traded and used.
- peculiarities with accounts receivables:
  = uncollectibles as % of all receivables booked, position obtaining and trend in the past.
  = cost of receivables collection as % of receivables booked.
  = receivables' likely quantum when incentives are associated with sale against cash.
  = availability of finance against receivables from commercial banks and otherwise.
  = possibilities of securitization of receivables.

SHORT-TERM INVESTMENTS

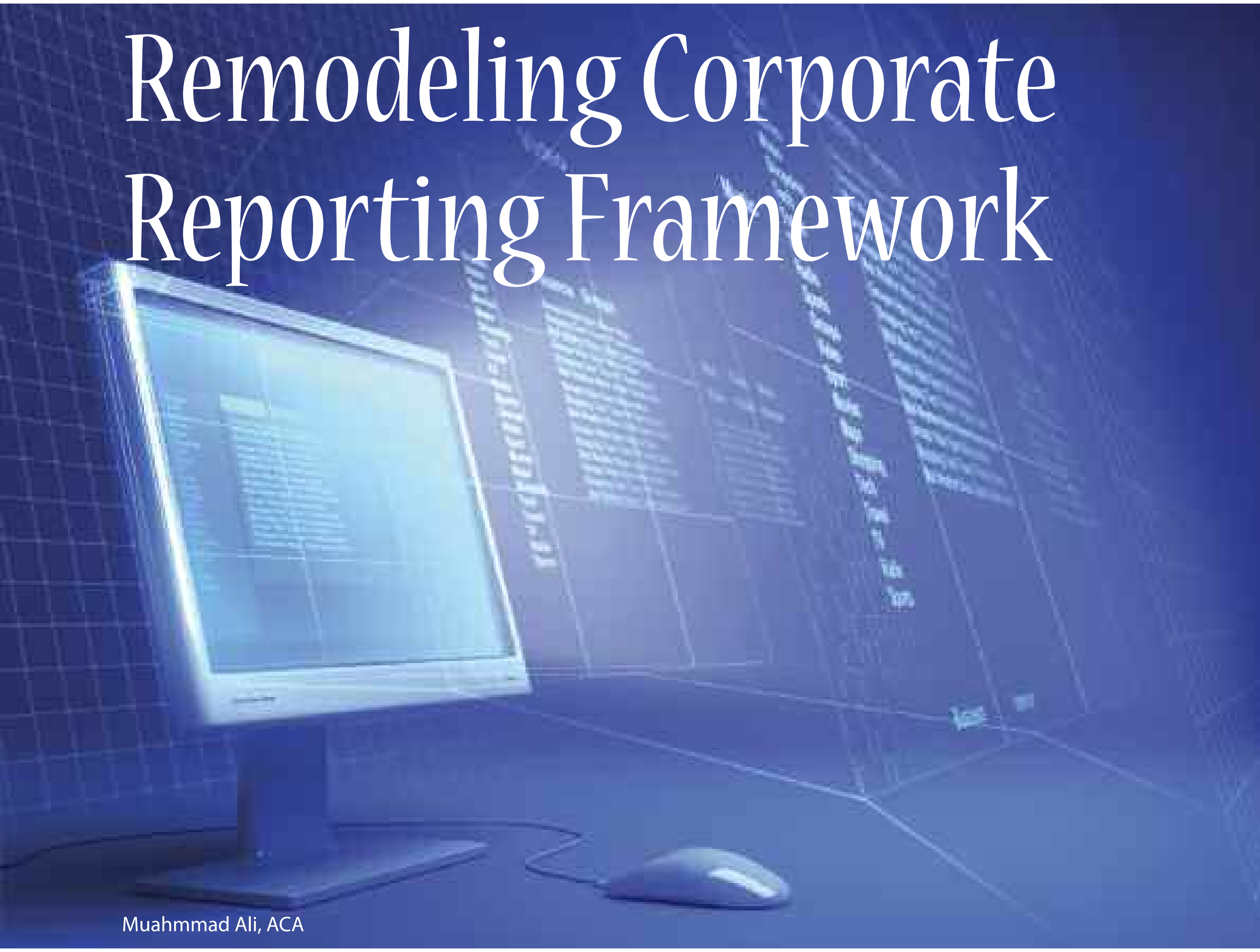
- possibilities of conversion into spot cash, effectiveness of discount offer for early cash realization and availability of credit against pledge of instruments of investment.

CURRENT LIABILITIES

- forms of availability of short term credit and terms thereof.
- terms associated with accounts payable, implications of extension in the credit period and availability of credit for payables' settlement.
- installments of term loans and interest forming part of current liabilities:
  = debt servicing obligations as % of current liabilities and as % of resources generation.
  = possibilities of down shift in impact of debt servicing.

A former Chairman of ICAP and ICMAP Joint Committee & Development Banker, the author is a corporate & sales tax counsel.

Remodeling Corporate Reporting Framework



Muahmmad Ali, ACA

Many investors believe that Management spends significant time aggregating and recalculating data from internal sources to construct the information demanded by regulatory reporting.

It is like the creation of a large building, which analysts and investors then spend a lot of time deconstructing so they can see the building blocks. This process is wasteful and ineffective. Corporate reporting should be more informative and accessible. But can it provide the information investors want without swamping them in unnecessary detail?

High-quality information on corporate activity is an essential ingredient for the successful functioning of today's capital markets and the societies in which they operate. There is significant potential to enhance the quality of companies' reporting by taking a more top-down, investor centric approach to determining what information is reported externally.

The current reporting model has been dominated for decades by financial information. While financial information is obviously and critically important, it provides only one part of the picture of overall business performance, and has a built-in bias towards recording the short-term results of companies, giving too little emphasis to their longer term value potential. This fact has been understood by both preparers and users of financial information, and most companies and investors now go to significant lengths to capture and analyze a broader information set.

> Investors are clear that 'corporate reporting' is not just about the numbers. They also want access to greater contextual information and key underlying data points.

Due to absence of alignment of external reporting with internal management information, the most technically able within the corporate and investor communities are finding it difficult to decipher the performance message of many financial reports. Sophisticated users of the current corporate reporting model typically pay attention only to parts of the information conveyed by companies (compiled at great cost to those companies) and have little choice but to turn to non-company sources to continue populating their analytic models. The concern is growing as the societies' expectations of the corporate sector increase; companies are by necessity aware of the need to be more transparent and more elaborative in their reporting – understanding that this is an intrinsic part of their license to operate. This makes reporting a critical business activity – box-ticking compliance is no longer an option.

It has been observed among leading companies that contextual narrative reporting helps to cut through the complexity and partial opacity of today's financial reporting.

While much effort is being committed on a global basis to create consistency around financial reporting, there has been little focus on creating consistency across the other key elements of information, the contextual and non-financial elements. These areas have tended to fall under the jurisdiction of individual countries and, not surprisingly, there is substantial variation in these requirements. In part, this divergence reflects differing cultural and societal expectations, but given the importance of contextual and non-financial information to investors, is this sustainable position in a global economy?

Collaboration in developing a framework for reporting may over time facilitate a more efficient flow of information from preparers to users.

Differing narrative reporting requirements

Historically, most jurisdictions have created guidance for the narrative reporting that accompanies financial statements. Many have now adopted or are in the process of adopting the US Securities and Exchange Commission (SEC) practice of mandating certain disclosures. The goal of much of the regulation is that reporting should be clear, comprehensible and complete – in a word, transparent.

However, specific mechanisms adopted to achieve this aim vary widely, from the SEC's detailed rules on the content of Management's Discussion and Analysis to the broader disclosure frameworks in place in many other reporting jurisdictions. Those broader frameworks tend to identify the type of content to be included in narrative reporting rather than defining the content itself.

The narrative reporting landscape in UK is largely driven by the Business Review legislation for all quoted companies along with the ASB (Accounting Standard Board) best practice statement called OFR (Operating and Financial Review) to improve the quality of reporting.

International Accounting Standard Board (IASB) has published an International Financial Reporting Standard (IFRS) Practice Statement Management Commentary, a broad, non-binding framework for the presentation of narrative reporting to accompany financial statements prepared in accordance with IFRS.

Current narrative reporting tends to focus on performance outcomes (such as changes in turnover and customer retention). This is just one important element of the value chain of a business. Perhaps more important are the front-end elements of the value chain, which explain how management intend to create value. In this context, investors value information explaining a company's markets (for example, changing customer demographics), an outline of its strategy (such as objectives around improving customer penetration) and resources and relationships needed to implement strategy (for example improved processes to engage with customers). This information is even more valuable when it includes quantified metrics and comparative data showing relative performance against competitors, as well as goals and targets – all of which the highest scoring companies are providing.

Gaining a real understanding of performance requires some key elements of information and a depth of analysis that gets below the surface. Growth is one element. How have revenues and profit grown year-on-year? How much is due to organic growth rather than acquisitions?

What has been the impact of price and volume changes? And what part have currency movements played?

The evolving reporting requirements and guidance being introduced around corporate reporting has made companies to fundamentally rethink their reporting frame work.

TOP TIPS CHECK LIST

Setting the Scene:
An analysis of a company's market environment, including a discussion of expected future trends and factors.

- Ensure that your reporting covers the most relevant aspects of your market place – competitive, regulatory and macro-economic
.
- Wherever possible adopt a forward-looking orientation by explaining the future trends and

factors likely to impact on your market environment.

- Support qualitative statements with quantifiable evidence.

Strategy is the bedrock:
Clear identification of a company's objectives and the strategic plans in place to deliver them.

- Outline company strategy
- Make strategic statements highly visible.
- Ensure that actions/resources identified as important to business success are adequately reflected in the strategy.
- Remember that performance against strategy happens over time – there is value in reiterating plans/actions from previous years, and progress made.
- Where possible, include specific targets for each strategic priority.
- Be balanced – if targets have not been met, explain why, and what is now being done to meet them.

Communicating the measures of success:
Communicate the measures used to assess strategic success, either through the use of Key Performance Indicators (KPIs) or other clearly-defined measures.

- Clearly identify KPIs in the report.
- Align these KPIs to strategic priorities and the key resources necessary to deliver on the strategy.
- Ensure an appropriate balance between financial and non-financial KPIs is maintained, in line with strategic priorities.
- Where appropriate, support each KPI with a definition, prior-year comparisons, benchmark data and targets for the forthcoming year.
- Be consistent year-on-year – if KPIs have changed, explain why.

Mapping out the principal risks:
An assessment of how well companies have focused on those risks that are key to company success.

- Be realistic about how many risks are 'key'.
- Differentiate between company/industry-specific and general risks.
- Explain how each risk is identified, monitored and managed.['through the eyes of management']
- Where possible provide quantitative analysis to support any statements on risk management.
- Provide an assessment of the company's overall risk profile, analysed between likelihood of the risk occurring and its impact.

Segment reporting – comparing apples with apples:
How well companies detail their strategies and performance by segment, and align this information with the overall group.

- Ensure the segment analysis represented in the narrative section of the report reflects the way management runs the group. ['through the eyes of the management']
- Clearly explain how each segment is delivering on group strategic priorities.
- Highlight any segmental strategic priorities that differ from those of the group as a whole.
- Where possible, provide group KPIs by segment and support them with relevant segment-specific KPIs.

Investors and other stakeholders demand for more in-depth information underscores the importance of creating a 'light touch, principles-based framework' one which establishes, at a high level, the scope of information that needs reporting.

Concluding Remarks:

Companies do provide what some call 'contextual and non-financial information' about their performance and prospects – but top reporters provide a great deal more than average ones. From the investor community's perspective, there is plenty of room for improvement. From the companies' perspective, enriching their narrative presentations and accompanying metrics offers the opportunity to provide a view 'through the eyes of management' that investors would highly value.

Does that mean creating bulkier reports, with more cost and more effort that may be better applied elsewhere? While adhering to regulatory requirements, companies have enough latitude to make choices. They can delete routine but superfluous disclosures. They can provide insights and related numbers that management already uses to operate the business. Taking a top-down, investor-centric approach may be the future where corporate reporting is concerned. To that end, it's important to know the broad situation today.

Muhammad Ali ACA is an Asst. Manager at KPMG Taseer Hadi & Co. The readers are welcome to contact the author to discuss any part of this article on email: muhammad.ali.yasin@gmail.com

Improving Public Sector Financial Management In The Asia-Pacific Region

The Confederation of Asian and Pacific Accountants **(CAPA)**, the regional organisation representing professional accounting organisations in the Asia-Pacific region, in May 2011 staged a successful conference in titled **"Improving Public Sector Financial Management"** in Seoul, Korea. The Conference was co-organised with the Korean Institute of Certified Public Accountants (KICPA), and supported by various international and Korean organizations. Sponsorship was provided by the Korean Big 4 Accounting firms.

1st and 2nd from left - KICPA President, Ou-Hyung Kwon, and Director General, Jaeseek Park seated with speakers

The key theme of the conference was strengthening accounting in the public sector. The Conference program provided an overview of the International Public Sector Accounting Standards (IPSAS), as well as regional case studies. The experiences of countries in various stages of transition from cash-based accounting to accrual-based accounting brought a real hands–on perspective to the program. More than 120 participants from 19 countries in the Asia-Pacific region, ranging from public servants, professionals in practice and aid agencies to academics, attended the Conference.

CAPA President, Keith Wedlock stated that the Conference represented a significant event as the first of its kind organised by CAPA. "We were very happy to be able to engage many high quality, influential, and international speakers for this Conference, including representatives from the Korean, Japanese and Chinese governments, and the IPSAS Board. Leading organisations such as the Japanese Institute of Certified Public Accountants, New Zealand Institute of Chartered Accountants, Australian accounting bodies, ACCA, the Chartered Institute of Public Finance and Accountancy (CIPFA), the World Bank, and the Asian Development Bank (ADB) were prominent."

CAPA Chief Executive, Brian Blood also commented that the public sector was an increasingly important area of focus in CAPA's strategy and activities. "In achieving our objectives and supporting the objectives of the global profession, CAPA recently issued a Position Statement reflecting our commitment to public sector financial management. This Conference supports our stand in this important area. CAPA is looking at opportunities to stage similar regional Conferences in the near future or other activities demonstrating our commitment in this area."

The Conference opened with an address by Director General, Jaeseek Park, from the Ministry of Strategy and Finance of Korea. He presented an overview of the Korean Government's accounting reform system and the three-year roadmap towards a new accounting system. A case study of the Korean government's journey of improvement delivered by Sang Ro Kim, Senior Officer at the National Accounting Standards Centre of Korea set out the key steps.

The case for 'Strengthening Accounting in the Public Sector' was put from two different perspectives, firstly by Tony Hegarty of the World Bank, then by Professor Andreas Bergmann, Chair of the IPSAS Board. Hegarty stated that the World Bank has a vision of 'a world free of poverty', and for this to be achieved, governments must be held accountable for using resources economically, efficiently, and effectively. "To that end, the financial management capacity of partner countries must be enhanced to provide reasonable assurance over the use of donor funds," he added.

Professor Bergmann reflected that financial crises are caused by a lack of **transparency**, and stressed that the accounting profession has the methods and concepts to improve that transparency and decision-making through the usage and guidance of IPSAS, ultimately reinforcing **accountability** – a key responsibility for legislators and public officials. According to Professor Bergmann, the full suite of IPSAS standards has been developed for world-wide application to deliver that transparency and accountability to citizens. This theme was later covered by Tadashi Sekikawa, a member of the IPSAS Board, who gave an overview of both the accrual and cash basis of accounting, particularly where IFRS standards do not effectively address public sector issues, for example, revenue and transfer revenue recognition.

Left to right - Prof. In Ki Joo with Tony Hegarty and Andreas Bergmann, taking questions from the audience

Participants agreed that the highlight of the Conference was the session **'Journey to Improvement'** – a series of five case studies with discussions ranging from the New Zealand experience over some twenty years, the mid stream position of Japan, to the contemporaneous programs of Korea and China. Further, the case examples of developing nations including Lesotho and Nigeria reinforced the involvement of the profession and education as facilitators of change. These were later supplemented by case studies from a UK perspective in the session on **'Managing the Transition to Accruals'**.

Importantly, the Conference presented a range of issues and processes that are the building blocks in improving public sector financial management. They are:

- Any change in the public sector financial management process needs a **clear vision and will** of legislators and senior officials towards the imperative for accountability, transparency, and good governance. This is usually implemented with **legislation** to mandate the transition to enable better decision-making in public sector undertakings, improved financial systems, guidance, and reporting.

- The proposed **change processes must be well-planned** with due regard for all stakeholders, and importantly, allowing realistic time horizons.

- It is crucial to have **financial information systems** to enable management information to be readily utilised and facilitate drawing of agency level information into central or consolidated whole of government accounts; and such systems require significant capital investment, programmed implementation, and education for users.

- The process of **integration and reconciliation** of financial information with cash based budgetary systems is extremely important at an agency level and whole of government level, and appropriate systems must be developed to facilitate critical budgets and forecasts.

- **Education of public sector managers** during the process of change is critical to ensure success. Similarly, legislators must be involved in the education process to understand the implications of information they are dealing with.

- An **oversight body** should be appointed to ensure agencies perform in the transition, to provide technical and practical implementation support, research, and consultation on a day-to-day basis.

- **Supreme Audit Institutions** have a critical role in supporting public sector governance, accountability, and compliance. They must take active roles with agencies and central government in all aspects of financial management, improvement processes, and education, with experience in identifying areas for improvement and providing suggestions for rectification.

- Similarly, as in the private sector, parliamentary **audit committees** or Public Accounts Committees must play a key role in ensuring that the process of financial management, reporting, and auditing are first rate.


Seated left to right – Brian Blood, CAPA Chief Executive, and Sang Ro Kim, Senior Officer of the Korean National Accounting Standards Centre; standing - Lou Hong, Deputy Director General from the Treasury Department, Ministry of Finance presenting China's case study

Left to right – speakers Tony Dale, Alan Edwards, and Hidetaka Tabata taking questions from audience

While discussions have been steered towards accrual accounting being the solution for public sector accounting, the cash basis is utilised in many jurisdictions and is recognised through certain IPSAS standards. Whilst the financial reporting benefits are significant, experienced public sector financial managers see some of the greatest gains as being able to determine the true cost of programs and activities, as indicated by Neil Wallace of the ADB in the concluding session. Ultimately, this delivers better information for economic planning and decision-making at both the agency and whole of government levels.

The accounting profession has significant international experience and capacity to support the development of public sector financial managers. Access to international experience, benchmarking, and support should be sought through engagement with organisations such as IPSAS, the International Federation of Accountants (IFAC), and CAPA which could facilitate sharing of knowledge with other experienced nations.

The Conference was followed by a high-level Roundtable discussion hosted by the National Accounting Standards Centre of Korea and attended by representatives from government departments of participating countries, CAPA representatives from corresponding countries, conference speakers and experts from the profession. The Roundtable provided a great opportunity to share experiences.

Materials from the Conference are available in the library section of the CAPA website at this address:
http://www.capa.com.my/article.cfm?id=496

POSITION STATEMENT

The Confederation of Asian and Pacific Accountants (CAPA) fully supports and encourages the convergence towards International Public Sector Accounting Standards (IPSAS) by all member countries in the Asia/Pacific region to assist in the improvement of public sector financial management.

Users of financial reports produced by the private sector have, for many years, demanded and supported the development of globally accepted high quality financial reporting standards. These users have included regulators and central government agencies. This has resulted in an increasing number of countries adopting and implementing IFRS as the financial reporting norm for the private sector.

Concurrently there is a growing international movement to improve financial reporting in the public sector. This has resulted in many countries initially adopting cash based accounting; moving to a more sophisticated accrual basis for financial reporting; and finally a number are adopting and implementing accrual based IPSAS.

Improving the quality of financial reporting in the public sector is viewed by CAPA as critical in addressing the huge risks, such as unexpected sovereign debt crisis situations that may remain obscured, when robust accounting and reporting techniques are not used in the public sector.

From a public interest perspective the more effective monitoring of financial performance within public sector entities is critical. CAPA supports accrual based financial reporting as the only means to provide the necessary high quality, transparent reporting of public sector activities and position.

Achievement of this ensures that the same high standards of financial reporting are applied by both the private and public sectors of an economy – thus leading to better informed decision making at both the micro and macro levels.

CAPA therefore calls for governments in the Asia/Pacific region to fully recognise the need for robust financial systems, and to lead changes in public sector accounting and reporting to support enhanced public sector financial management.

Participants at the Roundtable discussion

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Plan the Business Planning

Muzammil Bhelim, ACA

Planning is considered as the tool of success whether you talk about business management, country affairs or war. But point is how better planning may be done to get the better results. Process of Planning consists of preparing a course of action step by step to achieve some specific goal by effectively utilizing the available resources and come up with set of direction and within time constraints. A plan is like a map. When following a plan, we can always see how much progress towards goal and how far from the destination, knowing where it is essential for making good decisions on where to go or what to do next.

As Planning is a complex process, how better planning can be done to get the best is of the utmost importance, it brings achievable objective estimates in do-able time frame with effective and efficient utilization of available resources otherwise strategic or annual business planning may have defects, misdirected estimates and time consuming exercise leading to adverse impact on business.

In any business model, planning besides other risk factors (e.g. competition) and initiatives (e.g. new launch) starts primarily with sales volume and all other aspects are planned to get the primary objective of any organization i.e. profit or maximize the value for shareholders.

Following are the major segments in planning from sales volume planning moving next to raw material, production, manpower, supply chain / resources, financial planning and external environment.

Sales volume: Total volume estimates with break down in packs and flavors

Raw material: Required materials estimates based on the sales volume

Production: Capacity and shifts availability (manufacturing and outsource decisions)

Manpower: needed manpower based on permanent and contract labor availability

Supply chain: All needed resources starting right from storage to vehicles to make the sales

Financials: Profitability right from gross revenue, discounts, cost of sales and expenses to bottom line

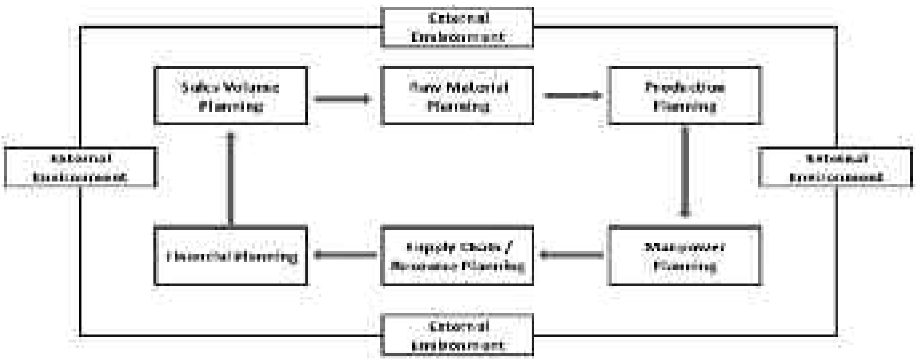
External environment: Competitive edge and Government regulations etc.

Primarily, the above referred segments depends on the approach of Bottom Down or Bottom Up, meant whether targets / estimates coming from top management and drilled down to desired results or estimates worked out based on current and forecasted trends from lower level and cascaded in the desired results then fine tune by top management.

Next deciding factor is really important whether to go for each segment of planning in isolation or at central level work out the plan for all functions collectively.

In **Isolated functional planning**, each function individually estimates and finally all segment are merged to develop one plan. Each function at its own work out all risks and benefits which finally translated in financials. Following diagram No.1 illustrates this concept:

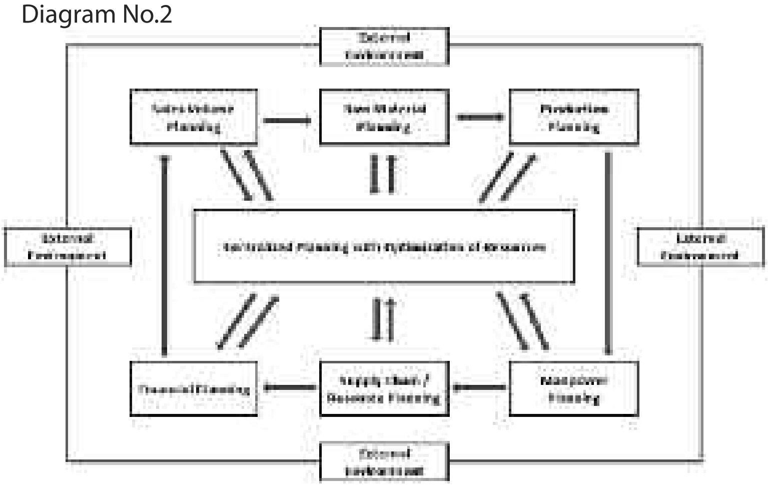
Diagram No.1



Centralized planning on the other way looks at the each above referred planning segment at centralized level collectively based on the available / targeted resources taking in to account the primary objective of maximization of profit or shareholder's value.

Optimization of resources is the key factor in centralized planning as one window approach taking into account the input from all functions. Concept moves like as estimates or initiatives coming from the function immediately tested by translating in financials and in broad objective of the organization while covering all the risks, if found as per the targeted objective keep in the plan otherwise sent back for further improvement to the function with the recommendations e.g. if sales volume planning is considered it may be sent back to sales function to fix as per the profitable packs and if considering the supply chain it may be reconsidered in terms of increasing the efficiency and reducing the requirement of resources through optimization to get the desired profitability. Diagram No. 2 illustrates this concept:

Diagram No.2



Plan tone should be based on the clearly identifiable objectives in terms of short and long run which requires differentiation between strategic and annual operational aspects of the plan separately. Annual Plan should have the reflection of the long term strategic objective.

Next aspect is to Plan the Planning/Financial model with all best possible historic and forecasted information to be sought from the functions and to be best fit in the business environment for foreseeable future. Key is to eliminate the redundant information which might consume major planning time. Modeling need to have majorly linked variable information showing impact on the desired results so that any KPI change in the model would automatically evaluate the impact in terms of deliverable results instantly.

Planning of phasing of the estimates / objectives is utmost important before the final implementation of the plan which normally taken care of in the planning / financial model. Here keys are the attainable time frame and most important consideration of business and product seasonality. Normally based on the seasonality volumes and financials are tuned so that actual vs. plan gap is narrowed down to best possible level.

Finally the implementation of the plan with all custodian functions with clear objectives and time frame is necessary and constant follow up is necessary as direction may need to be corrected at any point in time for the successful implementation of the plan.

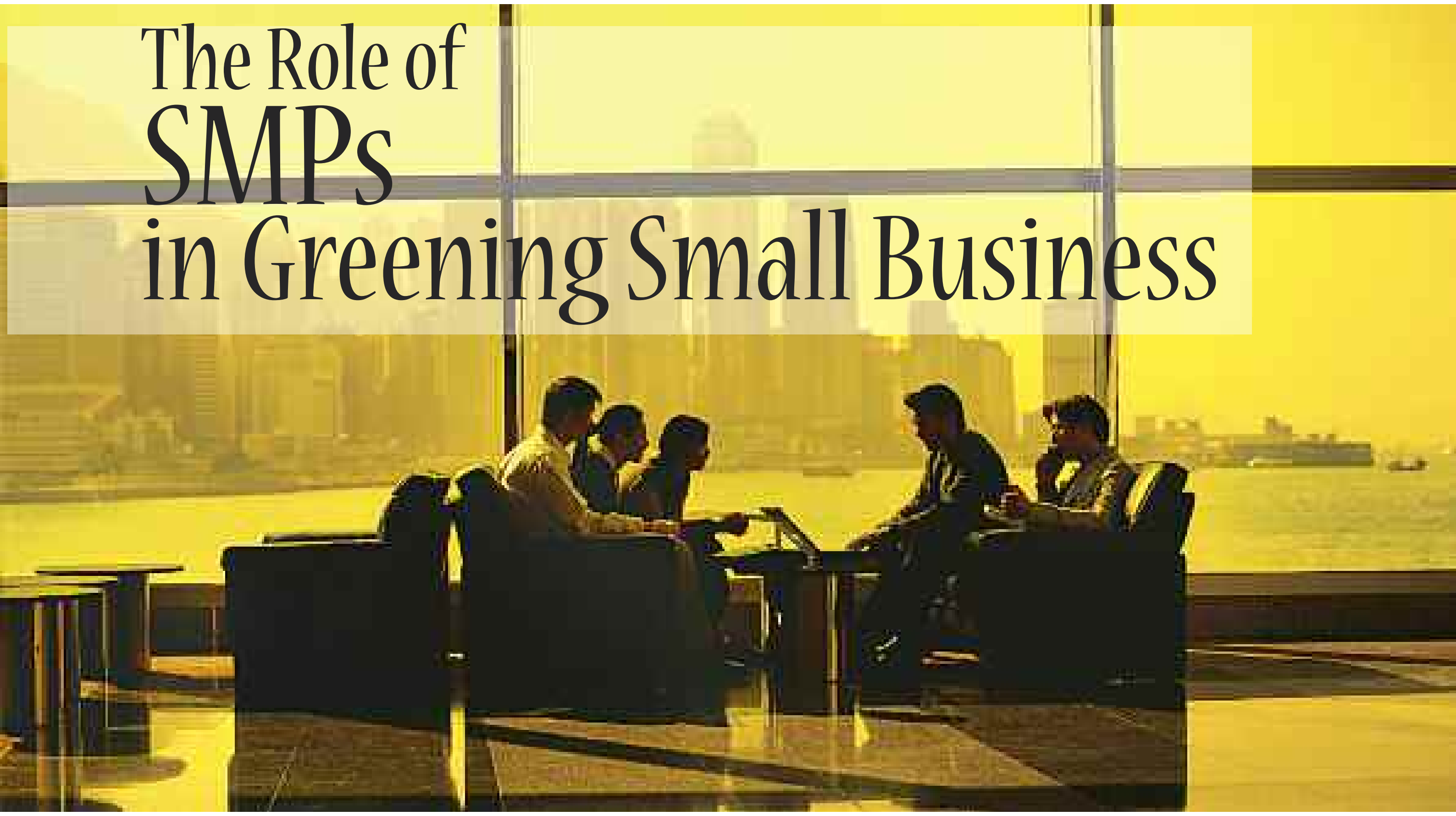
Whole planning exercise besides the normal procedure of estimates, counter any foreseeable risks and initiatives heavily depend on how good interaction is in progress between the functions and planning team and how open functions and organization is to make any change based on the results coming from the centralized results evaluation.

All above referred aspects if turn in right direction and having plan your planning will definitely lead to set the right direction, saving time consumption and above all will answer all your upcoming questions when you will compare the actual vs. plan job ahead to come in future.

M. Muzammil Behlim is a Chartered Accountant and Masters in Economics from Pakistan and working for Aljomaih PEPSI Saudi Arabia as Budgeting & Planning Manager.

The readers are welcome to contact the author to discuss any part of this article on email: pak_muzammil@yahoo.com

The Role of SMPs in Greening Small Business



Sylvie Voghel, SMP Committee Chair (see bio) and Paul Thompson, Deputy Director, SME and SMP Affairs, IFAC

This article examines the relevance of integrated reporting to small business and highlights how small- and medium-sized practices (SMPs) can help small businesses improve their environmental performance.

INTRODUCTION

While the significant challenges posed by sustainable development and sustainability have been well recognized for some time, management of these challenges has yet to become a core competency of most organizations—big and small. Why? First, while awareness among business leaders is growing, many are not eco-literate. They do not recognize the environmental benefits of making environmentally sustainable business choices, including reducing their carbon footprint, and contributing to cleaner water and better air quality. Second, many business leaders do not believe that the environment is a legitimate business concern. Many do not realize that with minimal investment in more efficient technology and simple changes in human behavior, their organizations can reap significant cost savings.

Fortunately, there are signs that things are changing. According to a recent research study, conducted by the American Institute of Certified Public Accountants, the Chartered Institute of Management Accountants, and the Canadian Institute of Chartered Accountants, small- and medium-sized entities (SMEs) are placing greater emphasis on developing a sustainability strategy as it becomes increasingly linked to business performance.

However, most SMEs that are moving toward sustainability seem to be doing so in response to market pressures in the supply chain—large corporate customers are imposing requirements on their SME suppliers as a condition of their purchase order to reduce their own carbon footprint and/or fulfill their environmental reporting obligations. But there are other reasons to embrace the green agenda.

WHY SHOULD SMES EMBRACE THE GREEN AGENDA?

There is mounting scientific evidence that business needs to embrace the green agenda by adopting more sustainable business practices, including the development and implementation of more eco-efficient products and services. And, small business should not be exempt.

Why? Small business is the cornerstone of most—if not all—national economies. According to data from the Organisation for Economic Cooperation and Development (OECD), the SME sector accounts for the majority share of private sector GDP, economic growth, and employment in OECD economies and beyond, and, consequently, has a carbon footprint comparable with that of the listed-company sector.

Some claim the SME sector is often ignored or given low priority when solutions or tools to address business issues are designed. It is argued that the tools makers and policy shapers are typically the large corporate players and governments, and "small" is not typically part of their repertoire. Yet, given their cumulative environmental impact, small businesses need to be a part of the solution. To do so, they may need the help of their most trusted business advisor, the professional accountant.

HOW CAN PROFESSIONAL ACCOUNTANTS HELP SMES GREEN THEIR BUSINESSES?

SMPs are well positioned to take advantage of SMEs' increasing demand for value-added business advisory services, including sustainable business advice (see The Role of SMPs in Providing Business Support to SMEs). As small businesses themselves, SMPs understand and appreciate the needs of their SME clients, including the need for tools that are affordable and practical.

SMPs also appreciate the need for their small business clients to formalize their operations to instill better management control, which can help SMEs become more eco-efficient, do more with less and, hence, increase and green their bottom line. For example, accountants can advise on the benefits of reducing energy costs, from simple behavioral changes aimed at eliminating waste, to investment in new equipment and alternate sources of energy.

SMPs can also advise SMEs on developing an Environmental Management System (EMS), which enables an organization of any size or type to identify and control the environmental impact of its activities, products, or services; set and achieve environmental targets; and demonstrate that these targets have been achieved. Implementing an EMS should lead to cost savings and a reduction in the organization's carbon footprint. Business advisory in this area can include:

1) informing clients about the value of an EMS, and connecting them to tools to help them get started; and 2) helping them prepare, for example, an EnviroReady Report, to demonstrate the presence of a robust and credible EMS and help position them as good corporate citizens; and 3) help SMEs meet the reporting needs of their large, listed suppliers who often have to meet certain requirements, such as compliance with the International Organization for Standardization's ISO 14001 dealing with EMS.

In addition, in the next few years, increasing numbers of SME owner-managers will be retiring and seeking to sell their businesses. Buyers are likely becoming more discerning when it comes to the green credentials of potential purchase targets.

All this opens opportunities for SMPs to build on their existing relationships and offer sustainable business advice, helping clients to comply with sustainable reporting and any attendant assurance requirements, green their business, improve their bottom line, and attract new clients or buyers.

WHAT TOOLS CAN SMPS USE TO HELP SMES GREEN THEIR BUSINESS?

IFAC's Sustainability Framework (Section 2.1) includes a number of relatively simple steps that SMEs can take to lower costs through minimizing waste. SMPs can help their SME clients implement these measures. For SMEs seeking to implement a business excellence framework, a universally applicable tool is the International Organization for Standardization's standard, ISO 14001 (see above).

SMPs interested in supporting SMEs on the path to sustainability should download the IFAC SMP Committee's free Guide to Practice Management for Use by Small- and Medium-Sized Practices, which offers guidance and tools spanning a range of topics.

HOW CAN SMPS AND SMES INFLUENCE POLICY MAKERS?

The International Integrated Reporting Committee (IIRC) recently released its Discussion Paper, Towards Integrated Reporting - Communicating Value in the 21st Century. The paper presents the rationale for integrated reporting, offers initial proposals for the development of an international integrated reporting framework, and outlines next steps toward its creation and adoption. Why should SMEs and SMPs respond to this paper? Integrated reporting will allow organizations to release more inclusive and useful reports on all aspects of performance, including environmental, social, and governance, as well as economic, in a concise and user friendly format. This information will allow organizations to provide an assessment of the long-term viability of an organization, as well as meet the needs of investors and other stakeholders.

Comments are encouraged from various stakeholders, including reporting organizations, investors, employees,[1] and assurance providers. Of most relevance to SMEs and SMPs is question 4 on the applicability of integrated reporting (IR) to SMEs and the initial focus of integrated reporting on larger companies. Tell the SMP Committee what you think by responding to this question on its Discussion Board.

[INSERT MEMBER BODY RESOURCES]

IFAC RESOURCES

The following resources (all free of charge) are accessible via IFAC's SMP Committee website at www.ifac.org/SMP.

- Publications—Guide to Practice Management for Small- and Medium-Sized Practices (PM Guide) and accompanying User Guide, The Role of SMPs in Providing Business Support to SMEs, and Sustainability Framework
- Quarterly eNews and Relevant Links: Business Advisory

For translations of the PM Guide (both completed and in progress), filter by language in the Publications and Resources area of the IFAC site:
www.ifac.org/publications-resources.

[1] Comments can be submitted to dpresponses@theiirc.org or through www.theiirc.org by December 14, 2011.

Partnering Employees to Share-Ownership for Good Governance and Growth

S. Athar Hussain Zaidi, FCA and Mubeshir Ali, ACA

Introduction

Savvy companies that aspire for the engagement not just of their shareholders but also of a wider circle of encompassing customers, employees, communities, suppliers, business partners and relevant non-governmental organizations can be competitive in the short-term and more sustainable in the long-term as compared to those which focus exclusively on the financial bottom line. Good business is, by its very nature, socially responsible business. It is argued that if employees have an ownership stake they will be are more committed to the company. This leads to motivation and efforts, hence to productivity and profitability.

The question both for business and government is how to engender such participation and involvement and, specifically, whether this can be brought about through employee shareholding, when such individual shareholdings, taken separately, are insignificant in terms of the overall share capital of the enterprise?

Even by pooling the voting rights – although not necessarily the actual ownership – of their shares, an employee shareholder trust could represent a significant voice.

However, some mechanism is needed to translate individual employee shareholding stakes into a collective voice that can deliver results, both in terms of representing the interests of employees and in convincing employees that their shareholding gives them a stake in the enterprise. Such a move could have important beneficial effects for corporate performance and hence economic growth. It could also have significant welfare effects in terms of enriching the experience of working life. Main reasons and issues need to be addressed before considering sharing ownership plans are:

The following are some of the reasons for having a sharing ownership plan:

- **Link between work and reward:** If you are going to ask the most from your employees, they will expect something in return. Increasingly, pay is not enough. A plan that rewards employees with a share of the fruits of their labor draws a direct connection between work and reward.

- **Culture of ownership:** When employees are rewarded based on their contributions to the company's success, they feel like owners. As owners, employees have more incentive to increase the company's profitability. However, this strategy will work only if a culture of understanding the company's challenges and contribute to the solutions has been created over time. Open two-way communication, flat management structure and employee involvement foster such a culture faster.

Following are the issues to be considered when creating a sharing ownership plan:

- **Empower employees to succeed:** Employees must be able to make decisions that will have an impact on their bonus. "It [profit sharing] is not worth much, unless there's participation in decision making," says Bob Nelson, president of Nelson Motivation Inc. in San Diego, Calif., and author of *1001 Ways to Reward Employees*.

- **Clear objectives:** Before developing a partnership plan, any organization needs to have defined objectives in place; is it employee recruitment? Retention? Do you want liquidity for your equity? Do you want to boost production, or perhaps, you want a little of everything. The answers will help you choose the right plan for your company.

- **Know your industry:** Old economy businesses may have actual profits to share. New economy enterprises may be years from that, so stock options carry more appeal. If your workforce is young and well educated, immediate stock awards provide more motivation. Older workers may be more interested in plans geared toward retirement.

- **Stage of business development:** At the startup stage, a company may want to protect cash and offer stock options. At a rapid-growth or mature stage, when a company has become profitable, stock-option awards, cash and stock bonuses, or profit sharing become possible.

Employee participation within the workplace is generally regarded as important in generating and sustaining loyalty and commitment to the organization. Establishing and sharing a company ethos and culture is seen as a desirable outcome for organizational success. One reason for this is that attempting to secure effort from employees via supervision is at best costly and often difficult if not impossible. Incentive schemes may be impracticable where results depend on team effort. To work, incentives in this case need to go beyond simply appealing to individual calculations of the costs and benefits to the employee of deploying greater effort – since such a calculation would often result in the employee deciding rationally to "free ride" and still benefiting from the collective incentive scheme. Instead, such schemes need to be designed to engender collective trust and commitment.

Shared ownership by employees has long been the subject of corporate and public policy discussions. Given the advantages, meaningful employee participation through the particular route of ownership stakes has taken a number of forms over time and in different economies.

Is participation actually enhanced by ownership? Do employee participation and employee share ownership have the same results? To be successful over the long term, companies need to innovate both in what they produce or offer and in the way in which they produce or the processes they adopt. The active participation of the workforce is seen as increasingly important in these processes, particularly in high value added sectors and in the "new economy." On the other hand, the short-term interests of shareholders may get dividend rather than research and development and other innovative investments; the payback from which may not only be uncertain but also, at best, long term.

Cost cutting strategies and work intensification can bolster profitability in the short term, in the longer term developing participatory and representative mechanisms may prove increasingly important. While it is widely recognized that "flexible" employees are important for firms' competitiveness, the above work found that such practices need to be complemented with adequate involvement mechanisms including reward systems and training, without which they could result simply in an increased intensification of work.

EMPLOYEE SHARE OWNERSHIP

From individual point of view, it makes more sense to hold shares in a company other than the one for which you work, otherwise, should that company go bankrupt, the individual risks losing his or her savings as well as their job. To advocate the holding of shares in the company for which the individuals actually work therefore requires two things. First, there needs to be a good reason for advocating such a decision. That is, one must be convinced that mechanisms exist to ensure that the sort of potential benefits associated with such ownership. There must be a visible outcome in terms of company performance that follows as a result of such shareholdings. Otherwise, the employees would be better off holding shares in other different companies.

Second, if the mechanisms are in place to ensure that there is a potential benefit then employees should be encouraged to take and hold on such ownership stakes, rather than taking stakes in enterprises other than the one for which they work.

POLICY IMPLICATIONS

Employee shareholder trusts could be used to solve the problem of the owners of listed companies (shareholders) who normally have no interest in the long-term success or otherwise of the firm. As far as the company is concerned, institutional shareholders come and go. An employee shareholder trust would be there for the long haul. They really would have an interest in the good governance and long-term success of the firm. The policy implications of the above discussion are twofold.
First, the tax incentives for employee shareholders could

be further developed with the specific aim of encouraging employee shareholders to actively participate in trusts that provide a collective voice within the organization. Such a voice could have a positive impact on the performance of companies and thereby the economy as a whole. Without a belief that such individual collective shareholdings are contributing in a meaningful way towards a collective voice, there may not be the necessary commitment from the individual employee shareholders to hold on to those shares. Indeed, they might in this case be better advised to sell and re-invest in some different sectors of the economy.

There could be ways in which the specifics of how the tax incentives currently operate might be improved. More importantly, the reference to "approved" collective shareholdings is important. The current criteria for approving trusts could be extended so that schemes would be designed and operated in a manner that was clearly open and democratic, and whose objectives were to operate in the best interests of the company, rather than just to maximize financial returns to the individual shareholder.

Second, such schemes are only likely to develop and operate successfully if a body is established to ensure that this happens, along the lines of the existing supporter's direct unit.

The remit of such an organization would go beyond what is currently offered by the Treasury and Inland Revenue. It would allow the appropriate legal and other structures to be developed and to be then provided to any such collective employee-shareholding group. But it would also actively seek to enable each group to benefit from the experience of others in using such holdings to provide an effective collective voice at work.

EMPLOYEE SHARE SCHEME IN PAKISTAN

Section 14 Of Income Tax Ordinance, 2001 has a set of rules that an owner must obey to avoid paying hefty taxes on his or her contracts. In this section **"Employee Share Scheme"** means any agreement or arrangement under which a company may issue shares in the company to:

(a) An employee of the company or an employee of an associated company; or

(b) The trustee of a trust and under the trust deed the trustee may transfer the shares to an employee of the company or an employee of an associated company.

Provision of this section would apply in Employee Share Scheme as follows:

- **The grant is not a taxable event:** The value of a right or option to acquire shares under an employee share scheme granted to an employee shall not be chargeable to tax. However, consideration received against disposal of right or option would be taxable under the head "Salary" in the year in which disposal will take place.

- **Taxation begins at the time of exercise:** Where, in a tax year, an employee is issued with shares under an employee share scheme including as a result of the exercise of an option or right to acquire the shares, the amount chargeable to tax to the employee under the head "Salary" for that year shall include the fair market value of the shares determined at the date of issue, as reduced by any consideration given by the employee for the shares including any amount given as consideration for the grant of a right or option to acquire the shares. For example, if an employee is granted 100 shares of Stock A at an exercise price of Rs.25, the market value of the stock at the time of exercise is Rs.50. The amount included in the salary income on the contract is Rs.2,500 (Rs.50 – Rs.25 x 100).

- **The sale of the security triggers another taxable event:** If the employee decides to sell the shares immediately (or less than a year from exercise), the transaction will be reported as a Capital gain (or loss) and will be subject to tax at ordinary income tax rates and vary from different holding patterns. If the employee decides to sell the shares a year after the exercise, the sale will also be reported as a capital gain (or loss) and the tax will be reduced to a maximum level or would be exempt from tax subject to certain conditions.

CONCLUSION

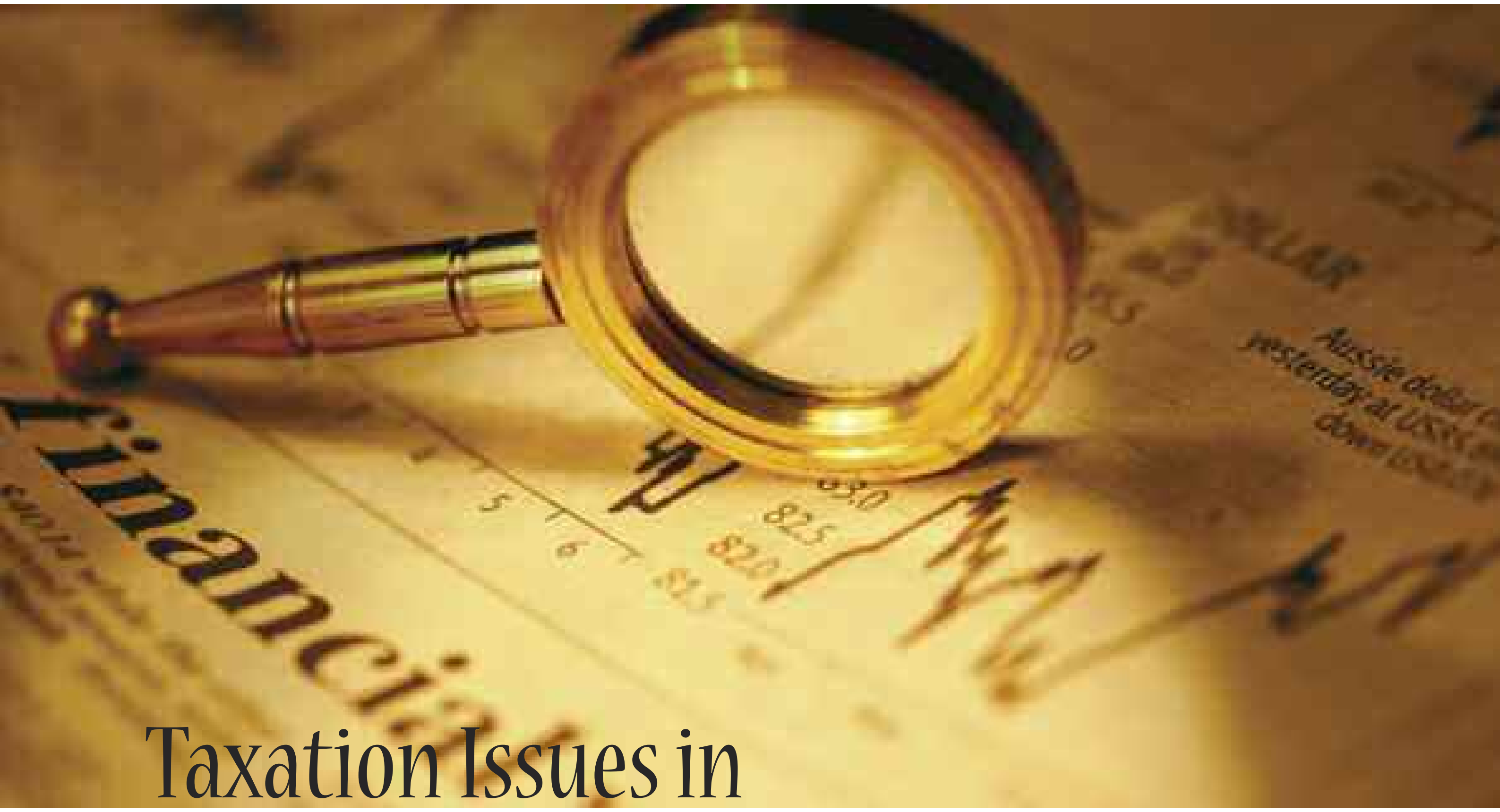
The philosophy to partnering employees in the business is that if the employees feel that they have a stake in the enterprise or organization in which they work, they will be more committed to work. This in turn will bring positive outcomes in terms of productivity and organizational performance. This is time-tested theory and is based upon simple logic which every sane manager acknowledges. Partnering employees creates significant links between progressive human resource practices that promote participation and involvement, corporate performance and organizational outcomes on the one hand and getting taxation benefit of holding such participation by the employees on the other.

About the authors:

Athar Hussain is a senior finance professional in Iran, a fellow member of the Institute, on the visiting faculty of various institutions - professional bodies and universities, lecturing in various management disciplines.

Mubeshir Ali Kazmi, M.Com, ACA is a CFO and Company Secretary in Pakistan and on the teaching faculty of a number of institutions.

The readers are welcome to contact the authors to discuss any part of this article on email:
Athar Hussain: atharhzaidi@hotmail.com,
Mubeshir Ali: mobiali@gmail.com



Taxation Issues in Islamic Banking

Omar Mustafa Ansari, FCA & Salman Haq, ACA

During the last decade, Islamic banking has emerged as a full fledged industry with its own contribution not only with reference to the Shariah compliant banking but also to the economy and socio-economic system of the society. The regulatory regime in general and various taxation regulations in particular have so far been unable to focus on this specific group of economy.

With the introduction of the 7th Schedule to the Income Tax Ordinance, 2001, an omnibus provision was inserted which was apparently aimed to provide level playing field to the Islamic finance industry in line with the measures taken by various countries including the UK. Nevertheless, such provision is a little bit confusing or rather badly drafted and as a result has not provided the overall comfort to the industry, as may have originally been planned. Additionally, this provision is for the Islamic banking institutions only and do not deal with their customers or other Islamic financial institutions.

This article is intended to summarize few taxation related issues being faced by Islamic banks along with the identification of possible practical solutions.

SALES TAX – MURABAHA TRANSACTIONS

As a general principle, sales tax under the Sales Tax Act, 1990 (the ST Act) is not applicable on Murabaha transactions. However, there still remains an issue regarding payment of sales tax at the time of purchase / import of such goods and passing-on of the same to the eventual purchaser.

If a Murabaha transaction is not subject to the Sales Tax, it means that the input tax that is paid by the Islamic bank while importing / purchasing the goods can not be passed on to the customer, who legally can not claim the same.

At present, contrary to the Shariah principles as laid down by the State Bank of Pakistan (SBP), generally the supplier of such goods raises the invoice in the name of the customer, whose actual capacity is of the agent and not the Islamic bank being the purchaser in the first leg of the transaction. Accordingly, generally speaking the customer gets the benefit of the input tax, which otherwise can not be termed technically correct.

Proposed Solution
Proper amendment should be brought about in the Sales Tax Law which should permit the Islamic bank to pass-on the input tax paid on purchases / import of taxable supplies to the customer.

SALES TAX EXEMPTION – OTHER TRADE BASED MODES

Other trade based modes of financing, such as Salam, Istisna, Musawwama, Istijrar and Sale in Wakalatul

Istithmar are not provided with any specific exemption or treatment vis-à-vis sales tax. As a result the banks offering these products are subject to risk of levy of sales tax on supply of goods in these trade based mode of financing.

Another issue in respect of these transactions is in respect of sales tax at the time of purchase of such goods by the Islamic bank. Practically speaking, it has been witnessed that when the bank purchases an item for sale to another person; it does not receive a sales tax invoice identifying the input tax. In other words, generally these transactions are net off sales tax, which technically is an issue as to whether this is a genuine sale or not.

Proposed Solution
As in the case of Murabaha transaction, the Federal Board of Revenue (the Board) may consider ousting these transactions from the scope of the term "supply" as defined under the Sales Tax law.

The Board may also consider introducing a special procedure whereby the Islamic Bank may pass-on the Input Tax in relation to Islamic financing products to its customers. This would also provide a level playing field to the Islamic banks as compared with conventional banking.

SALES TAX – UNITS OF DIMINISHING MUSHARAKA

In Diminishing Musharaka (DM) transaction, when the goods sold by the Islamic bank are subject to sales tax there is a risk of levy of sales tax on such supply. Particularly, the issue gains more importance if it is the common practice of the Islamic bank is selling such goods on a more frequent basis.

Academically speaking, DM is a hybrid form of leasing transaction. However, it is not generally called leasing, so it is not clear whether it is enjoying the exemption from sales tax applicable to leasing transactions.

In addition, even if it is considered exempt or not subject to sales tax, there would remain an issue with regard to the mode of transfer of input tax paid to the customer.

Proposed Solution
The provisions of Sales Tax law should be made inapplicable to DM transactions.

WITHHOLDING INCOME TAX – AGENCY

In most of the Islamic finance transactions, there is involvement of agent for purchase, sale, possession, negotiation and payment or recovery. The role of these agent differ from one transaction to another and in certain cases these agents are entitled to a fixed / variably agency commission / fee which, at times, (as in the case of Salam, Istisna, and Wakalatul Istithmar transactions) is fairly material.

Agency commission is subject to withholding tax generally at 10% of the gross amount and is normally construed as a final discharge of the tax liability of the agent.

Proposed Solution
Being part of an overall Islamic financing transaction, the agency commission received by the agent should be made subject bottom line profit taxation. Hence, the tax withheld from payment of such commission should be treated as an advance payment of tax rather than a final discharge of the tax liability of the agent.

WITHHOLDING INCOME TAX – IMPORTS

In case of import Murabaha, it is the Islamic bank that should be the importer-on-record and all the duties and taxes should be borne by it. However, practically speaking, it is the customer who is the importer-on-record and accordingly all the duties and taxes at import stage are paid / borne by the customer. Such an arrangement is normally undertaken so that the customer could avail the benefits of the duties and taxes that are paid at import stage. From a Shariah perspective however, this situation results in an issue, as to whether the risks and rewards are actually transferred or not.

If we wish to correct the situation then there must be some methodology available under the Income Tax Ordinance, 2001 whereby the Islamic bank has the option to transfer the duties and taxes that it has paid at import stage to the customer.

Proposed Solution
The withholding tax provisions under the Income Tax Ordinance, 2001 are not applicable on banks (including Islamic bank) as per the Seventh Schedule to the Ordinance. Accordingly, in respect of Murabaha transactions the Board may consider issuing a clarification that in respect of imports it would be the customer who would be the importer on record and hence responsible for taxes and duties.

WITHHOLDING INCOME TAX – TRADE BASED MODES

Receipts to banks are not subject to withholding tax. However, when the Bank purchases the goods; there is a requirement of withholding tax at the time of payment.

Generally the Banks do not deduct this withholding tax and instead, either the customer deducts it and pays it into government treasury or the bank pays it separately through the customer in the treasury and two different pay orders are made i.e. first for payment to supplier (net of withholding tax) and second for payment of withholding tax into government treasury. In either case, officially it is not the Bank who is withholding tax; rather it is the customer who is withholding tax on record.

Proposed Solution
The Board may consider issuing a clarification that in respect of purchases made by Islamic banks for undertaking Islamic financing arrangements, it would be the customer / supplier who will be the deducting agents in respect of taxes and duties.

WITHHOLDING INCOME TAX - IJARAH

In case of assets purchased for Ijarah transaction, tax is either collected at import stage, or deducted at the time of making payment in respect of local purchases.

In either case, the withholding tax is deducted (or generally should be deducted) in the name of the Bank, which is recoverable by the bank or adjustable after submission of annual return. Particularly, in case of cars the invoice etc. are in the name of the bank.

On the other hand if the invoice is in the name of the customer, then from Shariah perspective there are issues. In addition, the deduction of withholding tax in the name of the customer results in a situation that the pricing of the asset is inappropriate.

Proposed Solution
The Board may consider issuing a clarification that it is the ultimate customer "and not the bank", who would be subject to deduction / collection of tax in respect of Ijarah transaction.

INCOME TAX – SALE AND LEASE BACK

In conventional financing, a sale and lease back transaction is regarded as a finance transaction and accordingly, any gain on sale does not attract any income tax.

Nevertheless, in Islamic finance the situation is a bit different. Here you can not classify this transaction as a mere financing transaction.

In addition, in case of Ijarah transaction, the asset is actually sold and then the lease transaction is a mere lease in which the asset does not appear on the balance sheet of the lessee in line with the treatment specified by IFAS – 2. Accordingly, it is a risk that this gain can be subject to tax at corporate rate in the hand of the lessee.

Proposed Solution
In order to provide level playing field with conventional banking, Ijarah transaction should also be regarded as in the nature of sale and lease back arrangement and hence not subject to withholding tax under Section 153 of the Income Tax Ordinance 2001. Similarly, gain or loss on disposal of asset for the purpose of leasing it back under Islamic modes shall not be considered a taxable gain / expense for the purpose of computation of income of the customer. On the other hand, the lease rentals on Ijarah transactions shall be allowed for tax purposes after deducting the proportionate effect of such gain.

PROPERTY TRANSACTIONS – STAMP DUTY

In Islamic finance transaction where transfer of immovable property is involved, there is an issue of double stamp duty.

Most common of these transactions are DM transactions for housing and corporate DM transactions involving land and building.

In these transactions, in the first stage, the Bank becomes the owner, and in the second stage the Bank sells the property to the customer generally in monthly, quarterly or annual units. If both the transactions are registered separately, then at both the stages, stamp duty has to be paid. However, to avoid this situation, the Banks allows the customer to directly register the property in its name. If we want to correct this treatment, then we need to avoid risk of double levy of stamp duty.

Even today, there is a risk that since there are two different sale transactions so the relevant authorities may claim separate duty for both the stages.

Proposed Solution
Proper amendments should be made in the Stamp Act which should levy Stamp duty only once in relation to Islamic financing transactions.

CONCLUSION

The objective of this article is to identify few significant issues for the benefit of Islamic banks and regulators. It is not intended to provide final solutions and conclusions on all such issues, and instead it is just focused on a few major issues and to convince the stakeholders that there is a need to commence a dialogue on the same. It is also worth noting that other associated industries in the Islamic finance sector, like the Modarabas and the Takaful are also facing a few similar issues which also need to be addressed.

We suggest that SBP and PBA should now take this matter seriously and take it to the FBR and the Ministry of Finance in order to enable a smooth supporting environment for Islamic banking institutions. On the other hand, the government officials should also look into this matter and try to support this important industry which has evolved as a requirement of the constitution of Pakistan and the wishes of the founder of the nation in line with his speech on the occasion of the inauguration of SBP. The industry is not asking for any preferential treatments. What it all needs; is a real and comfortable level playing field.

About the Authors:

Omar Mustafa Ansari, FCA is working with Ernst & Young Ford Rhodes Sidat Hyder as Partner / Head of Islamic Financial Services Group. Omar's expertise is providing services to IFIs including Audits, Shariah-Audits, Corporate Finance, Transactions / Product Structuring, Accountancy, Training, MicroFinance, Risk Management & Development / Review of Manuals and Systems. He has authored two books, "Managing Finances - A Shariah Compliant Way" and "Islamic Microfinance Bank: Working Model" (in Urdu) and has contributed numerous articles. He is a regular trainer on Islamic finance. Omar is a member of various committees for Islamic finance and Takaful formed by ICAP, SECP and SBP.

Salman Haq, ACA is working as Partner Tax with Ernst & Young Ford Rhodes Sidat Hyder. He has dealt with numerous taxation issues for Islamic financial institutions from time to time, and have advised them on various taxation aspects. He also has a diverse experience of providing advisory on international tax matters including cross border transactions, transfer pricing, investment appraisals and Afghanistan tax matters.

ETHICS IN THE WORKPLACE

Farheen Mirza, ACA
Manager Technical Services

The word ethics is derived from the Greek word ethos, which means "character," and from the Latin word mores, which means "customs." According to Aristotle, one of the first great philosophers who study ethics - ethics was more than a moral, religious, or legal concept. He believed that the most important element in ethical behavior is knowledge that actions are accomplished for the betterment of the common good.

Ethics must be absolute that is you must take them seriously enough to override any human rationalization, weakness, ego, or personal faults. Unfortunately we are living in a world where we only need ethics in a time of crisis, the rapid solution to problems in such times.

In the ethics of crisis, the focus of morality is not on our life as a whole, but on a difficult situation we are currently in and don't know how to solve it. Ethics is questioned only when we are in a crisis, in dire straits. The ethics of crisis does not realize the interconnection of what we are and what we do. Instead of the ethics of crisis, we need the ethics of values. Now the question is what is the difference between the two?

The ethics of crisis is: what should I do, and the ethics of values is: what should I be? What is of Value to me?

Ethics is a requirement for human life. It is our means of deciding a course of action. Without it, our actions would be random and aimless. Ethics is not something outside us, it is not a something at all, but our own life that depends on what kind of person we want to be. Therefore, ethics is not a part of life. It is human life observed as a whole and in a special way by which we, using our own beliefs and values, change ourselves into something better than we used to be.

WORKPLACE ETHICS

Workplace Ethics is a set of formal and informal standards of conduct that people use to guide their behavior at work. Workplace ethics set the standard for right and wrong, develop ethical culture, making policies more efficient and the workplace more orderly.

It is commonly understood that there are ethics and then there are workplace ethics. Often we don't stop to realize that there is no difference between personal ethics and workplace ethics. Ethics are the same whether at work or in personal life, after all ethics are about making choices that may not always feel good like they benefit us but are the "right" choices to make.

We've all heard these rules to live by: Don't hurt, don't steal, don't lie, and the more famous "Do unto others as you would have done to you." In our personal lives most people try to follow these rules. Ethics are often thought of by many as something that is related to the personal side of life and not to the workplace side.

In an organization, workplace behavior ethics should be a core value. Ethics in the workplace help the organization to grow and prosper. It brings leadership, work culture and literacy. Aside from doing the right thing, conducting ourselves ethically has great rewards and returns. Being ethical is essential to fixing problems and improving processes. It is needed to establish baseline measures and increase efficiencies. Most importantly, it is essential to having strong working relationships with employees, allow for respect to be extended to each person within the organization, and promote customer relationships that are based on honesty and integrity.

It is also imperative that ethics for a workplace should be developed in such a way that the foundation of it will never shake or succumb to the evils of devious minds.

SELF-REFLECTION

Let's say that I believe that it is important to be an honest person. What do I do when I make an error at work? Do I admit it or do I cover my error and hope that no one finds out? I may rationalize, "If I tell my boss, he will be disappointed in me. I may not get that raise that is coming up next month. There is no harm in not telling him."

We humans tend to weigh the benefits and consequences of our actions and we look for the path of least resistance, where we will suffer the fewest consequences. When we are deciding what to do with our error, we need to ask ourselves, "Do I really value honesty like I say I do? If I am willing to lie to cover up my error, what am I really valuing?" When we lie to cover up our error, we are doing so to protect ourselves from the consequences of our actions. So, what is the greater value to us, honesty or self-protection?

The importance of being ethical must be even more emphasized if you are a leader or a manager. Leaders must always be cognizant of the fact that they are in a "fishbowl" and how they behave is clearly visible to others. Whatever they do will not only be seen by others, but may be duplicated as well. So it is important that "walk the talk" rule should be followed.

ETHICS PROGRAM

Ethical guidelines, in the form of policies and practices give employees the basic tools they need to take informed risks on behalf of their organizations. The real function of an ethics program is to allow basically good people to do the right thing and succeed. This is the essence of a healthy work environment because the top-quality people you want to hire are those who are looking for more than a job - they want to feel good about their work and about the integrity of the organization they work for.

Ethics programs and practices leads to have more positive organizational outcomes, less frequently observed misconduct and greater employee satisfaction. It has direct implications for sustaining a productive work environment, attracting and keeping good employees, and maintaining company's reputation among key stakeholders. It also tells employees that their company is heading in a positive direction.

ETHICAL PRINCIPLES ARE THE NEED OF THE TIME

Workplace is one of the most important places in our lives. We spend almost one-third to half of our life in workplace, that too during the primetime of our lives, therefore, the atmosphere in the workplace has a direct bearing on our health and happiness. Any chaotic and discordant workplace that does not follow any ethical principles will be at the mercy of the whim and fancy of its occupants. This is not only harmful to the workplace but also reduces its efficiency.

Multi-cultured and multi-ethnic workplaces of 21st century makes the workplace more confusing and requires charting out definite ethical principles that tends to minimize, if not eliminate, friction amongst the workforce and protect company's assets. The diversity in the workplace and the freedom of expression makes it necessary to set boundaries that should not be crossed during interpersonal behavior and the course of duty. Ideal ethical principles in the workplace must abide by the organizational culture, strategic goals of the organization, and value individual freedom and diversity.

WORKPLACE ETHICS PRINCIPLES

Irrespective of the working conditions, and the nature of work and workforce, some ethical principles must be followed by every employee to enhance the workplace harmony and in turn productivity. Some of them are:

- **Integrity:** Personal integrity of the employees is very important and must be honored at any cost.
- **Objectives:** Clear understanding of Company' objectives by each employee and clarity in their role to achieve it.
- **Responsibility:** Every employee should have as clear sense of responsibility.
- **Respect:** It is evident that every employee should respect seniors as well as subordinates and their views too.
- **Professionalism:** It should be shown by all at all levels.
- **Confidentiality:** It is a prime responsibility of every employee to keep the confidentiality of the data of the organization they are working for.
- **Fairness:** There must be fairness in every activity undertaken in the company. This fairness instills a lot of confidence and belief among the employees
- **Openness:** there must be freedom of expression to everyone that will instill the sense of belongingness and worth among the employees.
- **Equal employment opportunity:** There must be no discrimination between male and female at the time of hiring and during job at all levels.
- **Behavior:** A clear guidelines for interpersonal behavior must be set and taught to employees.

If important ethical principles in the workplace are drawn, it benefits hugely to the company not in terms of increased productivity but it will also make the workplace more beautiful, harmonious and conducive to personal as well as organization's growth.

MANAGEMENT ACTION

In today's highly competitive, performance-driven business climate, only ethical principles/ regulations are not enough. The real test of these principles comes from the resulting action. It takes a determined, company-wide effort, beyond inserting these words in an employee manual to make it happen.

First, management must lead by example. Good ethics should be most noticeable at the top. Every employee must be accountable to the same rules.

Second, a corporate values or ethics initiative must be "sold" and "marketed" aggressively throughout a company. Every forum and medium should be used to spread the good message. Of course, it will only be credible if the company is practicing what it preaches.

Third, training must be provided to get everyone on the same page. It's easy to ignore a motivational speech or pass by a poster, but spending time learning about the issues will have a lasting impact.

Fourth, both the employee and the company must be in it for the long haul. The commitment to promote ethics in the company should be extended to the next generation of employees.

In the end, it's all about beginning with our personal and collective understanding of ethics. The focus on sound ethics and the existence of the ethical management in the workplace is an important way to ensure the long-term effectiveness of governance structures and procedures, and avoid the need for whistle- blowing.

Living within means!

Altaf Noor Ali, ACA

Money isn't everything as long as you have enough of it. - Malcolm Forbes

Thinking of saving a trip to my physician and his fee which is getting hefty everyday, I politely downloaded the symptoms of my ailment to a fellow passenger who introduced himself as a doctor and sought his opinion. By golly, I gasped when told that he was a veterinary and would gladly take my questions on anything wrong with any of my pets.

I guess it must be easier learning about handling and addressing corporate financial needs than personal ones. If not, why wouldn't they teach you to be financially independent at the time of retirement in this era of unlimited spending venues, highly available plastic credit, high-inflation low-purchasing power and shrinking earning opportunities.

As finance professionals and en route to becoming a chartered accountant, one learns a lot about handling and addressing corporate financial needs but in the end it remains for an average individual to create means for achieving personal and family financial goals over a life-time.

One crude reality of life is that as long as we live we need money at every step to take care of ourselves and our dependants. Our spending patterns are life-long whereas our earning capacity is not.

For most of us, as salaried professionals, our earnings remain more or less constant after reaching a certain stage in career and comes to an end as we attain retirement age. How should one prepare to be financially independent at the time of attaining retirement is an individual question that requires an individual financial strategy and its application, but at its root lies an important question.

"Am I living within my means?" Quite rightly you may well be one of those prudent enough to pose this question to yourself regularly. However are you among those who really take the trouble of finding out if you are actually living within your means?

If not, it is just about the right time to learn about your own financial situation. Even if you very comfortable earning-wise, it still pays many times over not to fumble on your way and to be six by six on this important aspect of life. For average blogs, it is very important for *each one of us to refresh and apply in life the discipline of living within our means*.

NET WORTH:

The best evidence of finding out if you are actually living within your means is by putting it on a piece of paper what you own and what you owe. Whatever the difference between the two is your networth.

Your networth may be positive or negative depending on your earning and spending patterns.

Positive networth is the result of living within your means (savings in layman terms) which take the form of assets you own such as cash, local and foreign bank balance, amounts receivable from others, balance in your provident fund, investments in shares, certificate of investments, saving deposits, house, motor vehicles, etc.

Do take a pencil and paper and prepare a list of assets.

You now need to prepare another list of amount owed to others such as personal loans, company loans, amounts owed on credit cards etc. Sum up the list and you get the total amount of what you owe to others (liabilities, in accounting terms).

What if your assets are exactly equal to liabilities, that is, the result of reducing assets from liabilities is exactly zero? Well, it simply means that the assets you have have been sponsored (or financed) with courtesy to your creditors.

Also, that e you have nothing to worry

If you are young, try to maintain maximum distance between your hands and your wallet, and only spend what you have in cash. Count your TOP TEN vices that require constant finances. I will tell you what: quit smoking cigarettes (without starting cigars), its good for your heart, your wallet, and the environment; don't worry about the financial well-being of cardiologist, hospitals are working on over 100% capacity, so good that you will not be visiting any of them anytime sooner. Now you go figure out the rest of the nine vices.

If your net worth figure is a positive figure, it is 'an' indication of the fact that you have been living within your means. Your net worth figure represents the amount that you have been able to save. Congratulations. However before thumping yourself take a good look in the mirror and relate your net worth to your age to draw correct conclusions about its adequacy. In my view your networth is inverse to the number of hairs on your head.

More seriously, your net worth should be equal to five to ten times of your yearly income by the retirement age.

Example: Mr. A wishes to have an income of Rs. 1,200,000 per annum when he retires after few years. He expects the yearly return on national saving schemes to be around 12% when he retires. These facts mean that at the time of retirement the net worth of Mr. A must be atleast Rs. 10 million so that he derieves his target income, if he decides to convert his money in cash and keeps it in nsc.

If your net worth figure is negative or zero, welcome to a huge club of individuals who would like to follow the advice of living within their means but who need to bring in some discipline in their financial affairs.

Zero or negative networth is understandable for a young person who has only finished studies and started earning. However, for a person in his thirties low net worth should be cause of concern whereas for a person in his fifties or above, it can be a source of absolute financial insecurity. The underlying lesson is that the earlier you start saving and building your net worth the better it is.

IMPROVING NETWORTH:

There are three major strategies for improving your net worth. The first is to earn more, the second is to reduce your spending and the third is a combination of earning more and spending less.

May be at this instant the most practical and result-oriented strategy for you is to reduce your spending. Afterall every rupee saved is more than a rupee earned, if you take the impact of the tax. Here is how to do it.

ELIMINATE EXPENSIVE DEBT: BE DEBT-FREE

Yes, I know that life is boring without having your creditors praying for your well-being and recovery of the amount owed; settle the amount and you won't probably hear from them ever. The regular visits your creditors pay you also strengthen the social fabric of a society, specially when you are a defaulter. This is not only true for our beloved government but for us as well.

To bring some order in your financial house, your first priority should be to repay the money borrowed on high interest rates. A sense of urgency on this front will reduce the outstanding amount with every repayment. Equally important is that it will neutralise the high financial charges that you have been incurring for 'renting' these borrowed funds.

The piece of paper on which you wrote your assets and liabilities will also be handy in identifying the ones most expensive to keep and plump for a goodbye from our financial life.

Our goal is to identify the funds that are costing us the most in terms of percentage so that we can repay them first to take the venom out of financial charges we pay.

Lovers with credit card as valentines can rightly expect the balances outstanding on credit cards to feature prominently in the list for priority repayment.

You need to make yourself understand that any further increase in the amount owed by you today will bring you even more financial misrey tomorrow. If necessary, vow to 'freeze' the existing balance. Resist the temptation for reaching to your wallet and taking out your credit card at every payment opportunity if they feature high on your list. You also need to focus your attention on how to bring the outstanding amount to zero.

A basic method for computing monthly repayment figure is to take the total outstanding amount and divide it by convenient number of installments. For example if Rs. 100,000 is payable on your credit card, it can be divided in installments of Rs. 10,000 each. It will take you atleast ten months to repay the whole amount. The term 'atleat' recognises that the outstanding balance will continue to attract financial charges but each repayment will result in lower financial charges in the next month. You must be aware that it will take you more than ten months to clear the balance.

Once you repay the balance in full and make it a habit to clear the balance in full every month, you will find that a credit card statement appears to be at its best for a credit card holder without debit balance from previous months and financial charges. I actuall know a person who invariably deposits more than the due amount on his card, to take care of his future purchases. His previous months' balance is in credit rather than a debit balance (amount owed). Most people, however, dread the day the card-statement arrives in the mail. They do not even feel like opening it. The note of caution here is that the blind love affair with credit cards can be expensive and its always recommended that you remain loyal to only one credit card at a time. Have the audacity to cancel the rest.

One of my friends, deep in debt at one point, on settling it, as a matter of gratitude, has those expired cards framed and hanged them on the wall with the caption: "Rest in peace, you look better here than in my wallet".

Another option available to you to reduce your financial charges is to be on a look out for replacing expensive debt with a less expensive one. The balance transfer facility offered by various banks can be useful in replacing debt owed on credit cards.

The moral of above story is to start repaying high cost loan immediately, and stop only after reducing your liabilities significantly. If you devote some time in preparing net worth statement at regular intervals, you will find that your net worth will increase because of reduced financial charges, all other things remaining the same. In the end, the most recommended strategy for all times is to be debt-free.

AVOID UNPLANNED PURCHASES:

Soft purchases. How many times it happens that we go out to buy one thing and return with ten different things? It is not to say that those 'extras' were not required, but the question is that if they were required so badly howcome you did not went out to purchase them in the first place?

The examples of above situations are buying groceries, eating out, buying clothes or going out. Have you ever noticed that we all end up paying almost double of what we initially estimate in our minds?

The point is that most of us have become slaves to our needs and harbor uncontrolled desire for immediate gratification. In this age of communication, the fact is that we are so much bombarded with consumerism that we are literally seduced by marketing and create an artificial need and that sure is the most indisciplined phase an individual can get to. Also common is to find compulsive shoppers who are restless till the pockets are empty.

The way out is to always prepare a list of items required with quantities when going out for any kind of shopping and then sticking to it. No big issue in adjusting the quantities but no purchases should be made without thinking about it carefully in advance.

There may be thousand other ways to economise on each item of spending depending on situation but pausing to watch out everything coming with the word 'sale/discount/win a vacation, prize etc' is not one of them.

The last point that I wish to emphasis is about 'significant but invisible' spending like buying clothing accessories, stationery, birthday cards etc. By careful of spending money on things which do not appear to be expensive in isolation but when you add them up they become 'sizeable'.

Mega and Major purchases. Its again a fact of life that each one of us is involved in once in a lifetime financial purchase like buying a new home or major purchases like a car, television, DVD, stereos, refrigerators, camcorders, cameras, computers or any other consumer product.

The suggested approach in such situations is to carefully assess your needs and to think of options. If there is no option but to buy, the best way is first to go out and see what is available. Internet is an emerging source of such fact-finding. Even if you find what you are looking for, try to defer purchasing it for a week. This one week acts as a cooling period. After one week, if you are still for purchasing it, then by all means go ahead and buy it.

The key principle here is to defer your major purchases to the last extent possible. It should not be seen as denial of something but as a process that eventually benefits you. Even better is that you share your approach in advance with others involved in the decision, such as your spouse or children. Such understanding is critical and will save you from saying 'what the heck, I can afford it!' and rushing you into a decision which is a dangerous pretention. Patience is the key word in such decisions. If you hear yourself making such statements often then seriously consider to change the settings of decision to minimise undue pressure on yourself. If you don't, you will probably give in and regret one more wish of yours!

FINAL WORD:

Spending money is possibly easiest of things. One can also ignore the importance of living within means and continue to earn from one hand and spend the same from the other, hoping to hit a treasure one fine day. On the other hand, those who accept the reality of life prepare to synchronise earning capacity with spending pattern to save something for rainy days.

By no means our advice is for anyone to be a miser. Throughout we have emphasised the need to improve the quality of our spendings by being moderate and vigilant. It is possible to enjoy life within the confines of its financial realities.

Tax Savings through Investments......

Rahim Khakiani, ACA

As the global economy is struggling to get out of the current recessionary cycle, it has become a challenge for most governments around the world to manage their public finance either through increasing the revenues or by cutting expenditures. Since a major chunk of government's revenue come in the form of direct taxes, which is squeezed due to dismal profitability of companies thereby, forcing governments to increase tax incidents on individuals.

Pakistan is of no exception, the nation recently faced massive dent due to unprecedented floods, which tested their emotional and economic strengths, where a vast majority of them have succumbed to their adversities. While it is arguable to gauge government's capacity to whether such eventuality in future, the tendency is clear, which is to pass on the burden to the population in despair. The very nature of the skewed tax structure of the country, with the tax base is languishing at only around 2 million registered tax payers out of total masses of 170 million, many with considerable incomes at their disposal, does not pay taxes, calls the salaried class to manage their taxes legally. The overall tax incidence on salaried class is on the rise for quite some time as we have seen by the imposition of IDP taxes couple of years back and reducing the threshold for maximum tax rate (20%) on salaried individuals from Rs. 8.65 million to Rs. 4.55 million only in the last budget.

Fortunately, Pakistani tax laws provide some reliefs in the form of tax credits and rebates, though their awareness in the taxpayers remains low for host of reasons ranging from socio economic conditions to the general level of apathy. If the tools for tax credit and rebates are effectively utilized, they can bring annual savings of more than Rs. 360,000 (total tax saving for 20% tax slab) for a high tier salaried individuals drawing in excess of Rs. 4.55 million in annual salaries and other taxable benefits and more than Rs.132,000 (total tax saving for 10% tax slab) for individuals drawing an annual salary of around Rs. 1.2 million.

The Finance Act, 2010 also removed the exemption available on capital gains on listed securities including mutual funds, though there are avenues open to minimize / avoid its incidence. From pure legalistic perspective, section 37A has been inserted in the Income Tax Ordinance, 2001 to make way for capital gains taxes. Through the income from this source is made taxable form the current financial year beginning from July 01, 2010, their incidence has been kept low and only short term capital gains are being charged to tax currently. As per the amendments in tax laws, persons realizing capital gains with the holding period of less than 6 months have to pay 10% on such gains, while for the holding period of between six months and one year, the same would be taxable at 7.5% on such gains and on holding period beyond one year, the capital gains are not taxable. The same tax principles are applicable on mutual funds, with the only difference is that the tax on capital gains on mutual funds are subject to be withheld by asset management companies. An individual, while filing his / her return of income for that year can adjust the losses under this head and determine their final tax liability. In case of any unabsorbed losses under this head, the same are not allowed to be carried forward to the subsequent years.

While the capital gains are made taxable, there are many ways; one can reduce / avoid its incidence by investing smartly. As by now we are aware that capital gains are treated as a separate block of income as defined in the income tax laws and are subject to maximum 10% on the gains, the tax incidence is still very low considering the corporate tax rate of 35% and maximum tax slab of 20% for the salaried individual. In addition, the holding period restrictions as explained above can be viewed as a blessing in disguise for the reason to make us disciplined in the manner and approach, we save our money. It is pertinent to be said without argument that a Systematic Investment Plan (SIP), whereby a reasonable portion of our incomes are parted every month for investment purposes serve as a master key for most of investor profile types. Fortunately, many products based on mutual funds offer a SIP based approach for investment as per individual's risk appetite and investment goals. SIP on one hand gives us a stable average cost of investments by avoiding the unfavorable market timing to be entered into and on the other, does provide us the flexibility to withdraw money without taxes, provided that we are into this habit for quite some time.

Despite the fact that there are inadequate state based social safety nets for individuals, saving habits in Pakistan is not promising as evident from the low ratio of only 4.6% of banking deposits invested into mutual funds, which is around 11% in the neighboring India. One cannot deny the fact that financial independence with adequate savings at hand can give relief from many miseries. Every year, we should be asking ourselves: "How much money we saved last year and was that adequate enough to achieve our financial goals?" If we cannot answer this question then we should recognize that we are falling behind and therefore, are at risk. It is unfortunate that our money is lying in bank accounts and does not recognize the fact that over time money losses its value due to higher rate of inflation and that on an average banking deposits give a return of only 5-10% per annum and on top of it, bank profits are taxable at 10%. Also many people due to religious beliefs place their money in current accounts, which generally does not give any return and are at greatest risk of depletion in value of money over time.

The Mutual Fund Industry, though still evolving in Pakistan has come a long way by developing many innovative solutions to suit individual investors of both conventional and shariah-compliant mindsets. A typical money market fund, which normally invests around 70% in short term government papers, gives around12% annualized return without any restrictions on the holding period, with less risk than a PLS banking account. A savvy individual could easily distinguish the benefits of investing in mutual funds as compared to placing funds in bank accounts.

To emphasize the foregoing discussions on the tax credits/rebates, capital gain taxes, SIP based investments and benefit of investing in mutual funds over bank deposits, following illustration will make the case and clarifies the discussions.

ILLUSTRATION:

Mr. Hypothetical earns an annual salary of Rs. 1.2 million. Following is his other information:

- Age: 35 years.
- Annual income: Rs. 1.2 million, growing @ 10% per annum.
- Annual expenditure: Rs. 0.84 million, growing @ 15% per annum.
- Current savings: Rs. 2 million, placed in a PLS Saving Bank Account earning interest @ 8% per annum.
- Annual donations to approved charitable institutions:
  Rs. 0.05 million.
- Annual mark-up on house loan: Rs.0.30 million.

Investment possibilities:

His risk profiling determines his asset allocation as follows:

	Allocation	Estimated Return
Equity	25%	20%
Money market	75%	12%
	100%	**14%***

* Weighted Average Return on Investments

His savings can be placed in bank deposits or in mutual funds and pension funds in accordance with his risk profile and financial planning can be done based on the following scenarios:

Scenario 1:	He continues with his current saving habit by placing the money in PLS Saving Account @ 8% per annum.
Scenario 2:	He invests in mutual funds and pension funds as per his risk profile without claiming tax credit / rebates.
Scenario 3:	He invests in mutual funds and pension funds as per his risk profile with tax credit / rebates.

	Scenario 1	Scenario 2	Scenario 3
	----------------------------(Rupees in millions)-------------------------------		
Annual income	1.2	1.2	1.2
Annual expenditure	0.96	0.96	0.96
Current annual savings	0.24	0.24	0.24
Current net worth:			
- Bank account	2	-	-
- Equity funds	-	0.5	0.5
- Money market funds	-	1.5	1.5
	2	2	2
Tax credits and rebates:			
- Mutual funds	-	-	0.012
- Pension funds	-	-	0.024
- Markup on house loan	-	-	0.030
- Charitable institution	-	-	0.005
	-	-	0.071
Investment Value:			
- After 5 years	4.840	6.273	6.784
- After 10 years	7.452	13.039	14.572
- After 15 years	6.149	20.477	24.062

To conclude, we can say that adequate tax planning can do wonders to one's overall financial planning and a SIP based investment approach could serve as an icing on the cake. Life is full of eventualities and unforeseen adversities, so why do not we prepare an adequate plan for it. The key to success is to start early to help meet our financial goalsi.e. professional education and marriage of our children, old age sickness and retirement.