THE PAKISTAN ACCOUNTANT

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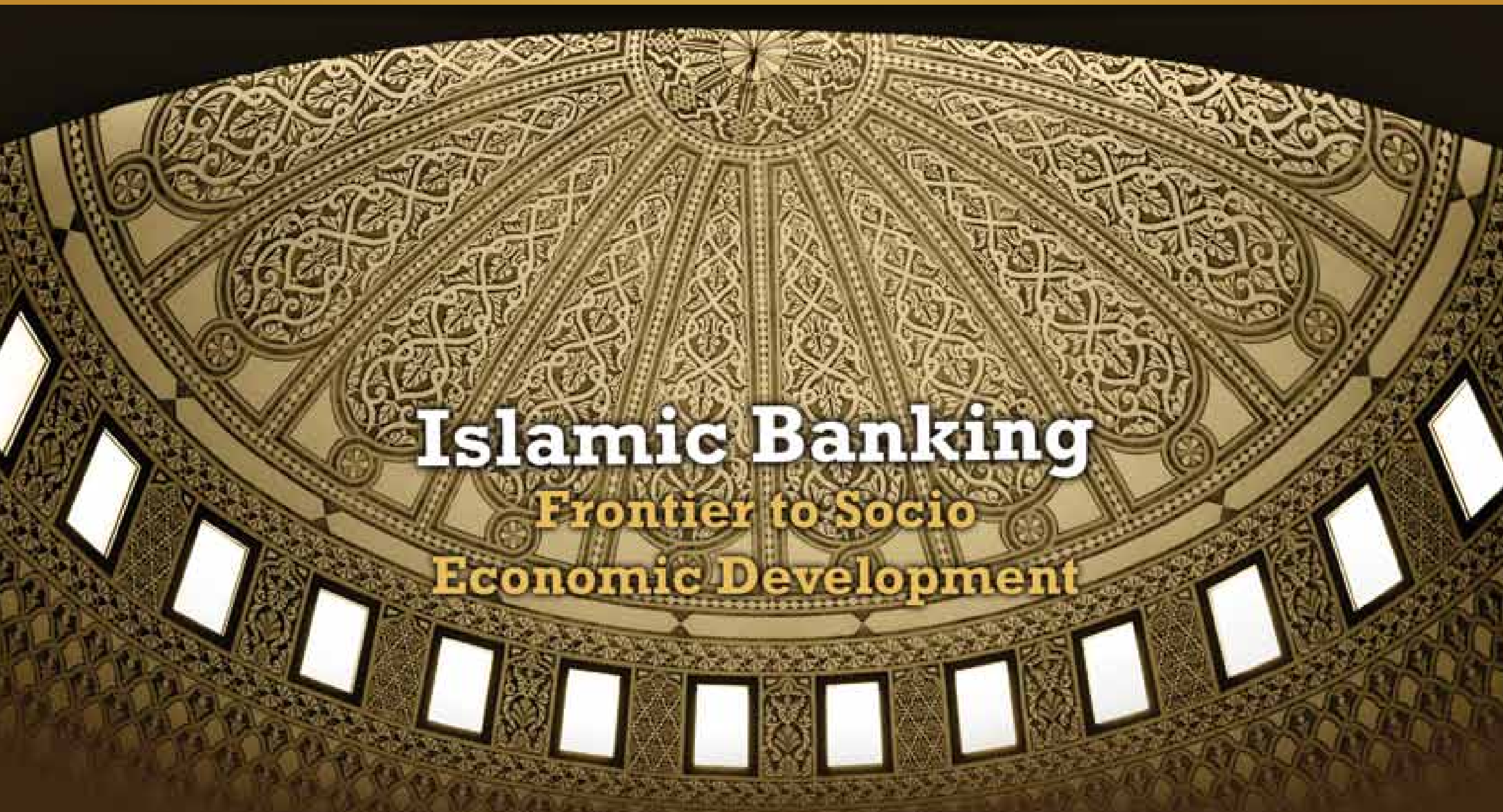

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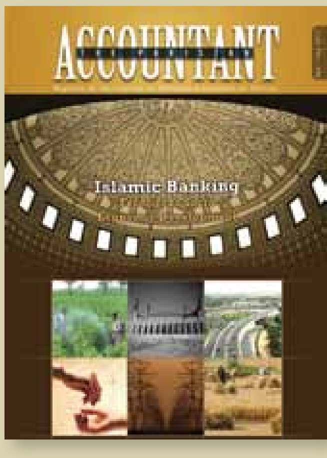


Islamic Banking
Frontier to Socio Economic Development

Editor's Letter

A well functioning and efficient banking system is vital for achieving robust economic performance. The banking institutions perform the important function of mobilizing funds that are channeled to productive investments thereby generating economic activity.

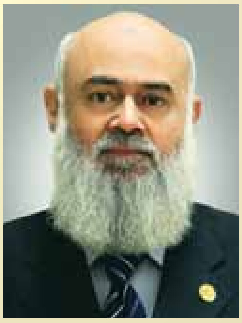
In Pakistan a growing trend of movement towards fixed/term deposits compared to traditional savings accounts shows that customers are now entering into long term relationships with Islamic financial institutions, evidencing the industry's credibility and reputation. Islamic banks prefer low-risk modes of financing, i.e. those which usually generate a stable return. Among these, Murabahah (cost plus mutually agreed profit margin), Ijarah (leasing) and diminishing Musharakah are the most attractive and popular modes of financing. However, lately the share of Mudarabah, Istisnah and Salam has also shown growth at a satisfactory pace, leading towards diversification of the Islamic banks' financing portfolios.

Islamic finance has the potential to channel wealth through alternative avenues for savings and investments, as well as offering the financial inclusion of devout Muslims. This argues well for establishing Pakistan as a good destination for belief sensitive foreign direct investment, especially from countries with significant Islamic finance conscious investors. It has been said that Islamic banking and finance is a "mirror of the sea" for until and unless we have the courage to explore its depth, we would never be able to uncover the treasures that reside within. Islamic banking as a new sphere of finance, promises vast opportunities and benefits for all. Its integration into the global financial system will contribute towards achieving our shared aspirations for financial stability to contribute towards balanced growth in the global economy.

To be part of the global Islamic banking industry, and introduce world class regulations in Pakistan regulators along with Shariah scholars and experienced professionals are constantly coordinating and moving towards integrating the regulations of Islamic finance industry across all areas and sectors of this industry: including banks, Takaful companies, mutual funds and other Shariah compliant institutions. The Institute also aware of its responsibility plays an important role through its committees to promote effective risk management practices and Shariah compliance.

Today Islamic banking is emerging as a viable and sound financial intermediation channel, and to meet the regulatory challenges, it can contribute towards the overall efforts to enhance and strengthen the stability of the international financial system, and increase the prospect for securing the path towards achieving the shared vision for sustainable long term global growth.

Adnan Zaman, FCA



President's Page

Islamic banking is a system or activity that is consistent with the principles of the Shari'ah-Islamic rulings and its realistic application through the progress of Islamic economics. Pakistan's identity as an explicitly Islamic republic has always made the country more inclined towards economic reforms geared towards greater Shariah compliance.

Efforts to Islamize the economy of Pakistan started in the mid-1960s. A significant attempt was made in the mid-1980s to convert the banking system to an Islamic banking system. It was a bold and comprehensive exercise, making Pakistan one of the few countries in the world to try to implement interest free banking at the national level. However, it was not successful due to certain constitutional and regulatory constraints at that time.

In 2002, policymakers and stakeholders decided to try again to re-launch Islamic banking in Pakistan. The State Bank of Pakistan's drive to promote Islamic banking as a parallel system, operating on a level playing field with conventional banking, was aimed at building a broad-based financial system in the country to enable all segments of the population to access financial services and play their due role in the overall economic development. There have been significant positive developments in Pakistan in recent years, including growth in the number of institutions and market share; expansion of branch networks; an increase in total assets, deposits and profits; and a decrease in non-performing financing. The growth experience to date has been quite remarkable.

By the Grace of Allah the Institute's Committee on Accounting and Auditing Standards for Interest Free Modes of Financing and Investment successfully issued IFAS 1 Murabaha and IFAS 2 Ijarah while Standard on Profit and Loss Sharing on Deposits is in final stages. Further the Committee is in process of developing standards on Diminishing Musharaka, Musharaka, and General Presentation of Financial Statements of Islamic Financial Institutions.

I would like to share a couplet of Allama Iqbal with you, which for me describe the reality of the journey called life.

"In man's crusade of life, the weapons he has:
Conviction - that his cause is just;
Resolution - to strive till eternity;
Compassion - that embraces all humanity".

The same can be applied to scenario of the Islamic banking in Pakistan; it is now at a threshold of exciting developments. The tides of Islamic banking are bringing once again greater co-operation, collaboration and understanding of the magnificent splendor of Islam. Deriving strength from the religion, we have ample opportunity to establish a financial model for the rest of the world to follow.

Rashid Rehman Mir, FCA

The Rise of Islamic Banking in Pakistan:

Comparative Study of Conventional & Islamic Banking-A Case Study from Pakistan

Presented at: Business & Economics Society International Conference 2012, Salzburg, Austria on July 6-9, 2012

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Prelude

The Western Economic System is under stress these days Occupy Wall Street (OWS) movement is spreading globally in North America, Europe, Asia, Oceania etc. One of the outcry in USA is "death to the Banker". It is generally believed that interest being charged by the banks globally in various shapes-usurious rates, compound rates, penal rates etc. have added to the cost of doing business and is resulting into high inflation. It has widened the gulf between rich and poor. The rise of Islamic Banking is steadily taking place globally. In this respect, we have carried out research from A-Quran. Seven (07) verses have been extracted and included in the paper which clearly include guidance against charging of interest (Riba). Moreover, the Constitution of Pakistan 1973 also contains commitment by the Government that Riba will be eliminated as soon as possible.

The rise of Islamic Banking is a welcome sign. However, at present, conventional banking and Islamic Banking (IBIs) are operating on a parallel basis in Pakistan.

This piece examines some interesting aspects for analysis of Conventional Banks and IBIs in Pakistan.

Terminology

IBIs	-	Islamic Banking Institutions
ND	-	No Date
NIB	-	Non – Interest Based Banking
NPFs	-	Non – Performing Finance
P	-	Page
PP	-	Pages
PTC	-	Participation Term Certificate
ROA	-	Return on Assets
ROE	-	Return on Equity
OWS	-	Occupy Wall Street
SBP	-	State Bank of Pakistan (Central Bank of Pakistan)
SME	-	Small & Medium Enterprises
TFC	-	Term Finance Certificate

Constituents

This piece consists of the following parts:

Part	Focus
I	Quranic Guidance and the Constitution of Pakistan, 1973
II	Historical Rundown and Developments for IBIs in Pakistan.
III	Growth, Development & Performance of IBIs in Pakistan.
IV	Conclusion & Recommendations For future Growth.

The above aspects are now explained below:

The data were extracted from Islamic Banking Bulletin released by the Islamic Banking Department of SBP in June 2011. Data relating to economy have been extracted from Pakistan Economic Survey 2010-11, released by the Ministry of Finance, Government of Pakistan, Islamabad.

Part I: Quranic Guidance and 1973 Constitution of Pakistan

1. Quran and Elimination of Interest

Seven verses have been selected from Al-Quran in respect of the above mentioned subject. These are quoted below with brief comments.

Allah has forbidden taking interest and has guided everyone to do business, trade and profession. In this respect, based on our research, some Quranic Verses are quoted below:

"Those who consume interest cannot stand [on the Day of Resurrection] Except as one stands who is

being beaten by Satan into insanity. That is because they say "Trade is [just] like interest". But Allah has forbidden interest. So whoever has received admonition from his Lord and desists may have what is just, and his affairs rests with Allah. But whoever, returns [to dealing in interest or usury] – Those are Champions of the Fire they will be abide eventually therein". [Al-Quran: 2-275]

One of the basic cardinal principles of being a true Muslim is a firm belief in Hereafter and on the Day of Resurrection. If these thoughts are indoctrinated in ones mind, no Muslim will follow Satan and consequently avoid coming into a state of mind characteristicly described with insanity. Accordingly, in the above verses, Allah has guided us as Muslims to stay away from taking interest. Those who are living under the misperception that interest is akin to trade are totally mistaken. Consequently, Allah has admonished us in this respect. If those of us do not believe in these thoughts, they are destined to be the Champions of Fire and will be delivered to the Hell for ever to eventually live there.

It is, therefore, required on our part that we as stakeholders must undertake all steps to eliminate interest from our economic and social life at the earliest. Under the 1973 Constitution of Pakistan, it is obligatory on the part of the Government of Pakistan (Article 38 (f)) to eliminate Riba as soon as possible. The Government must rise to the occasion and accept this as a challenge and meet their Constitutional obligation.

Another Quranic Verse is reproduced as under:

"Allah destroys interest and gives increase for Charity. And Allah does not like every sinning disbeliever". [Al-Quran: 2-276]

According to the above discussed verse, Allah has encouraged giving charity and destroying interest.

In another Quranic Verse, Allah says to human beings.

"O you who believe, fear Allah and give up what remains [due to you] of interest if you should be believers". [Al-Quran: 2-278]

Muslims as believers, based on above Quranic Verse, must give up interest and follow the orders of Allah.

The above mentioned Quranic Verse describes "Muslims as believers", must give up interest and should follow Allah's orders.

"And if you do not, then be informed of a war [against you] from Allah and His Messenger but if you repent, you may have your principle – "Thus" to no wrong nor are you wronged". [Al-Quran: 2-279]

Allah in the following Quranic Verse has also ordered that we should not consume usury in any shape. We must always fear Allah so that we may succeed in life. In this respect, a Quranic Verse is quoted below:

"O you who have believed, do not consume usury, doubled and multiplied, but fear Allah that you may be successful". [Al-Quran: 3-130]

Usury has been understood to be high or super high rate of interest charged by financial and other institutions.

Another Quranic Verse regarding taking usury is quoted below:

"And [for] their taking of usury while forbidden from it and their consuming of the people wealth unjustly and we have prepared for the disbelievers among them a painful punishment".[Al-Quran: 4: 161]

The foregoing verse from Al-Quran contains a strict warning of painful punishment for those who take usury which Allah has forbidden. Their act in taking usury constitutes consuming of the people wealth in an unjust manner and for them there will be a painful punishment.

In another Quranic Verse, Allah has said:

"And whatever you give for interest [i.e. advantage] to increase within the wealth of people will not increase with Allah. But what you give in Zakat, desiring the countenance of Allah – Those are the multipliers". [Al-Quran: 30-39]

In the light of above discussed verse Allah has again guided us to give up interest and has encouraged giving Zakat as He will, through his infinite wisdom and blessings, introduce multipliers through giving Zakat.

2. Riba and The Constitution of Pakistan, 1973

The present democratic Government is taking pride in claiming that they have restored the Constitution of Pakistan, 1973 in its original shape. Accordingly, they deserve congratulation. However, the crying need of today the implementation of the Constitution of Pakistan in letter and spirit. In this respect, an excerpt from Article 38 (f) of the above Constitution is quoted below:

"The State shall .... Eliminate Riba as early as possible".

There is a need to implement the above spirit of the Constitution as 40 years have already passed and the Nation is eagerly awaiting the happy moment when **Riba** will be totally eliminated from our social and economic life to usher in an era of Islamic Society where dividends can be reaped by the common man and all other persons across the board in our country.

Part II: Historical Rundown and Developments for IBIs in Pakistan

1. Historical Rundown

During the 65 years of the history of Pakistan some efforts, at times casual, at times half hearted, at times with speed, have been made to eliminate Riba. In this respect, the following Table contains salient features of the efforts made in the past:

Table: 1
Efforts to Eliminate Riba from the Socio-Economic Landscape of Pakistan

Decade	Main Effort
1970s	Some efforts started with no conspicuous results.
1980s	Bold and comprehensive initiatives were undertaken. Pakistan was ranked amongst the three countries of the world for commencing non-interest based banking. Various legislations (Companies Ordinance, 1984, Negotiable Instruments Act, 1882, State Bank Act and Recovery of Loans Laws etc). were reviewed to bring these in line with the tenants of Islam. A new interest free Instrument namely; PTC (Participation Term Certificate) for Corporate Financing was introduced and was later replaced with TFC (Term Finance Certificate). Non-Interest Based Instruments (NIB) Numbering 12 were announced. In the Conventional Banks separate interest free counters were opened on January 01, 1981. For meeting working capital needs of trade and industry, Musharaka was introduced on July 01, 1982. Profit and loss sharing basis was introduced in Conventional Banks on April 01, 1985.
1990s	In November 1991, Federal Shariat Court was established. An announcement was made on December 23, 1991 that transactions involving interest in banks would cease to have effect finally by June 30, 2001.
21st Century	Commission for Transformation of Financial System was constituted in State Bank of Pakistan. Task Force was set up in SBP to suggest ways and means to eliminate interest from Government financial transactions. However, parallel banking system namely; Conventional and Islamic Banking has continued till today.

2. State Bank of Pakistan Role

Islamic Banking Department was established in the Central Bank of the country namely; State Bank of Pakistan (SBP). Clear-cut statements in respect of Vision and Mission were announced. These are reproduced below:

Vision and Mission Statements of SBP

i. Vision Statement

"To transform SBP into a modern and dynamic Central Bank, highly professional and efficient, fully equipped to play a meaningful role on sustainable basis in the economic and social development of Pakistan. To make Islamic Banking role, the banking of first choice for the providers and users of financial services".

ii. Mission Statement

"To promote monetary and financial stability and foster a sound and dynamic financial system, so as to achieve sustainable and equitable economic growth and prosperity in Pakistan. To promote and develop Islamic Banking industry in line with best international practices, ensuring Shariah compliance and transparency".

Vision and Mission Statements of Islamic Banking Development of SBP

Statement of Islamic Banking Department of SBP about vision & mission are given below:

i. Vision Statement

"To make Islamic Banking, the Banking of **First Choice** for the providers and users of financial services".

ii. Mission Statement

"To promote and develop Islamic Banking industry with the "Best Inter-national Practices" ensuring Shariah compliance and transparency".

3. Strategy for Islamic Banking in Pakistan

Globally two strategies are recommended. The first one is known as Revolutionary strategy which Iran followed in respect of introduction of Islamic Banking. The second one is Evolutionary strategy which Pakistan announced for introducing Islamic Banking in the country. Similar approach is being followed in Indonesia and Malaysia.

State Bank of Pakistan has developed the following three point strategies relating to development of Islamic Banking in the country. These include the following:

a) Full-fledged Islamic Banks are encouraged to be established in Pakistan on independent footing. The objective was to help develop Islamic Banking away from the parallel run of Conventional and Islamic Banking.

b) The above category of Islamic Banks established, at (1) above have been permitted to establish their subsidiaries throughout Pakistan.

c) The Conventional Banking set ups in Pakistan were permitted to establish Stand-Alone Islamic Banking Branches in Pakistan.

Accordingly, SBP hopes that, through the evolutionary process, while Islamic and Conventional Banks may continue on parallel basis, efforts were initiated to introduce Islamic Banking in the country. However, as will be shown later in the Statistical Analysis, the pace of converting Conventional Banks to Islamic Banks is slow. A breakthrough effort is the crying need if Allah's command to eliminate interest from the society is implemented with true spirit and with committed and dedicated efforts.

Part III: Performance of IBIs in Pakistan

1. The Rise of IBIs

We have tabulated the growth of IBIs. Three indicators selected include Total Assets, Deposits and Net Financing Investment.

Table 2
Growth of Islamic Banks:
Some Important Indicators (December 2003 to June 2011)

Year	Total Assets		Deposits		Net financing investment	
December	Total Rs.b	Share of IBIs %	Total Rs.b	Share of IBIs %	Total Rs.b	Share of IBIs %
2003	13	1	8	1	10	1
2004	44	2	30	1	30	1
2005	71	2	50	2	48	2
2006	119	3	84	3	73	2
2007	206	4	147	4	138	4
2008	276	5	202	5	186	4
2009	366	6	283	6	226	5
2010 (June)	**411**	**6.1**	**330**	**6.4**	**236**	**4.6**
2011 (June)	**560**	**7.3**	**452**	**7.6**	**420**	**7.0**

Source: Extracted from: Islamic Banking Bulletin, Karachi: State Bank of Pakistan, June 2011.

The following conclusions emerge from the above table:

a) IBIs represented 7.3% of banking industry.
b) IBIs share of deposit was 7.6% and the share in net financing investment was 7.0% of banking industry.
c) Shares of all the three indicators have been registering a steady rise. This augurs well for the IBIs for the future.

The following Table has been compiled to present concentration analysis of Islamic Banks in Pakistan as on June 30, 2011:

Table: 3
Concentration Analysis of IBIs Branches by Districts

Name of District	Number of Branches	%
Karachi	223	28
Lahore	133	17
Islamabad	43	05
Bahawalpur	41	05
Faisalabad	35	04
Peshawar	32	04
Multan	27	04
Quetta	25	03
Sub-Total	**559**	**70**
Others	240	30
Total	**799**	**100**

There are over 100 districts in Pakistan. Unfortunately, Islamic Banking Branch Network exists only in 73 districts. Therefore, there is need to widen the network of branches in every district, tehsil and union council of each province of Pakistan, particularly in rural areas so that those who are desirous of opening their bank accounts and also undertaking their operations in Islamic Banking modes can really benefit out of it.

A detailed analysis has been carried out by us and the following Table presents IBIs branch network:

Table 4
Islamic Banking Branch Network in Pakistan

S. #	Particulars	Number of Branches	%
A:	**Islamic Banks**		
	1. Meezan Bank Ltd	232	
	2. Al Baraka Islamic Bank	87	
	3. Bank Islami Pakistan	70	
	4. Dubai Islamic Bank	66	
	5. Dawood Islamic Bank Ltd	42	
	Sub-Total	**497**	**62**
B:	**Islamic Branches of Conventional Banks**		
	1. Bank Alfalah Ltd	80	
	2. Faysal Bank Ltd	37	
	3. Askari Bank Ltd	29	
	4. Habib Bank Ltd	22	
	5. Bank of Khyber	21	
	6. Others	64*	
	Sub-Total	**253**	**32**
C:	**Sub-Branches of IBIs**		
	1. Bank Islami Pakistan Ltd	32	
	2. Dawood Islamic	08	
	3. Others Banks	09**	
	Sub-Total	**49**	**6**
	Total	**799**	**100**

*Standard Chartered (15) MCB Bank (14), Bank Al Habib (10), UBL (7), Soneri Bank (6), NBP (8), Habib Metropolition Bank (4).

**The Bank of Khyber (3), AlBaraka Islamic Bank (2), Askari Bank (2), MCB Bank (2).

Source: Extracted from: State Bank of Pakistan, Islamic Banking Bulletin, Karachi, June 2011 Annexure, P. 24.

By Allah's grace, the growth of IBIs branches has been steadily increasing as is shown in the following Table:

Table: 5
Growth of Islamic Banks Branches
December 2003 to June 2011

Year (December)	Number	Base Index	Number of Times
2003	17	100	1
2004	48	300	3
2005	70	412	4
2006	150	882	9
2007	289	1,700	17
2008	515	3,029	30
2009	651	3,829	38
2010 (June)	**667**	**3,924**	**39**
2011 (June)	**799**	**4,582**	**47**

Source: Extracted from: Islamic Banking Bulletin, Karachi: State Bank of Pakistan, June 2011.

An analysis, based on three categories of IBIs is presented below:

Table 6
Islamic Banking Branches Network
As on June 2011

Particulars	Branches	
	Number	%
A: Full Fledged Islamic Banks	497	62
B: Islamic Branches of Conventional Banks	253	32
C: Sub-Branches	49	06
Total	**799**	**100**

Source: Extracted from: Islamic Banking Bulletin, Karachi: State Bank of Pakistan, June 2011,Annexure, P.24.

2. Deposits of IBIs

As on June 30, 2011, a sum of Rs. 452 b represented deposits of IBIs. The following Table sums up the overall position and sources of deposits:

Table 7
Deposits: Islamic Banking Industry
As on June 30, 2011

	Particulars				**Rs. b**	**%**
A)	**Customers**		**Rs. b**	**%**	**423***	**94**
-	Fixed Deposit	:	163	39		
-	Saving Deposit	:	150	33		
-	Current Account Non-Remunerative	:	108	24		
-	Others	:	02	04		
			423*	100		
B)	**Financial Institutions**				**29**	**06**
	Total	**:**			**452**	**100**
C)	**Break UP – Currency-Wise**					**%**
-	Local Currency Deposits				433	96
-	Foreign Currency Deposits				19	04
	Total	**:**			**452**	**100**

Customers represents 94% of deposits. However, the other source namely; financial institutions has yet to be exploited. IBIs coverage from foreign currency deposits is very low. This also represents an area to be explored to their advantage in future.

3. IBIs Financing

A sum of Rs. 199.2 b represented IBIs financing as on June 30, 2011. The following table presents break up in respect of above:

Table 8
IBIs Financing Products, June 30, 2011

S. No.	Products	Rs.b	%
1.	Murababa	90	45
2.	Diminishing Musharaka	63	32
3.	Ijarah	23	12
	Sub-Total	**176**	**89**
4.	Others (Istisna: Salam, Musharaka, Mudarba)	23.2	11
	Total	**199.2**	**100**

Source: Extracted from: Islamic Banking Bulletin, Karachi: State Bank of Pakistan, June 2011, Table 4, P 5.

A comparative analysis of IBIs financing based on sectoral composition with banking industry is tabulated below:

Table 9
IBIs Financing: Sectoral Composition (June 2011)

S.No.	Sector	IBIs%	Industry %
1.	Textile	20.40	17.70
2.	Individuals	15.80	11.30
3.	Energy: Production & Transmission	8.50	10.10
4.	Chemical & Pharmaceuticals	6.90	3.80
5.	Sugar	4.90	3.20
6.	Cement	3.40	2.20
	Sub-Total	59.90	48.30
7.	Other Sectors (Including 34.41% for industry and 17.29% for industry others)	40.10	51.70
	Total	100	100

Source: Extracted from: Islamic Banking Bulletin, Karachi: State Bank of Pakistan, June 2011, Table 5, P 5.

Five sectors constituted around 60% of IBIs total financing. Textile industry (20.4%) was the main beneficiary, followed by individuals (15.8%) and remaining main sectors which benefited included energy (8.5 %), chemical and pharmaceuticals (6.9 %), sugar (4.9%) and cement (3.4%).

Due to energy crisis in the country, industries are operating at lower capacity and thus IBIs are in difficulty to collect the money lent.

4. Non-Performing Finances (NPFs) of IBIs

It is generally agreed that NPFs should not ordinarily exceed 4% of advances. Unfortunately, this trend is growing and stands un-arrested in conventional and Islamic banks.

The crying need is to keep it to most minimum level. In this respect, the following Table presents the position as on June 30, 3011:

Table: 10
Break UP of NPFs of IBIs
As on June 30, 2011

S. No.	Particulars	Rs.b	%
1.	Doubtful	2.3	15
2.	Sub – Standard	2.2	15
3.	Loss	10.4	70
Total:		**14.9**	**100**

The following Table presents time series of NPFs:

Table 11
IBIs NPFs Time Series

Period	NPFs
	Rs.b
December 2008	3.4
December 2009	10.0
December 2010	13.8
June 2011	14.9

Source: Extracted from: Islamic Banking Bulletin, Karachi: State Bank of Pakistan, June 2011, Table 8, P 7.

It would be apparent from the above Table that NPFs are rising. Perhaps due to liquidity problems of borrowers, it is becoming difficult to collect the money lent. Due to critical shortages of energy and uncertain dominating economic policies, NPFs are becoming a headache for banking industry in general and also for IBIs.

5. IBIs Investments

A sum of Rs. 231 b stood invested by IBIs on June 30, 2011. The following table shows the composition of investment:

Table 12
IBIs Investments: Composition
As on June 30, 2011

Composition	Rs. b	%
1. Federal Govt Securities	148	64
2. TFCs, Debentures, Bonds & PTCs	29	13
3. Fully Paid up Ordinary Shares	2	1
Sub-Total	**179**	**78**
4. Others	52	22
Total	**231**	**100**

Source: Extracted from: Islamic Banking Bulletin, Karachi: State Bank of Pakistan, June 2011, Table 6, P 6.

It is interesting to note that 64% of investments stood invested in Federal Government Securities. This represents risk free principal with assured and guaranteed rate of return. The remaining amount was mentioned to have been invested in several products including debentures which is not Shariah complaint.

Only 1% was invested in equity shares. Currently volumes are thin and trading on Stock Exchanges in Pakistan is slow. Available floats of blue chips are small and except for a few scripts, share prices show declining trends. Some steps have been taken by the government to increase volume.

Highly specialized and magnificently qualified professionals are needed to guide IBIs to help develop their investment strategies.

6. IBIs: Earning & Profitability Analysis

From three angles, we have analyzed the performance of IBIs and banking industry namely; income, expenses, and spread. The following table presents the position in a summarized shape:

Table: 13
IBIs: Earnings and Profitability
As on June 30, 2011

Indicator	IBIs %	Industry %
A) Income		
Net Income to Total Assets (ROA)	1.60	1.40
Return on Equity (ROE)	16.50	14.40
Net Interest Income to Gross Income	82.60	75.90
Trade & Fx Gains (Losses) to Gross Income	5.30	7.60
B) Expenses		
Operating Expenses to Gross Income	60.90	51.00
Personnel Expenses to Operating Expenses	36.10	37.20
C) Spread		
Spread between Financing and Deposit Rate	8.80	6.90

It is apparent from the above Table that IBIs have performed better than the banking industry based on the following three indicators:

a) Net income to total assets (ROA).

b) Return on equity (ROE).

c) Net interest income to gross income.

However, income earned from trade and foreign exchange to gross income is lower. This potential needs to be tapped and the source of income needs to be expanded.

Table 14
Selected Performance Indicators: IBIs & Banking Industry
As on June 30, 2011

S. No.	Particulars	IBIs%	Industry%
1.	**Capital**		
	Capital to Total Assets	9.2	9.4
2.	**Assets Quality Ratio**		
	NPFs to Financing	7.50	15.30
	Net NPFs to Net Financing	3.20	5.50
	Provisions to NPFs	60 .00	67.90
	Net NPFs to total Capital	14.30	26.60

Part IV: Conclusion & Recommendations for Future Growth

1. Suggested Investment Portfolio Mix for IBIs

In 2010, the then Deputy Governor of State Bank of Pakistan, while presenting a keynote address in an International Conference in Lahore outlined three points strategy for the guidance of IBIs. In this respect, our suggestions for investment portfolio mix for IBIs are as under:

a) Agriculture Sector

Agriculture sector has yet to be served by IBIs and unfortunately represents largely unserved. It constitutes 22% of GDP of Pakistan. However, based on data released by SBP, IBIs financing concentration in agri-business as on June 30, 2011 was only 2.80% of their total financing as against 6.10% of banking industry, which is also very low. IBIs need to train and develop a new breed of bankers to swing into action in rural heart of Pakistan and invest in agri-business with particular emphasis to small farmers so that poverty can be reduced, agriculture output may attain a quantum jump, expand exports of agri-based products to ensure food autarky and help develop a sense of confidence on self-sufficiency on agricultural front. It may be noted that agricultural sector has four components, as stated in the following table:

Table: 15
Agricultural Components In Pakistan

S. No.	Component	%
1.	Llivstock	54
2.	Crops-major and minor	43
3.	Fish	02
4.	Forestry	01
		100

An in-depth study of above can guide the IBIs to develop a strategy to select the sub-components within the above framework. There is also a crying need to develop agro-based industries i.e. Tomato Paste, Potato Processing, Cold Storages etc. to which IBIs need to direct their efforts for financing.

b) SME Sector

It is estimated that total SMEs in Pakistan are around 3.1 million. Out of this, it is generally believed that 2300 clients are being served in terms of financing by IBIs. There is an urgent need to address SMEs sector and divert their financing to it so that employment generation takes place, industrial output increases and poverty is tackled and alleviated in the short run and eventually eliminated in the long-run.

The outreach to small towns and rural / semi-rural areas should be tapped for achieving foregoing laudable objectives.

IBIs need to develop trained manpower to address the above issues. They must accept this challenge.

c) Housing Finance

It is believed that six million housing units deficit exists in Pakistan. There is a need to develop shelter policy in Pakistan so that untapped market be exploited and IBIs may render useful service of diverting their funds to this area and thus help meet one of the basic needs of the common man. This agenda be pursued with speed so that their tangible support brings some peace of mind to common man in meet in one of their basic needs.

2. Forecast

In the next three years, 1200 branches of Islamic Banks are visualized to be opened. The hope is that IBIs will be 12% of total banking industry in due course of time.

By 2013, total of Islamic Banking industry is forecasted as over Rs. 1 trillion.

Determined efforts are needed by all of us to push forward the process of Islamic Banking in Pakistan and taper off conventional banking and water down its impact.

3. Challenges

We visualize the following future challenges:

a) **Suggestions** offered throughout this paper be given proper attention for implementation to ensure a sound foundation of IBIs in Pakistan.

b) **Differentiated Products** should be developed. Some Islamic Banks have taken correct initiatives in this respect. This area needs to be logistically well cushioned with demonstrated results.

c) Islamic Banks must show **growth with profitability**. The top management must evolve the process to translate the above challenges.

d) **15,000 people** are needed in the next five years to equip IBIs. In this respect, Universities in Pakistan must respond to this challenge. Curricula must be changed in management education. Higher Education Commission should provide lead and motivation in this respect for Universities to positively respond.

e) **Sharia compliant** financial services should be expanded. Awareness should be created in this respect and logistics be developed as cushion to achieve the above objective.

f) **The scope of services** for users may be extended to such areas as micro finance, agriculture and small & medium enterprises. This will widen the base of socio-economic development in our country and will address the two vital issues in our country namely, promotion of self employment opportunities and alleviation of poverty.

List of Terms of Islamic Finance used in the article

Ijarah

Ijarah Economic term for leasing, typically offered through Islamic banks with long-term credit facilities for capital equipment purchases. May involve purchase or an installment sale, where a customer eventually acquires ownership of the equipment. Longer-term participatory finance may also be provided by the Islamic bank becoming a partner in business, according to the principle of mudarabah (profit sharing). The bank may provide all of the funding, acting as financier, with an active manager providing entrepreneurial skills and management. Funding may be provided to either a pre-existing company or a new company. One of the most active fields of Islamic banking activity. The leasing arrangement circumvents the charging of interest, which, according to many scholars, is forbidden in Islam.
(Page-133: The Oxford Dictionary of ISLAM).

Istihsan

Istihsan Juristic preference. Refers to the principle that permits exceptions to strict and / or literal legal reasoning in favor of the public interest (maslahah). Guides decision making in cases where there are several potential outcomes. Allows jurists to abandon a strong precedent for a weaker precedent in the interests of justice. Prominent in the Hanafi school of Islamic law, but rejected by the Shafi school Demonstrates the potential for multiple interpretations of texts and analogies based on context, revealed texts, necessity, and consensus (Ijma). Particulaly favoured in cases where following qiyas (analogical reasoning) would lead to hardship for the believer, since the Quran and Sunnah instruct that hardship should be avoided or alleviated. Modified version used by modern reformers as a principle for reforming Islamic law.
(Page-152 : The Oxford Dictionary of ISLAM).

Mudarabah

Mudarabah Legal contractual arrangement under Islamic law between two partners for profit sharing – one provides capital and the other provides entrepreneurial or management skills. Islamic banks allow depositors to provide capital for borrowers to invest. Depositors may earn a share of either the bank's profit or the profit of a specified investment. If the investment or bank incurs a loss, no profit is paid to the depositors.
(Page-209: The Oxford Dictionary of ISLAM).

Murabahah

Murabahah Islamic banking principle in which a bank purchases a good on behalf of the client and later resells it to the client at a marked up price. The mark up includes the bank's costs and allows return for risk taken during the period it owns the good being traded. The bank does not take delivery of the good but has responsibility of ownership. See also Banking (Islamic).
(Page-215: The Oxford Dictionary of ISLAM).

Diminishing Musharakah

Dimishing Musharakah The generic term for business partnership or "participation financing", of which there are a variety of forms. The most popular in modern Islamic banking is inan or limited liability partnership, in which partners share agency (not suretyship), contribute their work and their capital, divide profits in accordance with their agreement, and share losses in proportion to their contributed capital. The different legal schools treat the forms variously, affording an unusual degree of maneuverability to the contracts. See also Banking (Islamic).
(Page-217: The Oxford Dictionary of ISLAM).

Quran

The book of Islamic revelation, scripture. The term means "recitation". The Quran is believed to be the word of God transmitted through the Prophet Muhammad (PBUH). The Quran proclaims God's existence and will and is the ultimate source of religious knowledge for Muslims. The Quran serves as both record and guide for the Muslim community, transcending time and space. Muslims have dedicated their best minds and talents to the exegesis and recitation of the Quran. Because the Quran is the criterion by which everything else is to be judged, all movements, whether of radical reform or of moderate change, whether originating at the center or at the periphery of the Islamic world, have grounded their programs in the Quran and used it as a support.

Revelation of the Quran to Muhammad (PBUH) began in 610 with the first five verses of surah 96. No further revelations followed for a period of up to two years, at which point Muhammad (PBUH) received reassurance that the revelation was from God, not the devil. Thereafter, revelation continued without interruption until his death in 632, at which time the Quran was considered complete. Partial collections of the Quran were made during Muhammad's (PBUH) lifetime by his wives, companions, and scribes. The final, authoritative version was completed and fixed under the direction of the third caliph, Uthman, within twenty years after Muhammad's (PBUH) death. The Quran consists of 114 surahs (chapters), varying in length from 3 to 286 ayat (verses). Surahs are arranged by length, with the latest and longest surahs at the beginning and the earliest and shortest surahs at the end. Very early commentators classified these chapters into Meccan surahs (received while Muhammad (PBUH) lived in Mecca) and Medinan surahs (received after the hijrah, when Muhammad (PBUH) and his followers moved to Medina).

The fundamental message of the Quran may be summarized in the terms tawhid, the oneness of God. Both men and women are held to be rational and ethically responsible creatures whose duty is to submit to the divine truth expressed in revelation. This act separates Islam, surrender and submission to the one God, from *kufr*, disbelief. Men and women who trust in God and live moral lives in thought, word, and deed become God's stewards, responsible for caring for the rest of God's creatures on earth. The society composed of such witnesses to the truth appears in history as the community created by Muhammad (PBUH) and his Companions in Medina in 622 – 32.

The revelation of the Quran as a book to be read emphasized the importance of literacy and the recording of scriptural text, leading to the development of the Islamic science. Hadith reports recording the words of Muhammad (PBUH) not contained in the Quran came to be regarded as authoritative for explication of the Quran. The sciences of the Arabic language, from lexicography to grammar and rhetoric, were developed in order to gain a precise and accurate understanding of the Quranic text. The need to understand the legislative content of the Quran gave rise to Islamic law and legal theory. Historiography originated with the aim of elaborating the Quranic view of religions history, according to which Adam was the first bearer of the divine message and Muhammad (PBUH) the last.

The Quran is considered to be the ultimate authority in all matters pertaining to religion. It furnishes the basic tenets of the faith, the principles of ethical behaviour, and guidance for social, political, and economic activities. It is used in the five obligatory daily prayers and for special prayers during Ramadan, when it is recited in its entirety. It is a basic vehicle of education, since most Muslim children learn the Arabic alphaber in order to be able to read the Quran. The Quran is used to invoke God's blessing, and verses from it are often recited at the death of a loved one, at the beginning of public political and social meetings, at conferences, and sometimes at government or official functions. The Quran is the focus of thythmic chanting and the art of calligraphy – the most highly developed artistic skills in Islamic Culture.

Modern Quranic exegesis emphasizes the use of classical analytical tools such as ijtihad to reform both religious practice and society as a whole and to achieve social and intellectual development. Modern exegetes use the Quran to interpret and explain itself, rather than relying on external sources. Although the Quran is considered authentic only in Arabic, scholars in the twentieth century have produced translations of the Quran into local and regional vernaculars in order to make the text available to non-Arabic – speaking audiences. These translations also provide commentary, so as to clarify the meaning of the text. Important contemporary translations of the Quran include those by the Indian modernist Abdullah Yusuf Ali in English, the Pakistani reformer Sayyid Abu al-Ala Mawdudi in Urdu, and the Indonesian scholar, poet, and independence activist Hamka in Bahasa Indonesia.
(Page-256-257: The Oxford Dictionary of ISLAM).

Riba

Riba Interest or usurious interest. Quranic verses prohibit riba, a practice that doubled a debt if the borrower defaulted and redoubled it if the borrower defaulted again. Islamic legal scholars have historically interpreted this as prohibiting any loan contract that specifies a fixed return to the lender, since it provides unearned profit to the lender and imposes an unfair obligation on the borrower. In the modern world, most Muslim countries allow the charging of moderate interest, prohibiting only usurious or compound interest, although some reformers condemn all interest as an impediment to social justice. Prohibition of interest is considered by them as critical to Islamic economic reform.
(Page-264 &266: The Oxford Dictionary of ISLAM).

Salaam

Salaam The root of the term connotes safety, but the world generally means "peace" One of the divine names of God. The most common Quranic usage is as a salutation; "al-salaam (u) alaykum (u)" (Peace Be Upon You). Also appears in Quran as "salvation", both in this world and the next. Although from an early period the salaam greeting was considered an Islamic institution, it was a greeting before Islam, corresponding to the Hebrew greeting *shalom*. In prayer, salaam is conferred upon the prophet prior to the confession of faith (al-salaamu alayka, ayyuha al-nabiyyu).

Salaam (u) Alaykum (u), al – Peace be upon you. Used by Muslims as a greeting Response is "wa-alaykum al-salaam" (Peace Be Upon You also). Hadith portray use of the greeting as a good work.
(Page-274: The Oxford Dictionary of ISLAM).

Shariah

Shariah God's eternal and immutable will for humanity, as expressed in the Quran and Muhammad's (PBUH) example (Sunnah), considered binding for all believers; ideal Islamic law. The Quran contains only about ninety verses directly and specifically addressing questions of law Islamic legal discourse refers to these verses as God's law and incorporates them into legal codes. The remainder of Islamic law is the result of jurisprudence (fiqh), human efforts to codify Islamic norms in practical terms and legislate for cases not specifically dealt with in the Quran and Sunnah. Although human-generated legislation is considered fallible and open to revision, the term shariah is sometimes applied to all Islamic legislation. This was supported by formal structures of juristic literature and many specific statements from the tenth through the nineteenth centuries. Modern scholars have challenged this claim, distinguishing between Shariah and Fiqh and calling for reform of fiqh codes in light of modern conditions. See also Renewal and Reform; Usul al-Fiqh.

Shariah Courts In premodern times, the primary judicial institution presided over by a judge, called a qadi or hakim, and empowered to adjudicate legal disputes in private (e.g. marriage, divorce, inheritance), civil (e.g., contracts and torts), and public (e.g., criminal activity) matters on the basis of the Islamic legal codes. In the earliest period, the qadi ruled in accordance with his own legal interpretations. But by the eleventh century, judicial discretion was essentially limited to choosing appropriate precedents,. In traditional shariah courts the plaintiff and defendant represent themselves, without a jury. The qadi passes judgment on all evidence in accordance with strict rules of evidence and testimony meticulously laid out in the schools of law. He retains the right, however, to impugn the integrity of any witness and to refuse to admit that witness' testimony.

The nineteenth century witnessed a number of far-reaching changes for shariah courts, as Muslim lands came under the direct rule of the European powers and the influence of European legal codes and concepts. There was concern over the hostility of Muslim jurists toward the admission of circumstantial evidence (insisting instead on the testimony of eyewitnesses), for example, and the unequal treatment of non-Muslims. Massive social, economic, demographic, and political changes in the modern era also pressured the traditional legal system. As a result, under the Ottomans and then the colonial powers, many issues were removed from the jurisdiction of the shariah courts and paced under that of special foreign tribunals, so-called mixed courts, and / or secular national courts. Shariah courts were left presiding only over cases of personal status (marriage, divorce, custody, and inheritance) and waqf (pious endowments). This trend continued in the twentieth century.
(Page-287-288: The Oxford Dictionary of ISLAM).

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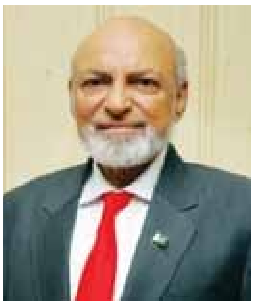

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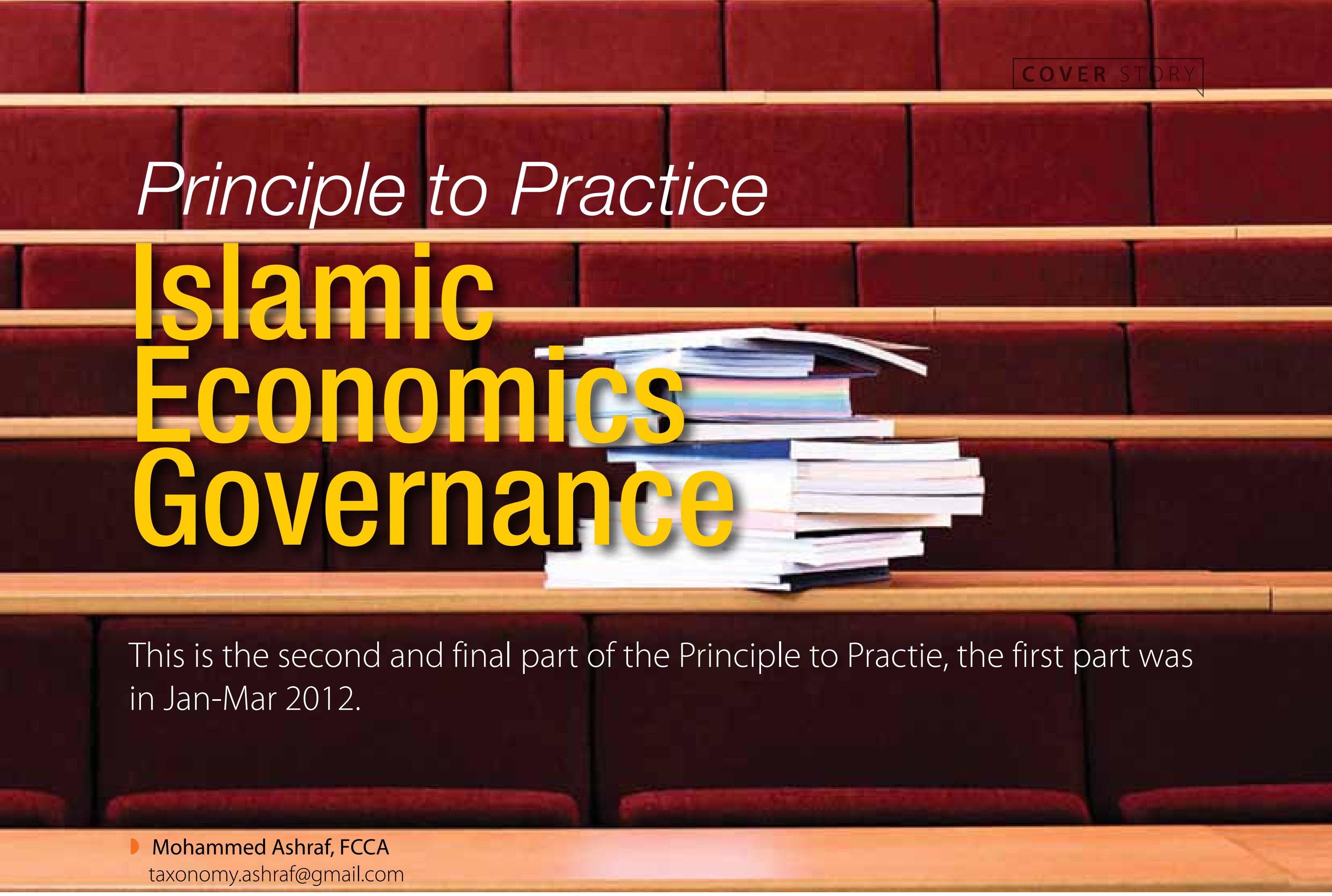

Principle to Practice

Islamic Economics Governance

This is the second and final part of the Principle to Practie, the first part was in Jan-Mar 2012.

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Allah Subhanahu Wa Taala has provided us principles not rules and the divine principles are never redundant. The principle and practice of Islamic Economic Governance rests upon the concept that Government and Social responsibility run side by side because of its roots generated from Islamic Sociology.

Islam does not only provide the economic principles but the earlier Muslim Governments since Islamic Caliphate of Rashideen has also practiced the modern concepts of Accounting, Auditing, Management, Treasury, Budgets etc that can be assembled under the umbrella term of Islamic Economic Governance. Consequently, this article is an endeavor to highlight the key aspects of modern economic governance that are derived from Islamic Economics Governance principles.

Bayt al-Mal - Treasury

Bayt al-mal is an Arabic term that is translated as "House of money" or "House of Wealth." Historically, it was a financial institution responsible for the administration of taxes in Islamic states, particularly in the early Islamic Caliphate. It served as a royal treasury for the caliphs and sultans, managing personal finances and government expenditures. Further, it administered distributions of zakah revenues for public works.

As stated earlier, Bayt al-mal was the department that dealt with the revenues and all other economical matters of the state. In the time of Hazrat Muhammad PBUH till Hazrat Abu Bakr RA, there was no permanent Bait-ul-Mal or public treasury. Abu Bakr RA earmarked a house where all money was kept on receipt. After consulting the Companions, Umar RA decided to establish the Central Treasury at Madinah.

Modern Islamic economists deem the institutional framework Bayt al-mal [Treasury] appropriate for contemporary Islamic societies and as a consequence, ministry of Finance is normally the part and parcel of every Islamic Countries' ministerial portfolio. Currently, for better governance, the treasury's two main functions are sub-divided and assigned to revenue authority being responsible for collection of taxes [FBR] while State Bank of Pakistan is responsible for Balance of Payment.

Bayt al-Mal – Treasury Accounting

Abdullah bin Arqam RA was appointed as the Treasury Officer. He was assisted by Abdur Rahman bin Awf RA and Muiqib RA. A separate Accounts Department was also set up and it was required to maintain record of all that was spent.

Currently, the accounting function is performed by respective Government Departments including revenue authorities, central bank and accountant general. PIFRA is computerizing all the records at the moment including revenue and expenditure. The accounting or recording of expenses and revenue is audited by auditor general of Pakistan. Consequently, good practices of Islamic Economic Governance are already in place.

Provincial and Federal Bayt al-Maal

Later provincial treasuries were set up in the provinces. After meeting the local expenditure the provincial treasuries were required to remit the surplus amount to the central treasury at Madinah.

Abu Huraira RA who was the Governor of Bahrain sent revenue of five hundred thousand dirhams. Umar summoned a meeting of his Consultative Assembly and sought the opinion of the Companions about the disposal of the money. Syeddana Uthman ibn Affan RA advised that the amount should be kept for future needs. Walid bin Hisham suggested that like the Byzantines separate departments of Treasury and Accounts should be set up.

The above instance closely resemble our existing situation whereby concept of provinces and federation are present in the constitution. However, after 18th amendment a major deviation has occurred whereby though provinces are empowered for revenue generation but there is no concept of repatriation of surplus. This non-repatriation concept contains two evils – non-affiliation concept with federation, no budgetary limits resulting in immense discretion ending on corruption.

Secondly, according to several Ahadees, the ownership of revenue generating land like but not limited to mines, oil and gas wells cannot be sold because they ought to be used to for the betterment of all Muslims. Consequently, this need to be kept by the federation and the interest ought not be sold on mere royalty basis. The concept is practiced in Kingdom of Saudia Arabia also.

Welfare Economic State

As stated earlier, principle and practice of Islamic Economic Governance rests upon the concept that Government and Social responsibility that run side by side because of its roots generated from Islamic Sociology. However, the Governmental responsibility is fulfilled through a welfare economic state which is the prime goal of Islamic Economic Governance. The indispensible tools of Islamic Economic Governance to achieve a welfare economic state are as follows though practiced nowadays also but without the spirit!

a. Taxes and Utilization

The taxes (including Zakat and Jizya) collected in the treasury of an Islamic government were used to provide income for the needy, including the poor, elderly, orphans, widows, and the disabled.

Umar RA also made sure that the public treasury was not wasted on "unnecessary luxuries" as he believed that "the money would be better spent if it went towards the welfare of the people rather than towards lifeless bricks."

The current purposeless taxation embodying Income, Sales, Excise and Professional tax has never been popular among the masses as they can see how the revenue is utilized. Elimination of differences would raise the trust of people in the system and introducing a judicious taxation would make it more meaningful and transparent.

Moreover, there were and are many perceptions regarding the applicability of Tax being un-Islamic as people believe that ***zakat, khiraj, fai*** and ***Jazia*** are the only prescribed taxes. However, taxes are not limited to that but one may wonder **import tax – octroi (chungi)** was first imposed during the period of first four Caliphs as this is a need of the society. The principles of taxation in Islam are based on purpose and are evident from following piece of history:

> *"At times, Syria (Sham) was attacked by Tatars, the King decided to take judicial decree from the Islamic Scholars for imposing a tax to meet the expenses. When the issue came before Imam Noovi [Rahmat ullah Alah], he opined*
>
> *The King lives a lavish life and has a lot of wealth, he also spends a lot of money but his wealth, income and perquisites are not taxable, let him start first by donating his wealth and then the treasury has the right to tax over the common people."*

I again refer to the Kingdom of Saudi Arabia model whereby Zakat is payable by GCC nationals while Income Tax is payable by other than GCC nationals. Though I am in a bit disagreement with applicability of Zakat over GCC nationals because it is against the principle laid down by Last Prophet SAW during the Last Sermon whereby no Arab is superior to non Arab and vice versa.

An effective model may make zakat applicable on all Muslims while non-Muslims would pay Income Tax. The concept is based on the decision of Umar RA who changed the name of Jazya when Christians requested him to collect it with another name. In implementing the concept, a problem would arise in corporate, partnership and other entities comprising of Muslims and Non-Muslims.

In such scenario the ratio of share holding by Muslims and Non-Muslims should be the ratio decidendi whereby the Income Tax should be payable on Non-Muslims share in business entity's profit and on the other hand, business entity's Muslims' share would eligible for payment of zakat according to the principles of Quran and Sunnah deductible from their personal zakat payable.

Other purposeful taxes should be spent on the infrastructure of their purpose. For instance, motor vehicle tax for infrastructure of transportation including roads, stamp duty for legal infrastructure, Capital Gain Tax for legal infrastructure of purchasers and sellers while Income and Value Added Tax can be used for spending on military, police, education, healthcare, welfare benefits etc.

If the development expenditure is financed by Islamic Financial Instruments then the revenue generated from judicious taxation can effectively be used for very purpose it was collected for, that is, spending money on infrastructure, military, police, education, healthcare, welfare benefits etc. This policy would effectively erode the reliance over bizarre taxation, Seignorage, fiscal deficit, sale of assets and issuing bonds.

b. Ethics for Tax Collectors

A revenue collector has received some gifts and this instance was brought into the knowledge of Last Prophet [PBUH] who immediately ordered him to deposit the same into the Bayt al- maal. When he asked for the reason, the Last Prophet [PBUH] replied that you received these gifts owing to your position if you were not on this position then you would not have received it! This is the desired mentality of the tax collectors.

Moreover, the beaurocracy Civil Services [CSS] training must embody the concept of Islamic Professionalism which is based on Taqwa. The concept of Islamic Professionalism has already been implemented in Governmental Organizations and surprisingly the private organizations are voluntarily adopting it.

c. Food Stockpile

According to the Islamic jurist Al-Ghazali (1058–1111), the government was also expected to stockpile food supplies in every region in case a disaster or famine occurred. Umar RA introduced further reforms, such as the introduction of food rationing using coupons, which were given to those in needs and could be exchanged for wheat and flour.

On the other hand, we used the concept of ration to cope up shortages, that is, a family's ration card was used to sell wheat and flour instead of a means to identify and provide the ration to poor and needy.

d. Armed Forces Salaries

With the extension in conquests money came in larger quantities, Umar RA also allowed salaries to men fighting in the army.

e. Elimination of Class Distinction

In his time, equality was extended to all citizens, even to the caliph himself, as Umar RA believed that "no one, no matter how important, should live in a way that would distinguish him from the rest of the people." Umar RA himself lived "a simple life and detached himself from any of the worldly luxuries," like how he often wore "worn-out shoes and was usually clad in patched-up garments," or how he would sleep "on the bare floor of the mosque."

Limitations on wealth were also set for governors and officials, who would often be "dismissed if they showed any outward signs of pride or wealth which might distinguish them from the people." This was an early attempt at erasing "class distinctions".

Umar RA also made sure that the public treasury was not wasted on "unnecessary luxuries" as he believed that "the money would be better spent if it went towards the welfare of the people rather than towards lifeless bricks."

The huge president, prime minister, chief minister and governor houses are currently signs of class distinction where some of the even middle class people come and forget their past. Those who are sitting in such huge castles and moves with an army in the name of protocol cannot implement the concept of Islamic Economic Governance as the concept requires free movement among masses except one of the senior minister of KP – Siraj Ul Haq having affiliation with Jamat e Islami.

f. Social Security and Pension

During the Khilafat e Rashida, various welfare programs were introduced by Caliph Umar RA. Umar's innovative welfare reforms during the Khilafat e Rashida included the introduction of **social security**. This included unemployment insurance, which did not appear in the Western world until the 19th century.

In the Khilafat e Rashida, whenever citizens were injured or lost their ability to work, it became the state's responsibility to make sure that their minimum needs were met, with the unemployed and their families receiving an allowance from the public treasury.

Retirement pensions were provided to elderly people, who had retired and could "count on receiving a stipend from the public treasury." The caliphs Al-Walid II and Umar ibn Abdul-Aziz RA supplied money and clothes to the blind and crippled, as well as servants for the latter.

This continued with the Abbasid caliph Al-Mahdi. Tahir ibn Husayn, governor of the Khurasan province of the Abbasid Caliphate, states in a letter to his son that pensions from the treasury should be provided to the blind, to look after the poor and destitute in general, to make sure not to overlook victims of oppression who are unable to complain and are ignorant of how to claim their rights, and that pensions should be assigned to victims of calamities and the widows and orphans they leave behind. The "ideal city" described by the Islamic philosophers, Al-Farabi and Avicenna, also assigns funds to the disabled.

The concept of Employees' Social Security, Employees Old Age Benefit etc is present in our existing governance concept but the difference arises in its applicability and utilization of funds. The laws need to be aligned with concept in preceding paragraphs. Moreover, the private hospitals should subsidize the rates to registered persons. This would have many benefits as the revenue of such private hospitals including the rates would be surfaced that can also be used for tax collection point of view.

g. Poverty Measurement Threshold

Another innovative concept that was introduced was that of a poverty threshold, with efforts made to ensure a minimum standard of living, making sure that no citizen across the empire would suffer from hunger. In order to determine the poverty line, Umar ordered an experiment to test how many seers of flour would be required to feed a person for a month. He found that 25 seers of flour could feed 30 people, and so he concluded that 50 seers of flour would be sufficient to feed a person for a month. As a result, he ordered that the poor each receive a food ration of fifty seers of flour per month.

Nowadays, statistics department collects the data and State Bank of Pakistan computes the Sensitive and Consumer Price Index but do not suggest measures prerequisite for Islamic Economic Governance. Mere collection of data would not serve any purpose unless and until the data is utilized.

h. Poverty Alleviation Measures

Further reforms later took place under the Umayyad Caliphate. Registered soldiers who were disabled in service received an invalidity pension, while similar provisions were made for the disabled and poor in general. Caliph Al-Walid assigned payments and services to the needy, which included money for the poor, guides for the blind, and servants for the crippled, and pensions for all disabled people so that they would never need to beg.

We have blind's association and we normally spends millions on advertisements of eradicating polio but do we use the data of blinds for helping them or do we provide polio affected persons any citizens and Islamic Economic Governance duly contains this concept which is absent presently.

i. Anti Poverty Avoidance Measures

In addition, the poor and disabled were guaranteed cash stipends. However, in order to avoid some citizens taking advantage of government services, "begging and laziness were not tolerated" and "those who received government benefits were expected to be contributing members in the community."

Currently, the people who are getting unemployment allowances sit at home enjoy their laziness and beg from others. The Islamic Economic Governance model does not tolerate this attitude and obliges such persons to serve for the community and implementers must devise a plan according to the capabilities of persons.

j. Orphanage

Babies who were abandoned were also taken care of, with one hundred dirhams spent annually on each orphan's development.

k. Waqf or Charitable Trust

Umar RA also introduced the concept of public trusteeship and public ownership when he implemented the Waqf, or charitable trust, system, which transferred "wealth from the individual or the few to a social collective ownership," in order to provide "services to the community at large." For example, Umar RA, brought land from the Banu Harithah and converted it into a charitable trust, which meant that "profit and produce from the land went towards benefiting the poor, slaves, and travelers."

When communities were striken by famine, rulers would often support them though measures such as the remission of taxes, importation of food, and charitable payments, ensuring that everyone had enough to eat. However, private charity through the Waqf trust institution often played a greater role in the alleviation of famines than government measures did. From the 9th century, funds from the treasury were also used towards the Waqf (charitable trusts) for the purpose of building and supporting public institutions, often Madrassah educational institutions and Bimaristan hospitals.

l. Treatment of conquered peoples

Caliph Umar was the first Caliph to provide Allowance to non-Muslims, or Dhimmi, after they reached old age. The very first Non-Muslim to receive pension from the Rashidun Administration was a Jew.

Once Caliph Umar RA was in the streets of Madina when he saw a man begging! He went to him and asked him; "why are you begging? Are you not receiving maintenance (allowance) from Bait al-mal". The man replied; "I am a Jew and I am doing this so that I can pay the Jizya". Hearing this Caliph Omar took him by his hand to the Bayt al-mal and decreed "In the name of Allah you pay Jizya all your life and then you get betrayed when you reach old age." He ordered to provide that man pension and from that day it was so ordered for all Jews and Christians and others.

It is evident that the concept of Islamic Economics Governance could create an economic welfare society that can only be implemented by the ruler having fear of Allah SWT. The other prime concepts of Islamic Economics Governance are discussed below.

Price Setting and Subsidies

Narrated Ibn e Abbas [RA], Allah's Messenger [PBUH] said, "Do not go to meet the caravans on the way (for buying their goods without letting them know the market price), a town dweller should not sell the goods on behalf of the latter." Ibn Abbas was asked, "what does he mean by no selling the goods of a desert dweller by a town dweller?" He said, "He should not become his broker."
[3:367-O.B – Bukhari – The book of sales (bargain)]

The policy would create open competition among the new entrants and let the market forces determine the prices. Such healthy competition would eliminate the concept of subsidy. The policy of open competition should be adopted in all those areas where prices are regulated and consumers are subsidized.

Narrated Ibn Umer [RA], Allah's Messenger [PBUH] said, "you should not try to cancel the purchases of one another (to get a benefit thereof), and do not go ahead to meet caravans (for buying the goods) [but wait] till it reaches the market." [3:374 - O.B – Bukhari – The book of sales (bargain)].

For instance, if we take the example of IPPs, then the root cause was the initial contract of Government in 90s agreeing over the basic price of purchase of electricity. Moreover, the current practice of purchasing the wheat and cotton at preset prices from farmer is a mere eye illusion.

Islamic Economic Governance would only require purchasing from small farmers who have no access to market or are helpless but that is also neither at preset prices nor for further sale.

a. Price Stability and Cost Audit

Price stability is chronic issue which wasn't always tackled at the grass root level. Regulators never looked at the pros and cons of the issue, hence, it was never dealt at strategic level. Islamic Economics suggests the concept of fair profit.

The fairness in the concept of fair profit is left at the discretion of the businesses that are expected to act fairly in this regard. However, industry's profit and general profit level could be used as benchmark in this regard. It is in accordance with the principles of shariah that the traditions and convention of each community are to be referred to for deducing a judgment in such matters as sales, renting, measuring and weighing where there is no fixed judgment.

Further, many writers suggest the elimination of the concept of deduction of Royalty, Technical and Management Fee by declaring it an inadmissible expense under the Income Tax Ordinance, 2001.

Consequently, one wonders about the dormant concept of cost audit embodied in Companies' law. The concept of cost audit may be implemented fully fledged being a deterrent to unfair prices. At the moment there are fair number of professionals of accounting bodies [ICAP, ACCA and ICMAP] are available to effectively help the government in implementing the same.

b. Price Stability and Future Trading

Looking at west, creative accounting, off balance sheet transactions, complex financial derivatives and future trading are the root causes of price instability which result in erosion of prices, that is, inflation. These issues are creeping and are against the constitution principles of Quran and Sunnah.

It is pertinent to note that *al gharar* (the sale of what is not present) and *Habal il Habala* (the sale of what is in the womb of an animal) is prohibited. Narrated Abdullah bin Umer [RA], Allah's Messenger [PBUH] forbade the sale called Habal il Habala which is a kind of sale practiced in the Pre-Islamic Period of Ignorance. One would pay the price of she-camel which was not born yet and would be born by the immediate offspring of an extant she-camel. [3:353 - O.B – Bukhari – The book of sales (bargain)]

It is worthwhile to note that if somebody sells fruits before their benefit is evident and free from blights and then they get afflicted with some defects (they will be given back to seller). Narrated Anas bin Malik [RA], Allah's Messenger [PBUH] forbade the sale of fruits till they are almost ripe. He was asked what is meant by 'are almost ripe'. He replied, "till they become red", Allah's Messenger further said, "If Allah spoiled the fruits, what right would one have to take the money of one's brother (i.e. other people)?" [3:403 - O.B – Bukhari – The book of sales (bargain)]

It is strongly suggested that future markets and badla in stock exchange are strictly prohibited in Islam and will deteriorate the result of any efforts for price stability. The core reason is that it is normally done in raw materials through speculation meant to mint money from money.

Distribution not Concentration of Wealth

Excess capacity of an economy means that insufficient demand exists to warrant expansion of output while interest based economy bondholders view strong capacity utilization as a leading indicator of higher inflation which decreases bond prices. Consequently, tight monetary policies shrink the size of economy by reducing the level of economic activities.

Apart from above, the crowding out effect can only be extinguished through the effective implementation of Islamic Economics. Islamic economics, in contrast, advocates for generation of economic activities instead of limiting the same. This concept can easily be deduced from the concepts of Islamic Financial Instruments and conceptual framework of zakat and sadqa. This concept is duly adopted by Multinational Companies (MNCs) through expansion as many industries in the developed capitalist economies suffer from *chronic* excess capacity.

The critics of capitalism are in favor of very principles enunciated in Islamic Economics. However, the generation of economic activity should be aligned with development expenditure (instead of non development expenditure) and Islamic Financial Instruments.

Islamic Financial Instruments for Development Expenditure

The alternate of auction of treasury bills and bond market is Islamic Financial Instruments. Development expenditures in developing or even developed economies are normally identified on the basis of its potential benefits which are then transformed in the shape of feasibility report. In the light of principles of Shariah, such development expenditures ought to be carried either on the basis of "Build, Operate and Transfer" or "Islamic Financial Instruments".

The most important aspect of BOT basis is an independent check over collection on the project of development project and audit by external professionals for the very purpose of transparency. The payment to the contractor on the basis of Islamic Finance ought to be correlated with rate of return on such development expenditure. Each project of development expenditure ought to be audited by external professionals. External professionals may include members of ICAP, ACCA and ICMAP.

This approach will have many folds like transparency in development expenditure, generation of economic activities, limiting non-development expenditure to the extent of tax revenue, reducing the pressure of financing on the development expenditure and elimination of fiscal deficit or reliance over treasury bills and increase in employment.

International Loans and Interest

During the Last Sermon of Holy Prophet SAW, he made it clear that interest is no more payable among Muslims and is evident from his declaration about Abbass RA. However, co-relating the various verses of Holy Quran and Ahadees, it is strictly forbidden.

It is suggested that no more international loans should be taken on interest, hence, whatever has been taken should be the ending line for the start of a new era. Consequently, existing commitments of repayment of loan and interest thereon should be fulfilled.

Foreign Currency Reserve/Gold Standard and Barter

Austrian economists advocate the return to genuine free market leading to abolition of the state-sponsored central bank that protects, supports and controls modern fractional reserve banking and advocate free banking or a return to a 100 percent gold standard which is practiced in Islamic Economic Governance.

In fact the recent statement of IMF is more surprising. Dominique Struass-Kahn, the ex-head of IMF suggested that the organization one day might be called upon to provide countries with a global reserve currency that would serve as an alternative to the US dollar. "That day has not yet come, but I think it is intellectually healthy to explore these kinds of idea now." He said having other alternatives to dollar "would limit the extent to which the international monetary system as a whole depends on the policies and conditions of single, albeit dominant, country.

Moreover, he said that we must build on this positive momentum: to reform the fund into an institution even better equipped to meet the challenges of the post crises era. Consequently, it is high time for strategic thinker to look at the pros and cons of the statement of ex-IMF chief in terms of foreign currency reserves.

Islamic Banking and Takaful

Islamic Banking and Takaful industry has developed with the passage of time. Shariah Advisory Boards are already in place at Bank and State Bank Level. However, there is a dire need that conflict of interest need to be avoided. The person appointed on State Bank of Pakistan Shariah Board should not be a member of shariah board of a Bank.

This would encourage the concept of Shariah Compliant Financial Product Audit at SBP. Further, on test basis the audit report be further vetted internationally by IDB etc. The Takaful regulatory framework needs to be aligned by SECP with the concept of shariah board of SBP.

Conclusion

The implementation of Islamic Economic Governance is not much difficult as most of the postulates are already in place but it is the zeal and fervor that is requisite. The solution of our economic problems is available in Islamic Economics prima facie Ahadees of Bukhari quoted above that provides a clear cut solution. On the other hand, the monetary and fiscal economists even do not agree on any remedial measure for inflation and ending recession. It is much more than adjusting interest and exchange rates apart from adjusting Government Expenditure and increasing tax to GDP ratio.

Tax Laws in the Islamic Republic Favour Rent Seekers and Interest Earners

Nasim Beg, FCA

Our taxation system is a continuation of an archaic system where the feudal landlords, on behalf of the rulers, collected taxes from the people. The rulers exempted the landlords from paying tax.

There is on-going debate on the unfair system of exempting the feudal landlord's agricultural income. But this is only one part of the issue – the landlord earns agriculture income and invests his surplus in property. In turn he earns rent on the property and pays a reduced rate of tax of a maximum of 10% not the normal rate of 25%. The other option he has is to earn interest on bank deposits or National Savings Schemes; here too, his interest income (called 'profit' so as not to prick his religious conscience) is taxed at a maximum rate of 10%.

On the other hand, if you wish to indulge in entrepreneurial activity and invest your money in a business, you will be taxed at a much higher rate for being a profit seeking businessman. If you set up a company to run your business, the company will pay a tax rate of 35%. If the company has enough left over after paying taxes and distributes a dividend to the investor, he will pay another 10% tax on the dividend out of the already taxed (at 35%) income. There is further discrimination, if the corporate entity retains some earnings for future expansion and keeps this money on deposit, it will pay 35% tax on the interest earned but if it were to forgo expansion and pay out the surplus, the individual shareholder can keep the money on deposit and pay only 10% on the interest thereon.

Thus it is better to earn rent and interest and not risk your money in setting up a business, which will face various risks, including being cut off from gas and electricity, not because you didn't pay your bills but because someone else (probably a rent seeker) doesn't. Never mind if your entrepreneurial indulgence creates jobs and generates economic activity or perhaps earns foreign exchange. The system favours the rent seeker and the interest earner. Just sit home and earn your money, why take any risks or worry about paying back business loans lest you get hauled up in courts and are declared a defaulter and earn a bad name.

The tax law was not this skewed when we started out 65 years ago; we had inherited a tax law from British India whereby it distinguished between "Earned Income" e.g. salary, business income etc., and "Un-earned Income" such as interest and rent; the then tax law taxed un-earned income at a higher rate but somewhere down the line we, in our Islamic Republic, have started favouring rent seeking and interest earning.

Encouraging Leveraging

There is a further issue; like most other countries, our taxation system encourages high levels of leverage. The economic crisis that the world is facing today has been caused by excessive use of leverage. Given below is an example of how the taxation system favours leveraging:

The numbers used are just assumed figures and are intended to highlight the issue. The assumptions include that the businessman can provide 100% equity or a combination of equity and loan. The interest rate is assumed at 12%, the corporate tax rate at 35% and a total tax rate of 10% on dividend and interest income.

Particulars	Business based on pure equity (Rs. 000)	Business based on some equity and loans (Rs.000)
Capital Employed		
Equity	50,000	15,000
Loan	-	35,000
Total	50,000	50,000
Earnings before interest and tax	7,500	7,500
Interest	-	4,200
Taxable profit	7,500	3,300
Corporate tax	2,625	1,155
Distributable profit	4,875	2,145
Dividend	4,875	2,145
Tax on dividend	488	215
Tax paid on Interest (say a TFC)		420
Total tax collected by the exchequer	3,113	1,790
Net-of-tax earnings on equity investment	4,387	1,930
Return on equity	8.78%	12.87%

Thus a businessman is better off borrowing money - his return on equity is higher. Because of the tax arbitrage available, the businessman can actually lend money to his company by investing in corporate bonds issued by his company. The government effectively subsidises you if you borrow money and do business.

We need to address these very fundamental issues if we are to encourage investment in economic activity that will bring growth and create jobs. Even though the tax system encourages businessmen to borrow, it does not quite compensate for the flow of savings towards rent seeking and interest earning avenues – most of the money attracted by interest paying schemes ends up in funding budgetary deficits, i.e. wasteful spending; or money gets attracted to real estate and drives its prices beyond the reach of the common man. The tax arbitrage in favour of running a business on borrowed money is tilted in favour of big businesses, SMEs do not normally have access to borrowing money from the formal sector; thus they cannot claim interest expenses in case they pay this to loan sharks. In any event their return on equity will be lower than those who can borrow from the formal sector.

Non-Profit Making Organizations

Tax Heavens or Tax Evasion

Zeeshan Aslam
FCA, FCCA (UK), CIA(USA)

STOP giving more tax burden and INCREASING tax rates on the existing tax payers instead improve legislature and close down tax heavens, put more controls through effective statutory provisions and tax regulations.

One of the most risky and tricky area, as far as tax avoidance is concerned, is non-profit making organization including NGOs, Trusts and Societies and there are very minimal statutory requirements, also tax controls are effectively not in place and those that exist are not implemented.

These non-profit organizations are established with a purpose to serve the community and country in different areas including medical, education, health etc. We acknowledge that such organizations are really a great help for society, community and Government. However, there are many such other organizations, which are established under the banner of non-profit making organizations to take the advantage of flexibility in the existing laws available for these organizations and therefore it is a matter of grave concern.

Due to and in the absence of effective laws and regulations, these non-profit making companies are engaged in creating black money through money laundering, also for sponsoring terrorists and foreign agents in our country. Additionally, various branch offices are established for few Foreign Institutes, Universities and Colleges in Pakistan as non-profit making companies under the companies Ordinance, 1984 and therefore they are enjoying tax exemptions due to the stupidity of FBR, SECP and effectively it is a tax fraud with our country.

There is an increasing trend due to which many commercial organizations including colleges, universities, hospitals, health Universities etc are registered and in few instances after many years of commercial operations these companies are converted into trust, societies and non-profit making organizations in order to avoid tax. These companies establish their board of trustees including all their family members as board trustees so that their wealth in the hands of their family members and by doing so they avoid tax.

Additionally, by doing so these companies get tax exemptions for themselves and there is no statutory audit requirement nor there is any other law in place to control their activities. Also, in few instances such companies also get exemptions for the people donating to them to claim tax credits in their tax returns and therefore another way to money laundering.

Suggested Remedial Measures

1. There should mandatory, statutory audit requirements for all Non-Profit Making Organizations including Trust, Societies, companies or any other such establishments registered under any other law;
2. There should be special audits conducted under the relevant law and the Auditor should be appointed by the Regular with a special scope regarding money laundering, terrorist or financing for unlawful activities, tax evasion and money was spent as mentioned in the objective.
3. Tax authorities should conduct a thorough annual audit of these companies in order to ensure that there isn't tax evasion.
4. Corporate Governance structure should be proposed and non-executive directors, from tax authorities and SECP, should be appointed on their board to ensure monitoring.
5. They should be mandatory file annual tax return and with detailed financial statements although they may be given tax exemption or guidance but some scrutiny of their records should be conducted.
6. Increased monitoring of accounts from State Bank of Pakistan on these non-profit organizations.
7. The Institute of Chartered Accounts of Pakistan should also establish ethical requirements for audit firms regarding whistle blowing duty to disclose any such event or matter that comes to their knowledge during the audit and in case of their negligence they should be penalized.

Navigating risk & regulation in support of the real economy

Speech by Douglas Flint, Group Chairman, HSBC Holdings plc

Association of Corporate Treasurers Annual Conference, Liverpool 17 April 2012

It is a great pleasure to have the opportunity to make a few remarks in the early stages of one of the most interesting and definitely challenging years of recent times, with many of the issues that absorbed our attention last year still very much alive in 2012 and whetting our appetite as to what is to come.

I have always understood risk to be defined with reference to a range of possible outcomes and risk management as steps taken to reduce or eliminate the adverse and tail outcomes so far as possible. The unhedgeable risk is the most dangerous risk and often derives from being unable to quantify the full range of outcomes because of uncertainty. There is no question that the world has become a much more uncertain place to do business. On top of the aftermath of major events such as the geopolitical and natural disaster upheavals of the last year and the numerous elections and leadership transitions which we'll see this year, the financial world is undergoing a once in a lifetime transformation.

For corporate treasurers this new risk environment makes fundamental questions of how to hedge against business and economic risks, when and how to raise funds, and what cash to hold and where to hold it, significantly more complex.

Adding to the complexity is the reform of the monetary and financial system, its regulation and supervision – and for corporate treasurers, as customers of the regulated sector, your interests stand to be hugely affected by this debate and should be paramount in the minds of policymakers.

Our focus throughout the ongoing programme of regulatory change is to assess the impact on our customers; the people who use and rely on the financial system – and particularly those in the wealth creating parts of the economy. Any good outcome has to strike the right balance between preventing further crises and supporting the real economy. Without a clear eye on what role we want the financial system to perform in aggregate, unintended consequences will emerge, and endusers will be the ones who pay the price.

So I want to cover three themes today:

1. The shape of regulatory debate in the financial sector and why it matters to all of us
2. How these reforms impact on the real economy
3. How we can best avoid unintended consequences for the corporate sector

Background

- I don't apologise for spending most of my allotted time on the regulatory scene – it's where I spend my time and the consequences of the decisions made are perhaps the greatest influence on the shape of the financial industry and its ability to support the real economy.
- The economic challenges being faced today are immense, the solutions are neither obvious nor without risk.
- Without doubt decisions taken by this generation of economic, financial and political leaders will have consequences for many years to come.
- Perhaps we should sympathise with those who have the responsibility to make judgments today on how to move on from the worst financial and economic downturn since the 1930s – this time in a demographically ageing world – and one which is exhibiting lower than expected growth rates.
- On top of this, with interest rates in the developed world at record lows and with fiscal flexibility as commonly understood all but exhausted the armoury to address the challenges is limited.

The major anxieties are evident; the ability and timetable in which to confront them less so – the European sovereign debt crisis and its impact on the Euro; the constrained fiscal positions and recurring budget deficits in many developed countries; the ticking healthcare and pensions time bombs as populations age; the balance between austerity and stimulus; the challenge of addressing growing inequalities within and between generations – all require decisive action – leadership – to re-establish confidence in the future.

That word – confidence – is important, as it is worth observing in passing that there is no model, no proven recipe to recover or improve confidence – which is essential to economic recovery – and without confidence in the future there is no investment, no one willing to borrow, and you will have your own views whether our leaders today – whether political, financial or business – inspire confidence about the future through their words and actions.

And inevitably many of the necessary actions to establish confidence about the future are unpopular. Austerity programmes have – understandably – limited popular support so it takes political courage and leadership to get them through.

And we have to recognise that political support is dependent inter alia on a belief that lessons have been learned from recent crisis and that the financial system is aligned with the real economy it serves.

Hence there is an implicit focus to concentrate the benefits of regulatory reform on domestic operations – in reality a form of protectionism – for example:

- higher capital ratios lead to home bias in branch based organisations – the risk to treasurers is that funding availability from foreign branches will likely be at risk if the domestic operations are troubled or capital requirements are raised;
- cross border flows get constrained by regulatory attention, e.g. US mutual funds' short term funding of EU banks was severely cut back once regulators started asking for regular reports of exposure – and this impacted capacity to fund EU importers and exporters – understanding how your banks fund themselves is something you will need to spend more time on in the future.
- structural reforms that prefer certain sectors over others – e.g. ring fencing – will this require you to have more counterparties, enter into fresh CSAs, re-assess counterparty strengths?

The political/regulatory interaction seems currently to have got into a world of 'line of least regret' – in large part because there is no way of gauging our proximity to the next crisis. Hindsight allows self deception on both sides – we convince ourselves we really knew what caused the problem so that we can justify actions to avoid repetition or justify no actions because lessons have been learned. We fuel that self deception by selectively pointing to events that fit easily to our view of the world. We justify our respective positions by exaggerating the downside –'ok we may have gone too far but far better to overestimate the risk than underestimate it' and on the other hand 'the actions proposed will seriously damage the real economy'.

Two possible futures that neither side can contemplate:

- Why did you do nothing to prevent another crisis?
- Why did you turn the system upside down at huge cost to address an event that did not occur or was less damaging than predicted?

For example:

- Y2K
- Repeat of 9/11
- Climate change/global warming
- Nuclear proliferation
- The next financial crisis

All this having been said, we welcome the steps being taken by the official sector to improve the financial stability and resilience of the industry. They are necessary. But we must focus on what we want the wider financial system and the banks in particular to do – while recognising that the rehabilitation of the industry in terms of public trust and confidence can only be earned by **demonstrating** both that lessons have been learned and that social contribution trumps self interest.

So how well have we done?

Balancing the competing priorities of all the various constituencies to deliver a workable solution – without unintended consequences – has been one of the greatest challenges the industry and its regulators have faced and one where strains are now beginning to show as policy design moves towards practical implementation. Creating a robust, resilient and sustainable platform across which you – our clients – can manage your funding and your risks is essential to economic prosperity.

So what has been achieved?

- We have done a great deal to better calibrate risk, build loss absorption and liquidity and thereby improve the capacity of individual institutions to handle risk.
- We have made progress in defining how systemic risk might be better identified and how through macro-prudential tools that identification could cause the supervisory framework to recalibrate credit supply – but it is very early days in terms of putting this into practice.
- We have done a great deal to discourage that which we don't want to recur – but have done less to define what we want the system to look like once we are finished with reform.

- We are better able to calibrate the consequences of systemic collapse but no more able than before to predict when and for what reason the next crisis will occur.
- Partly as a consequence of being unable to predict the next crisis, we have identified the critical importance of effective cross border resolution – but have made little progress in getting the political buy-in to reforming and conforming national insolvency regimes to facilitate such resolution.
- We are in continuous debate around what is regarded as 'prudent precaution' on one side of the table versus 'unintended consequences' on the other, with both sides prone to exaggerate the risks to the downside – 'better to be safe than sorry'.

But if this sounds a bit grudging it is true to say that a lot was delivered in 2011 – building a framework for the industry in the future which will bring enormous benefits if successful - namely – greater financial stability, alignment of the financial system with economic growth objectives, more sustainable allocation of credit to the real economy, better alignment of investor and market participant rewards, market infrastructure improvements, enhanced competition, greater transparency, more effective supervision and greater linkages between micro and macro prudential supervision – to name but some.

So as we move into 2012, the epicentre of the debate has changed – no longer a debate about whether something should be done – but now about managing transition, timescales for implementation and avoiding unintended consequences.

But just like in so many areas of life today there is a real need for leadership to call the point at which we have to stop adding to the reform agenda and observe whether the aggregate of all that has been done has been sufficient to change behaviour so that the system in aggregate is fit for a purpose that is universally understood and accepted.

I make this point because as one stands back and looks at the enormity of what has already been done and what is still being attempted – a number of issues stand out.

- Are there gaps in coverage? Shadow banking?
- Is the aggregate of all the measures both complete and in train duplicative or reinforcing?
- Is there coherence between banking, insurance, pension fund and asset management regulation?
- Does the understandable focus of national fiscal authorities towards limiting their contingent risk to domestic deposit bases risk unwinding many of the elements of globalisation of economic activity?
- If a consequence is to unwind globalisation to some degree and establish a 'home market' bias - does this impact the availability and cost of financial services delivered to multinational groups? Does this change the competitive landscape between companies domiciled in Europe versus the US versus Asia? Does this matter?
- Does the public policy concern over SIFIs create a greater probability of stability because of higher capital requirements and supervision or does it further concentrate activity into these institutions because of their elevated status; we argued the latter and evidence so far suggests we are right.
- Is there too much focus on products, platforms, infrastructure, capital and liquidity because they can be defined and measured as opposed to focussing on behaviour which is much more difficult to pin down objectively.

Given that the hard wired rules are simply means to an end of getting the system to look and behave as we want it to, the current debate often hinges on hard to prove assertions around what would happen if we took a different policy course or exactly how we want people in the system to behave or indeed what the system should look like if it is to be optimally structured.

This understandably reflects how difficult it is for the official sector to really get to grips with management intentions, character and behaviour. To the hawks, banks are simply self serving whereas we bankers believe we are misunderstood.

But what is certain is that if we perpetuate a feeling of distrust and hostility we will exaggerate the downside risks to justify our respective positions and by preparing for the worst we may well ensure it occurs; and from your perspective we will increase costs unnecessarily.

And yet the challenge to deliver reform that meets all the expectations now built up will bring enormous benefits if successful.

But we have to be careful not to promise too much:

- One of the main contributors to the situation we now face was promising more than could be delivered – whether it was economic growth without productivity, credit growth beyond our ability to identify misallocation, a step on the housing ladder without any down-payment, higher returns without higher risk or growing social benefit, retirement and healthcare programs without commensurate and sustainable fiscal support.
- Secondly – there are clear inconsistencies in the multiple policy objectives now mandated:
    1. we want stability as well as growth, we promote economic growth as well as fiscal austerity;
    2. we want banks to lend more and also grow capital both in absolute and ratio terms;
    3. we want the banking system to raise more

capital privately while restricting its activities and restraining dividends;

4. we want to see more competition in financial services but we don't want to see the higher returns that would attract external private capital;
5. We want to add more capital, insert more buffers, mandate changes in collateral requirements, change settlement architecture and organisational design but we haven't got an impact study that informs how such changes will change demand or pricing;
6. we want to see fewer interdependencies without losing the benefits of scale;
7. we continue to incent the banking system to lend ever more to governments and then seek to stress test what happens if the same governments don't/can't pay;
8. we want the system to respect market signals but then we don't like what ratings agencies say;
9. we want to use more market based pricing in OTC derivatives but we don't really understand if credit default swaps are fit for this purpose;
10. we want greater transparency but fret about how immediately markets respond to events not yet understood at a policy level; and finally;

- Thirdly, what is good and rational for the few may be disastrous for the many – deleveraging an over-extended institution or country works when there are those able to take up the slack but doesn't if everyone does it at once, risk-off is fine if it is to bring an outlier back to normality or to adjust risk preference in a single portfolio but is hugely pro-cyclical and destructive if everyone does it at the same time.

It is also worth reflecting on some of the things we learned last year and some of the unintended consequences we now recognise:

- We learned there is no such thing as a risk free asset
- We learned that models failed us in the last crisis but we still believe we can build better models
- We learned that economies where investors hold most of the domestic assets are more resilient
- We wanted greater competition in financial services – that led to multiple trading platforms and greater use of technology so that markets have become ever more correlated – which has led to greater buffers as natural diversification is lower
- We admired interconnectedness when it facilitated the risk sharing that reduced the probability of a systemic crisis; we loathed the interconnectedness that spread the crisis when it did occur beyond our ability to contain it
- We learned that market signals can equally reflect competitive advantage, or mispriced risk, or information asymmetry or maybe all three and given we won't know till afterwards we should exercise caution on relying on such signals
- We learned about co-dependencies – stable banking systems depend on strong sovereigns and strong sovereigns depend on strong banks – and in times of stress financial systems will force 'home bias' to protect domestic depositors and national fiscs
- We promoted growth in trade, we delighted in the disinflationary benefits from accessing lower cost goods but couldn't get to grips with the growing and persistent current account imbalances
- We wanted greater transparency – that, leveraged by technology, has facilitated the high speed trading that accounts for 75% plus of trading across markets today – accentuating trends ahead of possible policy responses
- We encouraged people to reduce their indebtedness but not stop spending
- We saw why it was necessary to warn people of the dire consequences of not taking hard decisions in order to build political support for these actions but that made it difficult at the same time to encourage businesses to invest for the future
- We can see that we have to plan for a less connected world in the future in financial terms – less cross border funding, less foreign currency funding

And as we plan for the future the list of outstanding issues remains significant. The most relevant to you include:

- the capacity of the G20 / FSB to deliver a level playing field for banks and the scope within that for national solutions; this will clearly have an impact on how and where activities are performed and their cost
- addressing cross border resolution protocols – how will this impact established creditor hierarchies and established rights of set-off?
- the governance and operation of central counterparties – who have to post collateral – are there competitive challenges if some are exempt?
- the prospective role of clearing systems and exchanges – again will we see fragmentation or concentration of exposures and settlement accounts
- the calibration of the proposed new liquidity framework – clearly will have an impact on credit pricing and the liquidity of securities held for cash management

- what liabilities within banks – i.e. your deposits - are potentially subject to bail-in will no doubt influence where you place your cash balances
- the harmonisation and peer review of the calculation of the risk weights that drive capital requirements – again level playing field issues
- a re-assessment of the risk free treatment of sovereign debt – will this reprice the risk curve?
- Oh and on top of this – for all of us – the accounting rules on impairment measurement, hedging, securities valuation as well as further international harmonisation are all under review.

And on top of this the FPC is beginning to articulate how it wishes to exercise its statutory powers to direct and recommend:

- Direction to encompass the countercyclical capital buffer, sectoral capital requirements and the leverage ratio;
- And possibly also a time varying liquidity tool, the terms of margin and collateral requirements, disclosure requirements and Loan-to-Value and Loan-to–Income constraints.

I see this as a significant new risk for you all to get to understand as a change in sectoral capital requirements or commentary around emerging risks could easily materially impact access to credit and its pricing – think about the recent impact of the US authorities seeking information on US money market funds' exposure to Euro zone borrowers.

So the landscape remains massively uncertain both as to when the period of reform will come to a close and what the landscape for the capitalisation, shape and returns of the banking industry might be.

The potential implications for corporate treasurers are many. For example:

- The ability to obtain foreign currency and interest rate pricing through the use of over the- counter derivatives has become a cornerstone of modern financial management.
- Under the EU's draft proposals to implement Basel 3, OTC derivatives would attract high and potentially volatile capital charges, mainly through the so-called credit valuation adjustment charge. One of our principal areas of intervention is to seek to have this removed for corporate customers.
- Derivatives which are centrally cleared are likely to cost more after the necessary margin and collateral have been provided.
- Moreover, it is currently uncertain whether corporates in Europe will be treated on the same basis as against their competitors in Asia and America.
- Even if the regulations are the same, market pricing convention may well confer advantages to certain participants. For example, in industries which tend to require long-term investment of capital such as power generation, transportation and aircraft manufacture, many of the end products such as ships, oil service platforms, aircraft engines and power turbines are typically bought and sold in US dollars.
- US corporates therefore have – by definition - less need for derivatives to manage the currency and interest rates risks of operating in these industries – while corporates based in Europe will be among the heaviest users of such derivatives.
- Based on preliminary proposals, corporate could find that the costs of risk management increases by up to 300% as a result of the imposition of the CVA capital charge; hence our focus on removing this charge for corporates.
- As a matter of public policy we also are advising that such higher and more volatile costs of hedging could well impact on the ability or willingness of corporates in Europe to risk manage their businesses as they have done before – potentially creating an unlevel playing field in the global market.
- This touches on broader issues of global consistency and whether the regulatory agenda is favouring a transactional model over a relationship banking model.

The outcomes will be significant – and so the regulatory debate must sharpen its focus:

- On global consistency
- On the cumulative effect of regulations, and
- On the resultant ability of the sector to serve and support the real economy.

And operating in this context of increased uncertainty, corporates – and corporate treasurers in particular – need to consider:

- How the cost of managing risk in their business could change and become more volatile;
- Whether they understand fully how credit capacity and pricing could change as CDS pricing becomes more important in the regulatory framework going forward;
- Whether the finance function set up appropriately to address these evolving challenges;

A final thought – if we are to make the most of this reform period we really do need to focus more on what we want the financial system to do in aggregate and less on where there is a need for detailed reform. Candidly representations made by you – our customers – carry significantly more weight than input from our industry which is seen as self serving by too many.

Enterprise Risk Management ("ERM"): Key Success Factors for an Effective Rollout

Abbas Hasan Kizilbash, FCA, CIA &
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"Risk is like fire: If controlled it will help you; if uncontrolled it will rise up and destroy you."
– Theodore Roosevelt

Why is Enterprise Risk Management Needed?

Case Study 1: Parmalat

Parmalat's case been dubbed "Europe's Enron" – the saga that has engulfed Italy's milk-processing giant Parmalat and its senior executives, blue-chip European and American banks, accountancy firms, politicians and 130,000 hapless small shareholders following the discovery in 2003 of a $14bn black hole in its finances.

The revelation triggered an eight year marathon of court cases in Europe and America, the disgrace of the Tanzi family that controlled Parmalat, at least one death, the collapse into administration of one of Europe's most successful football clubs, and grave misgivings about the quality of governance in Italy's boardrooms. And it's still going on.

Case Study 2: Madoff Investment Scandal

The Madoff investment scandal broke in December 2008 when former NASDAQ Chairman Bernard Madoff admitted that the wealth management arm of his business was an elaborate Ponzi scheme.

He founded the Wall Street firm Bernard L. Madoff Investment Securities LLC in 1960, and was its chairman until his arrest. Alerted by his sons, federal authorities arrested Madoff on December 11, 2008. On March 12, 2009, Madoff pled guilty to 11 federal crimes and admitted to operating what has been the largest Ponzi scheme in history. On June 29, 2009, he was sentenced to 150 years in prison with restitution of $170 billion.

Case Study 3: Arthur Anderson

Arthur Andersen LLP, based in Chicago, was once one of the "Big Five" accounting firms among PricewaterhouseCoopers, Deloitte Touche Tohmatsu, Ernst & Young and KPMG, providing auditing, tax, and consulting services to large corporations. In 2002, the firm voluntarily surrendered its licenses to practice as Certified Public Accountants in the United States after being found guilty of criminal charges relating to the firm's handling of the auditing of Enron, an energy corporation based in Texas, which had filed for bankruptcy in 2001 and later failed. The other national accounting and consulting firms bought most of the practices of Arthur Andersen. The verdict was subsequently overturned by the Supreme Court of the United States. However, the damage to its reputation has prevented it from returning as a viable business, though it still nominally exists.

Scope of the Article

Regulatory initiatives have added impetus in recent years to proper risk management for corporates.

The scope of this article is to outline some of the critical success factors in rolling out an enterprise wide risk management programme, based on the experience of the authors. The scope of this article does not specifically cater for Risk Management in the banking sector.

Critical Success Factor 1 --- Demonstrate the Strategic Competitive Value of Risk Management

The foremost challenge in rolling out an ERM Programme is one of demonstrating the strategic value of an ERM programme to senior management already under cost pressures and onerous regulatory requirements. Are the costs involved in setting up an ERM programme really worth the benefits? If management is unconvinced about the answer to this question then setting up a risk management function purely to satisfy regulatory requirements is, obviously, a dysfunctional solution.

The challenge for the Risk Champion/Manager, thus, is to come up with a meaningful business case that satisfies not only the regulatory imperative but also outlines the competitive advantages to the company of the implementation of a robust ERM programme. These competitive advantages may include better/optimal investment decisions, greater resilience and ability to execute strategic initiatives and more predictable earnings. However, too many risk champions/managers draw upon the regulatory imperative as the primary driver to justify an ERM programme and in this economic climate this is definitely the wrong foundation to place the ERM structure upon.

Challenge 2 ---- The Buy in from Line Management

The Risk Management function is often perceived by line management to be another "compliance function" divorced from and lacking in, an understanding of the reality of front line operations and hence adding little value to the business. This thinking is, frequently, the primary cause of the lack of buy in by line management in an ERM Programme.

Consequently, it is of paramount importance for the Risk Champion/ Manager to position the function as a business enabler, as a service to the line and not as a control function. In our opinion **a good example of such positioning is the ERM policy statement of the UN Joint Staff Pension Fund** which states:

"Managing risk is not just about assessing and monitoring all the things that could go wrong. Rather it is about understanding all the things that need to go right for an organization to achieve its mission and objectives."

Secondly, the Risk Champion/Manager must ensure that the risk functions understanding of the company's value chain is adequate to challenge/ ask the "right" questions related to the attainment of line objectives. This is not an easy undertaking and the risk function must ensure that they get this right through a diligent review of the company's balanced scorecard, key performance indicators and key strategic goals and initiatives.

Challenge 3 ---- Clear Risk Management Roles and Responsibilities

Risk Management is clearly on the Board agenda vis-a-vis oversight. However, the contours of this oversight must be clearly articulated in a delegation of authorities or a Risk Management Charter. It must therefore be clear as to who sets the company's risk appetite, how are risk thresholds defined and how should risk be reported to the Board of Directors. In addition, the ownership of risks within the company should vest with clearly defined risk owners. It is frequently a (mis)conception amongst senior management that by forming a risk management function they have transferred accountability for all risks being faced by the company to this function. This is clearly absurd as risk management relies primarily on the expert assessments of line managers to identify and rate the magnitude and likelihood of risk events as well as in the determination of appropriate risk responses.

Challenge 4 ---- Evolution not a Revolution

Risk management rollouts typically take between three to five years to deliver meaningful results and it will make sense for a risk manager to outline and articulate to senior management the clear deliverables, including quick wins, to be executed within this time frame. This will help senior management understand the iterative process of risk management, clarify expectations, as well as giving them a yardstick to measure the progress of risk management efforts. The Risk Manager will benefit from referring to Risk Management Maturity models in the development of this roadmap such as the RIMS Risk Maturity Model.

Challenge 5 ---- Align/Embed Risk Management with the Strategy Development Process

The highest impact that enterprise risk management can make is if it is adequately aligned with the company's strategy development process. This should be the risk managers primary focus area at the commencement of the rollout and the relationship of the Risk Manager with the Business Planning or Corporate strategy team will play a strong part in whether this is executed successfully. Secondly, Risk Management should immediately be embedded at all key decision making forums of the company. These two "valves" are the high value areas that a risk manager must be successful in, if he/she is to roll out ERM successfully.

Conclusion

ERM's implementation needs a buy in of senior management as well as that of line management staff. It is possible through an evolution and not through a revolution. Once the role of management is defined and risk management is fully aligned with strategy development process, ERM's effective implementation becomes easier.

AVOID COMMON PITFALLS!

Suggested reading:
ISO 31000 (www.iso.org)
COSO ERM (www.coso.org)
Source for case studies: worldfinance.com and wikipedia

Recouping Tax Losses

Huzaima Bukhari & Dr. Ikramul Haq

Pakistan has been facing perpetual tax losses and resultantly every year fiscal deficit in increasing—this year it is nearly Rs. 1.5 trillion. The government, instead of recouping the tax losses, is extending waivers, amnesties and immunities to tax cheats, criminals and looters of national wealth. In other countries, serious efforts are underway to recoup past tax losses and bring illicit wealth transferred outside by signing mutual agreements with countries where untaxed money and assets are lying. Recently, the UK tax authorities have issued warning to the non-filers to file declarations by October 2012 of all the past years or be ready to face criminal proceedings. On the contrary in Pakistan, FBR announced in May and June 2012 all possible tax amnesties and immunities, yet it failed to achieve the target of Rs. 1952 billion.

It proves beyond any doubt that unless the ever-growing size of underground economy is taxed, the existing fiscal malady having serious political and social ramifications cannot be cured. Failure of successive governments—military and civilian alike—to tax underground economy has made Pakistan subservient to those forces that possess dirty money. These ruthless forces now control all organs of the State and are destroying Pakistan for self-aggrandizement.

Pakistan is not the only country in the world that is facing the problem of colossal loss of revenue due to underground economy. It is a worldwide problem. In Russia and Eastern European countries this malady once destroyed the entire social fabric, besides causing heavy losses of tax revenue. In Asian, African and Latin American countries, the issue of underground economy is extremely serious, and particularly such activities as smuggling, drug trafficking, money laundering and bribery have attained a considerable size. Even in the developed world with strong and established legal and tax systems managed by highly efficient governments, underground economic activities cannot be taken lightly. The Unites States has become the heart of global underground economy. According to the statistical data of the Internal Revenue Service (IRS), in 2012 the output of America's underground economy amounted to US$ 4539 billion.

An important issue facing the study of underground economy is how to accurately measure and calculate its size. In fact this task is extremely daunting. In Pakistan no serious effort has been made to precisely gauge the size of underground economy. State Bank says it is about 45% of regular economy. Many other studies put the figure as high as three times of the existing GDP. Dr. Aqdas Ali Kazmi, ex-Joint Chief Economist, Planning Commission, in his research paper *Tax Policy and Resource Mobilisation in Pakistan* mentioned that 70% of economy consists of 36% 'pure' black economy, 18% exempted economy, 9% illegal economy, 4.5% unrecorded economy and 2.5% informal economy (unreported economy). His study says that the problem in the low resource mobilisation is the rigid system of taxation, and emphasis of the government to increase revenue, ignoring the details of long-term policy measures.

According to latest figures released by State Bank, the parallel economy is growing at an alarming rate of 22.93% per annum. Every fifth rupee transacted in Pakistan is black, according to the volume of black money generated in the year 2010-2011 at Rs. 4600 billion. It is not the final count. They have not accounted for kickbacks in arm deals, foreign trade, smuggling (e.g. huge tax evasion in the name of Afghan Transit Trade) and foreign exchange racketeering, apart from narcotic trade and other criminal traffic. A conservative estimate is that Rs. 4000 billion is generated every year by the parallel economy. Add to this, black money generated through smuggling in goods and narcotics trade that is between Rs. 300 billion and Rs. 500 billion. This makes a whooping Rs. 4500 billion.

It is not possible to determine the precise amount of revenue loss and size of black money or informal economy in Pakistan. Revenue loss estimated by World Bank because of smuggling in 2010-11 amounted to $ 25 billion. Another report estimates revenue loss, because of discretionary tax regulations, at Rs 400 to Rs 450 billion in 2010-11. Apart from direct monetary costs of corruption, other significant costs, such as loss of government credibility, spread of injustice, disproportionate resource allocations and loss of foreign and local investment, are destroying the very fibre of society in Pakistan.

Judging from different studies quoted above and reports published in the print media from time to time, Pakistan's underground economy has the following salient features:

- Since 1979 (courtesy Gen. Zia's legacy of speed money culture and its pursuit by all the subsequent governments, notably that of Musharraf, Benazir Bhutto and Nawaz Sharif), our underground economy has developed at a surprising rate. Its large size ranging between 42% to 55% of GDP should be a cause of serious concern for both the officials and independent economists.
- Its manifestations are very wide. It is not only large and all-pervasive but also exists in daily life of every Pakistani. It includes production of fake and substandard goods, smuggling, "black society" economy, illegal business of sex and contraband intoxicants, massive infringement of copyrights, tax evasion and avoidance with active collaboration of tax officials, corruption and rent seeking [exchange of power for money] activities of government officials, pillaging of bank loans, just to name a few and significant ones.
- Massive migration towards big cities confirms that a large portion of Pakistan's population is directly engaged in underground economic activities. The large-scale mobility of people is also a contributing factor in generating underground economy e.g. high demand of local private houses to accommodate the mobile population.
- The active participation of government officials is the most disturbing feature of Pakistan's underground economy. Rent-seeking activities of the government functionaries emerge in an endless stream. They are the single most important catalyst for accelerating the growth and sustainability of underground economy. The State has miserably failed to check rampant corruption amongst their officials. They have emerged as the most powerful mafia whose control over the underground economy is now invincible.

Why and how has Pakistani underground economy evolved so rapidly since 1977 after overthrow of Zulfikar Ali Bhutto by General Zia? This question baffles every concerned citizen; however there is no one easy answer to it. There were multiple factors leading to this phenomenon, most notably State-sponsored corruption and deliberate tolerance to malpractices. Allotment mafia came into existence after independence and many notorious elements turned rich overnight. They continue to dominate the ruling elite as they enjoy money power without putting any effort for its achievement.

It is time to constitute an independent National Commission to determine the size and effects of the underground economy. The volume of parallel economy (both formal and informal) has certainly created distortions in statistical data vital for economic planning and macroeconomic decision-making, but its most devastating and direct effect is reflected in the considerable loss of tax revenues for the State. Theoretically, tax losses not only refer to a static result, i.e. tax revenue lost by the fact that taxes payable failed to be levied or collected for all kinds of reasons, but also mean a dynamic loss process. Tax revenue losses can be divided into three categories:

1. tax revenue loss of a compliance nature;
2. tax revenue loss of an administrative nature; and
3. tax revenue loss of an institutional nature.

Among these three categories, the revenue loss of compliance nature results from underground economic activities because of taxpayers' evasion and fraud by non-compliance with tax laws, and such a loss is characterised by erosion of the tax base. The latter two types of tax revenue losses exist in the public economic field, and are characterised by a reduction in effective tax rates. In Pakistan, tax revenue losses due to inefficient and corrupt tax machinery are equally significant. The tax officials do not only properly enforce the promulgated laws, they are always hesitant to probe tax frauds but also actively participate in providing their "expert services" in exchange for money to protect tax evaders and plunderers of national wealth. As a result tax officials have become active and potential generators of untaxed black money in the country.

In Pakistan, tax revenue losses stemming from the underground economy can be briefly summed up as under:

- Taxpayers do not register with the tax departments. One reason for this might be that the activities they undertake are illegal or even criminal, and another reason might be that they attempt to escape registration and interlope for the sole purpose of tax evasion, despite the legal nature of their business;

- Although a taxpayer registers with the authorities but he resorts to non-reporting.
- Taxpayers indulge in under-reporting so that a wide gap exists between the tax liability reported and the tax which would be payable if the return was correct.

On the basis of different studies conducted to determine the size of underground economy in Pakistan, in terms of different taxes, the following table shows the ratio of the lost commercial and industrial taxes to that of actually collected in the last 20 years:

Year	**% (losses)**	**Year**	**% (losses)**
1990-91	62.22	2000-01	87.83
1991-92	58.44	2001-02	88.25
1992-93	61.25	2002-03	87.95
1993-94	64.55	2003-04	86.35
1994-95	57.15	2004-05	85.19
1995-96	70.20	2005-06	85.44
1996-97	83.06	2006-07	86.07
1997-98	89.04	2007-08	86.28
1998-99	84.69	2008-09	86.45
1999-00	85.45	2010-11	86.48

As evident from above, underground economy has caused a substantial loss of revenue during the last 20 years, and brought about plenty of negative economic effects forcing the national growth to deviate from the objectives of efficiency and equity. A direct consequence of tax revenue losses is a reduction in the government fiscal targets. Our fiscal deficit could have been substantially low or even zero had the State effectively tackled the growth of underground economy. It is an irrefutable fact that tax revenue losses due to underground economy, in turn, aggravated income distribution and wealthy classes became more powerful thus making the entire society subservient to their interests and control. These colossal revenue losses reduced the efficacy of allocation of social resources therefore seriously retarding equitable distribution of societal benefits to cross-sections of society.

It is an incontrovertible fact that the income gap among Pakistanis has been gradually widening and trend of rich becoming richer and the poor, poorer is gaining strength. Generally, analysts have attributed it to economic policy, but they have neglected the impact on income distribution of tax revenue losses generated by the underground economy. Virtually all types of hidden incomes arising from vast and wide-spread underground economic activities escaped tax regulations and this should be considered as an important cause for the widening of Pakistanis' income gap over the last 20 years.

It is true that as long as taxation exists, tax revenue losses will not completely disappear, but such losses can be reduced considerably by employing countermeasures effectively. It is high time that our government should start attacking underground economic activities to reduce tax revenue losses. This work cannot be done solely by reforming the tax administration. In order to effectively reduce tax revenue losses, multi-sector participation and comprehensive coordination by and among different departments of the federal and provincial governments is needed to curb underground economic activities.

The introduction of feasible and effective countermeasures requires removal of the causes that generate black money and taxpayers' non-compliance. The theory of economics of taxation tells us that critical factors determining taxpayer's compliance level include benefit incentives, social pressures and a self-regulating mentality. The established causes for taxpayers' non-compliance are:

- selfish non-compliance, i.e. taxpayer makes a cost benefit analysis with regards to tax non-compliance and then decides that this course of action can generate greater net gains for him;
- non-compliance through ignorance, i.e. taxpayers do not intend to violate the tax laws, but choose so because of their ignorance of tax obligations; and
- social non-compliance, i.e. taxpayers' behaviour is influenced by the attitude of the whole society towards approving tax avoidance and evasion.

Keeping in view the above factors, the following major countermeasures are suggested to reduce tax revenue losses:

1. Selfish non-compliants should be tackled from economic perspective. Taxpayer should be considered as an economic person and the following formula should be applied:

   Expected returns of tax evasion = expected gains of tax evasion minus the expected cost of tax evasion

   Applying the above formula it is necessary to reduce taxpayers' economic earning arising from the underground economic activities and tax evasion. Even a more important step would be to devise measures to enhance the taxpayers' cost of evasion.

   Regarding the former, reducing the undesirable tax incidence from the weaker sections of society is both desirable and urgent. At present the tax penalties are not very high vis-à-vis tax evaders (instead they get tax amnesty schemes frequently to get their untaxed money whitened at a nominal rate of 5% to 10%). The critical matter is to reform the entire tax collection system preventing tax dodgers from going underground. As regards the latter, the first important issue is to strengthen tax administration raising the potential of discovering non-compliant taxpayers. The present situation in Pakistan is very weak as far as effectiveness of tax administration is concerned. Besides increasing cost of evasion for the taxpayers it is imperative to enhance penalties of underground economic activities.

2. The most disturbing aspect of Pakistani tax system is weak enforcement, whereas FBR's stance has always been that fault lies with tax legislation. It is a proven fact that the promulgated laws are not enforced effectively and whenever any shortcoming is pointed out, FBR stalwarts blame tax laws. The evidence of this attitude reflected in 2001 in the promulgation of Income Tax Ordinance, 2001 which has proved a useless venture having contributed nothing to ensure voluntary compliance and increase in collection of taxes. The mere promulgation of new laws cannot ensure enhancement of tax revenues—the greater need is to reform tax structures and improve attitude of tax collectors. In Pakistan, one never hears of prosecuting tax evaders sending them to prisons for their illegal acts. This confirms extreme slackness on the part of tax administrators and/or their connivance with tax dodgers. Instead of punishment, tax evaders are given generous waivers, immunities and amnesties encouraging them to generate more underground economy, which is getting larger and larger with every passing day. Reluctance of tax collectors to crack down on underground economy players needs proper investigation so that ways are suggested to ensure that in future this unwillingness or collaboration ceases to exist.

3. The predominant cause of non-compliance in Pakistan is based on conscious non-acceptance of tax obligations because of collective societal consensus that rulers lack credibility. The State has never bothered to promote tax culture through educating masses who have never been informed of their duties towards the State, nor are they convinced of proper utilization of taxes by the Government. There exists a relation of bad faith between the taxpayers and the State which needs to be addressed through a process of reconciliation. A new social contract is needed to convince the citizens that taxes paid by them would be utilized exclusively for the benefit of the country and not for providing a life of luxury to rulers and the civil/military bureaucracy. The fundamental solution to promote tax culture is to popularize knowledge of the law through education, media and information services, enhancing the citizens' awareness of the need to pay tax raising their status to compliant taxpayers and thereby promoting the idea that paying taxes is an honour whereas evading taxes is a national disgrace. This is indeed a difficult task requiring a long period of time to change the people's perception but to do this work and do it as soon as possible is indispensable if we want to survive as a self-reliant nation.

4. The task of attacking the underground economy and forestall losses of tax revenue, the most important and radical channel is deepening of reforms. Conventional formulas and half-hearted attempts will not work. The State will have to show its political will to crack down heavily on the underground economy. All tax reforms, which were initiated vigorously by obtaining loan from foreign donors, failed in uprooting black economy and eliminating its causes. Our State is presently controlled by corrupt politico-administrative structures where people having tremendous money power are the key players. How can the agenda of tax reform succeed in isolation? The need is to purge the society, make all financial transactions transparent, eliminate money power and corrupt administrative structures. Only then colossal losses of tax revenue can be successfully restrained.

The emphasis on tax reforms without tackling the issue of taxing underground economy, will bring more hardship for the common people of Pakistan as in their frenzy of collecting more taxes the incidence of taxation would be shifted to the poor and the vulnerable while those who enjoy invincible money power (generator and protector of underground economy) will remain outside the ambit of tax obligations.

The State has to give up its policies of appeasement towards plunderers of the national wealth and tax evaders. The foundations of corruption and rent-seeking activities of the State functionaries have to be destroyed with full force otherwise tax reform financed by huge loans would become another national wastage.

Tax-to-GDP ratio can only be improved significantly if the process of economic reform, especially elimination of underground economy goes hand in hand with tax reform agenda—first of all making FBR an independent and autonomous body insulated from all kinds of outside pressures. Once the government shows determination of cracking down on the underground economy, the citizens would certainly reciprocate by voluntarily paying their taxes diligently and honestly. This can be the only way to control and eliminate losses of tax revenue in Pakistan.

In the past, the National Accountability Bureau (NAB) has only been victimising political opponents of its mentor rather than cracking down on those who are engaged in massive tax frauds and evasions with the connivance of their friends in tax machinery. People of Pakistan want to see NAB actually nab all the tax evaders and looters of national wealth, especially those who make enormous money by selling plots allotted to them at nominal rates in Defence Housing Societies, at extravagant prices and yet not pay a single penny as tax [though this constitutes 'adventure in the nature of trade' and is chargeable to tax under the Income Tax Law]. How many in khaki, engaged in this profit-making, have paid any tax is a not a secret, yet not a single case has been registered so far against any tax evader and tax official—both are responsible for colossal revenue loss to national exchequer for not taxing such transactions.

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Business Continuity Planning

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"If you fail to plan, you plan to fail" a quote by Benjamin Franklin.

There are many factors that distinguish successful organizations from average and unsuccessful ones. A key factor that repeatedly shows up in all the research is *"Planning"*. Not just whether organizations plan, but the quality of the plan and how often performance is reviewed against that plan. A Business Continuity Planning (BCP) is a management process to ensure the continuity of businesses in case of an emergency or any sort of disruption that may occur. It is critical for an organization to ensure that the essential functions of business are carried out despite any sort of situation that may emerge and to persevere against all odds.

In a nutshell, The Business Continuity Plan is an umbrella for all activities planned and implemented before, during and after an emergent situation or disruption. These include plans for human needs and scrutinize the availability of technology to operate critical function of the organization.

Background/History of the BCP

The Business Continuity Planning is relatively a young discipline and, as such, its importance has yet to be fully recognized by most of the governments and organizations. In the recent history starting from the Millennium Bug and the 9/11 to the more than fair share of natural disasters like the October 8, 2005 earthquake several governments and organizations make the move to adopt the Business Continuity Plan considering the vulnerability to natural as well as manmade disasters. In the face of growing global legislation and edicts for security, it is becoming increasingly important for organizations to institute proper planning for ensuring the protection of information and the continuation of operations. Business continuity is the logical first step in helping mitigate business risk and in order to minimize potential losses.

The Life Cycle of BCP

The basic components of a good Business Continuity Plan vary in range from planning and implementing the activities of prevention and protection of anticipated risks to planning for the activities to be implemented or executed during and after a disastrous event. While the emergency response plan, evacuation plan, crisis management & communications plan, work-around or contingency plan, and then, strategic and tactical planning with resources & vital information and documentation of the activities for resumption, recovery, and restoration of businesses - both physical and logical, are a part of it and should be integrated into the Business Continuity Plan. However, among many other requirements of effective a Business Continuity Planning, the most crucial three are well-prepared backup sites, availability of a backup of key data and documents and well-prepared personnel to deliver the critical services.

The Business Continuity Management and Contingency Planning are, of course, essential and unavoidable tasks. However, the creation of a sound continuity and contingency plan is a complex undertaking, involving a number of stages and discrete activities like risk identification and quantification, vulnerability assessment, protection & mitigation, risk transfer, business impact analysis, emergency response, and plan to resume, recover and restore the businesses and technological infrastructure to support these businesses. It is recommended that all the risks with high impact and high probability should have proper response plans and resumption, recovery and restoration plans should be based on the worst case scenario.

The Business Impact Analysis (BIA) is a central element in the development of any Business Continuity Plan. If a BIA is conducted according to current standards, it will identify all of the resources needed to recover critical and other business functions and will state when those resources will be needed, mapping it up with inter-function dependencies. The BIA, as set out in modern business continuity guidelines and standards, is an excellent tool if fully implemented. However due to the complexity and cost of conducting a comprehensive BIA, this very rarely happens in real-life.

British Standard BS 25999

Realizing the importance of BCP, the British Standards Institution (BSI) released a new independent standard for the BCP i.e. BS 25999-1 in 2006. Prior to its introduction, BCP professionals relied on the BSI Information Security Standard BS 27001, which only peripherally addressed the BCP to improve an organization's information security compliance. The applicability of the BS 25999 extends to all type of organizations and missions regardless of government or private, profit or non-profit, large or small, industry or sector. The BSI published the second part i.e. BS 25999-2 *"Specification for Business Continuity Management",* which specifies the requirements for implementing, operating and improving a documented Business Continuity Management System (BCMS).

What is ISO 22301?

Minimizing disruptions - Maximizing recovery

Considering the strong response and international interest in the original British Standard i.e. BS 25999-2 and other regional standards, the International Standard Organization has recently issued a new International

Standard for Business Continuity Management i.e. ISO 22301, which has further enhanced its importance all over the world, specially for a country like Pakistan. Any organization meeting the requirements to gain certification will be recognized globally. The ISO 22301 identifies the fundamentals of a business continuity management system, establishing the process, principles and terminology of the Business Continuity Management. It provides a basis for understanding, developing and implementing business continuity within an organization and gives confidence in business-to-business and business-to customer dealings. It can be used to assure key stakeholders that the business is fully prepared and that it can meet internal, regulatory and customer requirements. The standard provides organizations with a framework to ensure that they can continue operating during the most challenging and unexpected circumstances – protecting their staff, preserving their reputation and providing the ability to continue to operate and trade. The ISO 22301 provides a formal business continuity framework and will help in developing a business continuity plan that will keep the business running during and following a disruption. It will also minimize the impact of a disaster so that a business can resume its normal service quickly, ensuring that key services and products are still delivered.

The standard is particularly relevant for organizations operating in high risk environments where the ability to continue operating is key for a business, its customers and stakeholders. This includes utilities, finance, telecommunications, transport and the public sector organisations. It will enable an organization to:

- Establish, implement, maintain and improve your BCMS
- Meet the requirements of your business continuity policy
- Give key stakeholders confidence in your conformity and commitment to internationally recognized best practice
- Achieve BSI certification/registration of your BCMS

81 percent of managers whose organizations activated their business continuity arrangements in the last 12 months say that it was effective in reducing disruption. In summary: business continuity works.

Today, businesses around the world are increasingly challenged by the rising levels of various risks. The increasing reliance of businesses on technology, coupled with the increased risk of natural and purposeful disasters has meant that businesses are increasingly likely to suffer significant disruptions. Therefore, proper and effective delivery of the Business Continuity Management is a matter of survival, which ensures that the continuity of critical processes in case of any minor or major interruption.

The financial system in Pakistan has grown substantially, benefiting from multi-pronged financial reforms. These reforms have been pursued persistently and vigorously over a decade or so and have supported economic growth. The inefficiencies and weaknesses, which were typical of banks' operations in the pre-reforms era, have been reduced substantially. However, to get maximum result, financial institutions should pursue the Business Continuity Planning very seriously on an enterprise-wide basis. In enterprise-wide business continuity planning an institution considers every critical aspect of its business in creating a plan for how it will respond to disruptions. It is not limited to the restoration of information technology systems and services, or data maintained in electronic form, since such actions, by themselves, cannot always put an institution back in business. Without an effective the BCP that considers every critical business unit, including personnel, physical workspace, and similar issues, an institution may not be able to resume serving its customers at acceptable levels. Institutions that outsource the majority of their data processing, core processing, or other information technology systems or services are still expected to implement an appropriate BCP addressing the equipment and processes that remain under their control.

Banks really have to start ramping up their Basel II compliance activities. There may be particular attention given to the operational risk aspects of Basel II, with these being less easy to define and measure than other aspects. The realization that business continuity is an important part of risk management may dawn on many people in the financial sector who had not previously 'seen the light'.

Today's marketplace is defined by intense competition, consolidation, globalization and increased government intervention all contributing to a more challenging environment for banks to operate. The National Bank of Pakistan (NBP), similar to many institutions of its size, did not have the resources to maintain and manage a facility in another geographic location, so the company looked to the IBM to consolidate its centralized servers from different locations around the country, to one centralized server. The NBP has selected the IBM for a Business Continuity and Resiliency Services (BCRS) to ensure uninterrupted services and protection of crucial data in the event of a disruption. The new agreement enables the bank to meet the stringent resiliency requirements of the State Bank of Pakistan and reduce the need for split-second decision making during an emergency.

Realizing the importance of the BCP, where the country is facing with multiple internal and external threats, some of which are man-made and others are natural like earthquakes, fire, wars, terrorist attacks etc., the State Bank of Pakistan has issued Guidelines on the Business Continuity Planning for the financial sector vide its circular the BSD Circular No. 13 of 2004 dated September 4, 2004. While addressing the issue of good governance, the SBP has issued another circular the BSD Circular No. 03 of 2007 dated April 4, 2012 on the Policy Framework in Banks/DFIs. In the fast changing but the highly vulnerable environment, *'emergency preparedness'* deserves attention while strategic planning for the business is underway.

In today's environment, the effect of long term operation outage may have a catastrophic impact as well as significant reputation and financial risk. The development of viable recovery strategy must, therefore, be a product of not only of the service providers of data processing, communication and data centre operations, but also the users of those service and management personnel who have responsibility for the protection of the institutional assets in particular the corporate and bank's information asset.

It is rightly said that the BCM initiative is like the country's defence forces, you cannot start building up the army when the enemy attacks, you need to be prepared at all times.

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CFO's Role in Organizational Change

Abdul Aziz Abdul Qadir, ACA

Understanding Organizational Change

This term designates a fundamental and radical reorientation in the way the organization operates, related to organization-wide change and not just smaller changes like adding a new staff, modifying a program or process, etc. Organization-wide change might include a change in corporate mission (e.g., from not for profit to commercial), restructuring operations (e.g., restructuring resources, layoffs, rightsizing, etc.), new technologies, mergers, major collaborations, process re-engineering, etc.

CFOs Role in Change Management Team

In summary, all change management projects are either a result of the organization's not performing as it was expected or organization's long term strategy to combat future threats that may involve technological improvements, redefining management style, maximizing existing and future resources etc. These all type of changes require a strong Strategic Planning (forward thinking to achieve desired financial results), implementation (tough decisions with a known cost and benefits) and follow up (to ensure the operational and financial results are indicative of successful implementation that is leading towards achieve long term objectives). Therefore a CFO being a natural planner with a thorough knowledge of overall corporate strategy and desired goals is always a strong personality to either lead or remain a strong element of the change management team. However, the level of CFO's involvement depends on the type of project. For example, if the organization is going through financial restructuring, bankruptcy proceedings or a merger including joint venture etc, then the CFO will play a lead role in how the project is designed, budgeted and implemented. If the project is more about changing operational systems or reengineering processes, the CFO will not take a lead role though will have a strong input. An interesting survey that was conducted by Deloitte in the aftermath of economic turmoil, CFOs reported to having performed "steward" and "operator" roles.

CFOs Insights Initiates the Need for a Change

CFOs are increasingly required to partner with CEOs to drive transformations in their organizations. According to CFO Signals (by Deloitte) survey, on average CFOs spend about 60% of their time as a catalyst for change and a strategist in their organizations. Their insight of organization's annual budgets, short to long term plans with a strong knowledge of market/customer behavior influencing the planned targets and risk factors threatening the profitability alert them well in advance about the need to change existing corporate layout. In most of the cases CFOs are the first corporate executives initiating an urge for organization wise change.

Partnering a Successful Strategy of Organizational Change

CFOs by nature are planners, they approach issues in a systematic order and controls the processes through by implementing practical, transparent and ethical procedures. Their systematic approach to Organizational

Change is beneficial. They help formally setting expectations and tying in all ends of the planning by compiling the expected results in a more meaningful financial outcome that is ultimately support organization in seeking all stakeholders consents. Without employing financial outcome as a tool to improve communication and proactively seeking ways to reduce misinformation, stakeholders are more likely to buy into a change initially but produce great resistance during the process as do are not able to see the big picture.

CFOs initiatives generally drive successful to Organizational Change Management strategies that include:

- Developing a big picture that will emerge after successful implementation of the change strategies that provides an agreement on a common vision for change
- Supporting executive leadership to be able to communicate the vision and sell the business case for change
- Helping in developing a strategy for educating employees about how their day-to-day work will change
- Preparing a concrete plan for how to measure whether or not the change is a success -- and follow-up plans for both successful and unsuccessful results
- Advocating rewards, both monetary and social, that encourages individuals and groups to take ownership for their new roles and responsibilities

Supporting Change Process by Unfreezing Organization

The term "Unfreezing" refers to the process of change in which an organization opens itself for a change. It involves changes of the systems whether operational or procedural and the CFOs with in deep insights of the systems play a pivotal role in this transformation. According to an article published in a technical journal of the Institute of Management Accountants', "the role of the CFO has expanded significantly in the past decade. It's becoming more difficult to tell where the accountant ends and the strategist begins".

CFOs are not only developing diverse business backgrounds, but they are also evolving from their traditional roles as "gatekeepers" and "cost cops" to "enablers of growth". CFOs' traditional focus on return on investment has generally shifted to managing a balance between profitability and growth. Many CFOs nowadays are the primary drivers of corporate strategy. This transformation from tactician to strategist has happened recently in a short span of time as companies are now rapidly responding to new realities in the marketplace. Modern day CEOs are chief strategist and are deeply involved with strategy formulation.

Successful change must involve top management, including the Board of Directors and Chief Executive Officer. A change agent is usually responsible to translate the vision to a realistic plan and carry out the plan. Needless to say that change is best carried out as a team-wide effort. Communications about the change should be frequent and with all organization members. To sustain change, the structures of the organization itself should be modified, including strategic plans, policies and procedures. This change in the structures of the organization typically involves an unfreezing, change and re-freezing process. CFOs in this process help employees recovering from their fear through the following:

- Explain long term vision and its impact of organization's finances and P/L statement
- Sharing organization's vision by translating ideals in to numbers that helps answering a general "what's in it for me" question at various levels of hierarchy
- Helps compiling in meaningful manner the affect on customers with internal analysis and data
- Set up task forces to analyze issues and recommend solutions.

Helping CEOs in Getting through the Change Successfully

Once the change process is established and properly announced, even though the senior managers buy-in the idea, they and the other employees whether affected directly or not, go through with a high uncertainty and anxiety creating anger and depression. Thus managers need to assist their employees through this change. CFOs play a major role in helping this situation that includes:

- Developing feedback mechanisms to gather employees' questions and concerns that helps in conducting bilateral communication
- CFOs do not react emotionally on employees concerns and resistances and therefore they are able to understand their real concerns, letting them talk it out and then deal with the genuine issues

- Ensuring clear understanding of why the change is necessary
- Work closely with the informal leaders and especially the middle management of the organization

Flag Runner of Management Strategies to Avert Resistance

It is inevitable for employees to resist change, as they wouldn't be ready to accept anything that is unfamiliar and stressful. Employees are comfortable in working in their present surroundings and work environment. They don't want their schedule to be disturbed by any kind of changes in the process and therefore, when new processes and procedures are exposed, employees try their level best to avoid changes. As a result, productivity, quality, and other results take a nose dive. Things will almost always get worse before they get better.

However, a responsible and responsive management team can intercede before staff resistance spreads like the plague and threatens the smooth transition of organizational changes. CFOs are often called emotionless corporate executives who handle any type of crisis with extraordinary temperament. They have a natural tendency to stay cool in the hottest environment and deliver the corporate expectation in a most precise manner. They are the most effective team leaders fully comprehend the reasons why changes in the organization are vital to its existence and growth. They help creating clear outline to reduce discomfort and insecurity that may arise if staffs are not made aware of the policies, principles, guidelines and structure of intended changes. CFOs in this situation force executives' commitments to the long term vision and carryout evaluation of the success of the change strategy at regular intervals to ensure its smooth implementation.

In general, CFOs and CEOs are usually challenged by the need to change culture. In this situation CFOs provide the fact base on outcomes that help CEOs and the other leadership in evaluating the costs of replacing staff and redirecting the organization. They also role model desired behaviors and create incentive programs to sustain new behaviors. Many CFOs have become an effective change partner by employing fundamentally new skills beyond those that got them to the CFO position. This edition of CFO Insights provides first steps to framing more effective approaches to change.

According to a McKinsey survey of the first 100 days on the job, 88 percent of 164 CFOs surveyed reported that CEOs expect them to be active members of the top senior-management team. More than half said CEOs counted on them to challenge company strategy.

Change within Finance Organization

During the process of Organization-wide change, CFOs change the culture of the finance organization. They partner with CEOs on broader organizational transformation. It is imperative to diagnose sources of resistance consequent to the change and develop appropriate strategies to mitigate that resistance. It will not be too difficult within finance department to identify resistance resulting from changes in workloads or changes in power and can be addressed through careful process and work design.

Senior financial executives play a key role in strategy development and implementation, working closely with the CEO to creatively design growth opportunities for the future. CFOs are usually called upon to identify and assess profitable business ventures, lead mergers and acquisitions, establish alliances, and shape internal growth strategies.

CFOs – Drivers of Organization-wide Change

Modern age CFOs are the drivers of organization-wide change. They exercise decisive influence on corporate strategy and its implementation. They fulfill a highly demanding role, working under significant time pressure to implement rigorous cost and cash flow management and at the same time open up new growth prospects for the future.

Put Options Written On Non-Controlling Interests

Syed Muhammad Nabeel, ACA

IFRS Interpretations Committee ("IFRIC") recently issued a draft interpretation on put option written on non-controlling interests ("NCI"). The draft interpretation addresses the issue of subsequent measurement of put option liability. Although IAS 32 *Financial Instruments: Presentation* already contains principles regarding initial recognition of such a liability, in practice such arrangements are complex and require estimation and judgment to ensure appropriate accounting treatment.

In the recent past, put option arrangements have become very popular which lead to increase in the number of such transactions. These arrangements are typically entered at the time of business combination, however, the motive of such transactions could be tax benefits, contingent consideration so as to resolve a price dispute between acquirer and acquire, employee compensation for retaining previous owners of the acquire until transfer of business knowledge or as an exit mechanism to resolve a dispute between NCI and majority shareholders.

IFRS guidance has always been principle based and guidance for put option is no different. Hence appropriate accounting treatment of put option arrangements require understanding the substance or business rationale of such arrangements.

Accounting Treatment

Recognition:

The put option arrangement will always result in recognition of a liability representing the present value of future cash outflow required to obtain NCI. This does not require existence of a symmetrical terms written put option and a purchased call option as paragraph 23 of IAS 32 states that *"an entity's contractual obligation to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation to purchase is conditional on the counterparty exercising a right to redeem (e.g., a written put option that gives the counterparty the right to sell an entity's own equity instruments to the entity for a fixed price)"*. Hence IFRS principle is clear regarding the recognition of redemption liability, however, the flip side (debit leg) of the accounting entry can take various forms depending on the substance of the transaction. These forms are discussed as under:

Put option arrangement not entered as part of a business combination

If put option arrangement is not entered as part of a business combination, then the guidance given in paragraph 23 of IAS 32 can be applied which states *"when the financial liability is recognized initially under IFRS 9, its fair value (the present value of the redemption amount) is reclassified from equity"*. This provides the principle of recognizing the flip side (debit leg) of the accounting entry in equity but it is not clear where exactly in equity. In practice judgment is required to resolve this issue. Recognition in equity may take the following forms:

- **De-recognition of NCI:** If other terms and conditions indicate that NCI does not have risks and rewards associated with the company (e.g., articles of Association is amended to state that the shares held by NCI is neither entitled to dividend nor residual interest in the company at the time of liquidation), the flip side (debit leg) of the accounting entry will lead to de-recognition of NCI as the only interest held by them in the company is in the form of put option liability.

- **Other equity reserve:** If NCI retains risks and rewards in the company, then flip side (debit leg) of the accounting entry will lead to recognition of other equity reserve (e.g., capital reserve) which will offset with NCI at the time of exercise of option.

Put option arrangement entered as part of a business combination

If put option arrangement is entered as part of a business combination, the whole transaction shall be viewed together to determine appropriate accounting treatment. A put option arrangement entered along with a business combination transaction may take following forms:

- **De-recognition of NCI:** If other terms and conditions indicate that NCI does not have risks and rewards associated with the company, it will be derecognized. De-recognition at the time of business combination means that the acquirer has acquired 100% stake in the target and put option arrangement shall be treated as a consideration for acquisition along with initial purchase consideration. Hence the present value of redemption amount will be combined with the initial purchase consideration resulting in flip side of the accounting entry impacting goodwill. In substance such arrangements may be treated as a deferred consideration (if the option price is fixed) or contingent consideration (if the option price is based on a formula).

- **Employee compensation:** Where the intention of the acquirer is to retain previous owners, in order to benefit from their skills and expertise, apart from entering into an employment contract, the acquirer may also enter into a put option arrangement with the previous owners so that they may be incentivized for future growth of the business. Practically such an objective may be achieved by first allotting such class of shares to the previous owners which neither entitles them to dividends nor residual interest in the company and then entering into a put option arrangement to buy those shares after a certain period of time. Such an arrangement may qualify as an employee compensation based on the indications provided in paragraph B55 of IFRS 3 *Business Combinations* and accordingly the flip side (debit leg) of the accounting entry will be recognized as expense in profit and loss.

- **Other equity reserve:** If NCI retains risks and rewards in the company, then it will not be derecognized and the flip side (debit leg) of the accounting entry will lead to recognition of other equity reserve (e.g., capital reserve) which will offset with NCI at the time of exercise of option.

Measurement:

Option liability shall be recognized at fair value which is the present value of the amount required to redeem the liability under the arrangement. Such arrangements can either have a fixed exercise price or a variable price (e.g., a certain multiple of future earnings). Hence there will be subsequent changes in the value of option liability caused by:

a) time value of money; or

b) changes in estimated future earnings (if the arrangement is variable price)

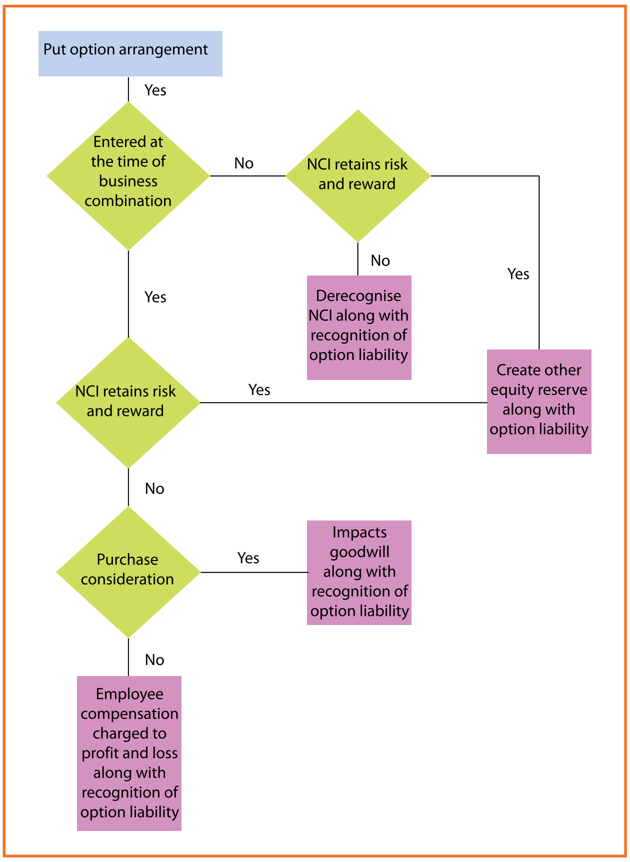
The accounting treatment of such subsequent changes depends on the nature of liability:

- If the substance of the transaction indicates that the arrangement is in the nature of a deferred consideration, a contingent consideration or an employee compensation, the option liability is a financial liability and all subsequent changes shall be recognized in profit and loss.

- If the substance of the transaction indicates that the arrangement is a put option, there was diversity in practice regarding accounting treatment of subsequent changes in put option liability. Some believed that such a liability meets the definition of a financial liability and accordingly provisions of IFRS 9 are applicable. Hence all subsequent changes in the liability shall be recognized in profit and loss. Whereas, others believed that subsequent measurement in profit and loss is counter-intuitive and it is more appropriate to recognize subsequent changes in equity. In order to resolve this issue, IFRIC has issued the draft interpretation supporting the former view.

Based on above, it can be concluded that put option arrangements may take various forms which require firstly an understanding of the business rationale and then application of appropriate IFRS principles.

The above discussion is summarized in following flow chart



PROFESSIONAL ACCOUNTANT in business

-Investing Overseas

Adnan Ali, ACA

Role of Professional Accountants in Bussiness, Investing in New Jurisdiction?

'Investing into new jurisdiction' is something which professional accountants usually come across during their professional life.

The investment decision in itself is not only dependent upon finance/accounting evaluations but also on wide arrays of business factors as well. We would examine some of the fundamental principles below and how they are relevant/ related to the work of professional accountants.

What is New Jurisdiction?

The new jurisdiction – for the sake of simplicity – could be a new country where company is setting up operations. The lifecycle of investment process can be generalized as:

- The bidding stage
- The implementation stage
- Monitoring performance
- Exit strategy

What is the Starting Point?

It is important to understand that it is 'business strategy' which derives the 'accounting strategy' and not other way around. Therefore, it is fundamental to obtain good understanding of 'business strategy' with respect to the new jurisdiction. The understanding can be obtained by some of following questions such as:

- Is prospective/new business part of growth objective of the organization?
- If the prospective/new business is not part of core business then detailed assessment is required to assess cost benefit of investing into the new jurisdiction.
- The resource mix of business (operating companies, group support, technical resources)
- Vision of organization with regard to this prospective/new business (market leader/global leader/niche market share)
- Which country?
- Existence of bilateral investment treaty or trade free agreement.

Whilst these questions – apparently – don't have any relationship with finance, however they tend to have major influence on future finance strategy of the business particularly with regard to the new jurisdiction. If the business strategy is clear or at least key dimensions are known then finance strategy could be built upon it.

A- The Bidding Stage

The bidding stage refers to the point in time when a bid for prospective/new business is made. The bidding process generally covers expression of interest (EOI) from the client, followed by submission of bids and then award of the contract. The bid document, depending upon the type of contract, business and complexity, can be more than hundreds of pages document.

The professional accountants in business are asked to share finance input at bid stage. This sometimes requires extensive research into understanding legal and regulatory framework of the new jurisdiction in addition to finance and accounting aspects. Fundamentally, all of the finance, tax data is input into the financial model (Excel based or software based) to work out IRR, NPV, payback period, ROCE etc.

Some of the fundamental questions that are sought at this stage include (though this is not exhaustive list and these questions could be complex depending upon the type of business, type of goods or services to be offered, and country where investment is being made):

1. The accounting framework of new jurisdiction

As of today, we know that IFRS is widely accepted globally; however some countries still have their own local GAAP. If you are investing into the countries (e.g. Russia) following local GAAP then some of the following questions would become relevant in this regard:

- The understanding of local GAAP
- How it is different than IFRS (if Parent is following IFRS)
- What are the key accounting treatment which are different than IFRS
- Two books of account (local GAAP as well IFRS if Parent is following IFRS)

2. The translation of business strategy into finance strategy

Multinationals usually consider using various group companies when it comes to delivering business results. This offers cost efficiencies as well seamless business operations. There could be following type of special purpose vehicle in use:

- Operating company
- Contracting company
- Treasury company
- Asset company
- Holding company

So it would be important to understand which companies are used and what is their country of residency as there could be tax consequences.

3. The supply chain

The supply chain is system of organizing business resources to deliver goods or services from supplier to customers. Today, many global organizations have adopted a central purchasing/ordering system whereas others are following decentralized system, each with their own business objectives. The professional accountant will have to obtain understanding of how supply chain would work in a new environment i.e. is it going to be local, global supplies or mix of both? This has finance, accounting, tax, and custom duty/VAT implications both for the business and suppliers as well.

4. Tax Treaty network

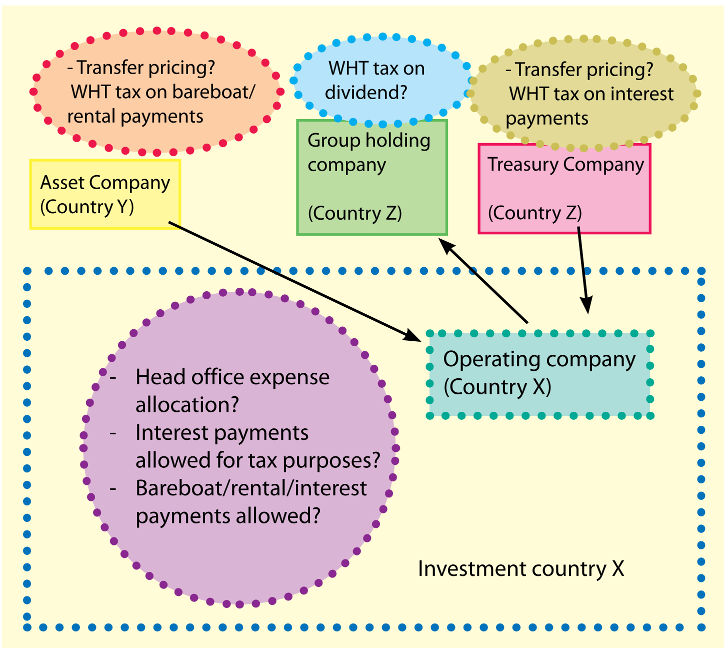
The tax is the important cost element of every business and it's planning, compliance carries weight when considered at the stage of bidding for a new contract. At the bidding stage it is important to understand:

- The tax framework of the country
- Reviewing the tax treaty network to explore which countries (where related entities are tax resident) can be used to minimize tax cost on major ticket items in your business model i.e. dividend, royalty, interest, intra group charges
- Transfer pricing implications on bareboat, intra group loans, intra group transfers, management services, royalty etc
- Corporate tax exposure and tax planning opportunities
- Tax exposure for group entities (e.g. asset company, treasury company)
- Efficient tax structuring to reduce tax cost (measurement tool could be effective tax rate for the new venture when compared to global Effective tax rate of the business)
- Tax implications with regard to exit strategy

EXAMPLE

Let's assume following parameters with a view to highlight key tax questions that need to be answered from each company's perspective:

1. Operating company is based in X country (investment country is X)
2. Asset company is based in Y country
3. Contract company is same as operating company
4. The group holding company is based in country Z
5. The Treasury company (based in Z country) has given loan to Operating company



5. Exit strategy

Whilst the exit strategy is not relevant at this stage, however, it has to be built into the business/finance model at inception. Specifically, relevant assumptions have to be built in with a view to consider relevant cash flow/tax implications in the project model.

6. The finance/treasury strategy

The finance strategy usually refers to how financing for the project/contract will be done. Will it be financed internally, a loan will be taken to finance operations, or a mix of both? Accordingly, if external finance is required from bank then the interest cost/repayments have to be considered into the project model/cash flow. This will increase the price of the product or service.

Whilst arranging finance is important, the other important leg is how cash will be repatriated/ extracted. The potential options could, subject to local regulatory and tax implications, include:

- Dividends
- Rentals/ bareboat/ time charters
- Management service agreements
- Royalty/fees for technical services/interest on intra group loan

7. Pricing strategy

The contract pricing can be in the form of lump sum price or day rate. The other dimension of pricing strategy is the currency of the invoice. If the contract revenue and contract cost are earned/incurred in the same currency then this eliminates transactional foreign exchange exposure at contract level and (sometimes) the need for hedging net transaction cost.

Another important aspect of pricing is how annual contract escalation logics are built into the contract. The commonly used approach is to link escalation factor with external indices (e.g. Consumer Price Index, Producer Price Index) as available. It is also possible to use basket of indices – depending upon currency mix of the cost incurred - to streamline any adverse impact of exchange rate and price on major cost elements.

8. Other factors

These could vary depending upon the type of business and its complexity but generally includes:

- Local set up of operations (time to set up, cost of set up, corporate secretarial requirements)
- Legal ownership (some countries require participation of local nationals) and beneficial ownership
- Regulatory approvals (type, timelines, cost and documentation required)
- Restriction on using accounting codes (some countries have rigid accounting codes which has to be used, so mapping could be required to link those codes with standard chart of accounts)
- Local compliance requirements (tax, regulatory)
- VAT/GST rates
- Excise duty, stamp duty
- Personal tax/social security
- Head office cost allocation
- Tax allowability of allocation of expenses
- Bank account operations and restriction/ approvals on repatriations

B- The Implementation Stage

Now the contract has been awarded and again professional accountant has to roll up sleeves to assist in implementation. Generally, the contract allows grace period before start of the contract generally referred to as 'set up phase/mobilization phase'. This is critical phase as final preparations are underway before the start of the contract. At this stage, the systems and policies have to be developed, finalized, test run prior to the start of the contract. In most of the cases, following factors are relevant and should be considered at implementation stage of the contract:

- Finalizing chart of account, opening books of account for the new contract
- Working capital requirements and cash flow forecasting
- The management reporting formats (if additional reports are required)
- The compatibility of accounting software and business wide softwares with the business model
- Review of accounting team strength (and identifying need for new staff/training)
- Additional reports/software required for countries with local GAAP (different than IFRS)

- Reconciliation of IFRS and local GAAP (capturing those differences at parent level if local GAAP is not flexible)
- Setting key performance indicators to monitor performance of the contract (comparison with the project model)
- Clarification/Confirmation of accounting treatment considered in the model (if there are any doubts)
- Mechanism to capture and review pre start up cost of the contract

C- Monitoring Performance

Monitoring performance requires review of the performance of the contract from finance perspective as well contractual perspective.

1. The finance parameters

This generally includes profit and loss management, revenue targets, variance analysis, debtor/creditors management, finance aspects of supply chain, treasury/ cash flow monitoring, local compliance and statutory obligations e.g. tax compliance and annual audits.

2. Gaps in the contract (from project financial model)

The exhaustive and detailed finance strategy should not result in surprises when the project is live. However, any identified discrepancies could be fixed or mitigated. Some of the possible options to address gap in business strategy and finance strategy at this stage could be:

- Quantification of the risk and consideration how this risk could be mitigated internally (changing internal cost arrangements without affecting quality)
- Coverage at the time of next renewal of the contract (i.e. request escalation on the cost or recovery of additional cost if not built into the contract)
- Addendum to the contract (if possible)
- Review of project model to eliminate/remove / reduce irrelevant cost on the contract
- Keep contingency premium in the original price
- Exit from the contract (however the cost of liquidated damages could be a deterrent)

D- Business Closure/Exit Strategy

Upon completion of the contract, the business may continue to have ongoing presence in a new country or decide to wind up unless there are strategic business reasons. Generally, the exit strategy can be any or mix of the following forms:

- Sale of assets
- Winding up/liquidation
- Close operations/divest

The exit strategy will again most importantly have tax implications (capital gains, transfer of business as going concern, transfer of asset, deemed sales etc).

Conclusion

The above discussion provides general overview of challenges faced with respect to investing into new jurisdiction. The nature, time and extent of above variables could largely be dependent upon the type of business, regulatory framework, and complexity of the business.

Evaluating and Improving Internal Control in Organizations

New IFAC Publication Provides Support for Professional Accountants Improving Internal Control

Vincent Tophoff
Senior Technical Manager, IFAC

The Professional Accountants in Business (PAIB) Committee of the International Federation of Accountants (IFAC) has issued new International Good Practice Guidance (IGPG), *Evaluating and Improving Internal Control in Organizations*, highlighting areas where the practical application of existing internal control standards and frameworks often fails in many organizations.

This new guidance is important to a professional accountant in business who works with his/her organization to continuously evaluate and improve internal control, and ensure that internal control is an integrated part of the organization's systems of governance and risk management.

In this guidance, internal control is defined as "an integral part of an organization's system of governance and ability to manage risk, which is understood, effected, and actively monitored by the governing body, management, and other personnel to take advantage of the opportunities and to counter the threats to achieving the organization's objectives." Better integrated internal control can save the organization time and money, and promote the creation and preservation of value.

At the heart of the IGPG are nine key principles for evaluating and improving internal control systems (see Key Principles) complemented by guidance on how to implement them. Questions that the guidance is designed to help answer are:

- What should be the scope of internal control?
- Who should be responsible for internal control?
- How should controls be selected, implemented, and applied?
- How can internal control be better ingrained into the DNA of the organization?
- How should the organization report on internal control performance?

Evaluating and improving internal control are among the core competencies of many professional accountants in business. Therefore, professional accountants can play a leading role in ensuring that internal control forms an integral part of an organization's governance system and risk management. With an integrated, organization-wide approach to risk management and internal control, professional accountants in business also encourage the practice that risks be viewed and treated in a more holistic way; that is, with improved internal control.

The guidance concludes with a limited list of relevant resources from IFAC, its member bodies, and other relevant organizations. It can be downloaded free of charge from www.ifac.org/paib.

Key Principles of Evaluating and Improving Internal Control

The principles below represent good practice for evaluating and improving systems for internal control.

A. Internal control should be used to support the organization in achieving its objectives by managing its risks, while complying with rules, regulations, and organizational policies. The organization should therefore make internal control part of risk management and integrate both in its overall governance system.

B. The organization should determine the various roles and responsibilities with respect to internal control, including the governing body, management at all levels, employees, and internal and external assurance providers, as well as coordinate the collaboration among participants.

C. The governing body and management should foster an organizational culture that motivates members of the organization to act in line with risk management strategy and policies on internal control set by the governing body to achieve the organization's objectives. The tone and action at the top are critical in this respect.

D. The governing body and management should link achievement of the organization's internal control objectives to individual performance objectives. Each person within the organization should be held accountable for the achievement of assigned internal control objectives.

E. The governing body, management, and other participants in the organization's governance system should be sufficiently competent to fulfill the internal control responsibilities associated with their roles.

F. Controls should always be designed, implemented, and applied as a response to specific risks and their causes and consequences.

G. Management should ensure that regular communication regarding the internal control system, as well as the outcomes, takes place at all levels within the organization to make sure that the internal control principles are fully understood and correctly applied by all.

H. Both individual controls as well as the internal control system as a whole should be regularly monitored and evaluated. Identification of unacceptably high levels of risk, control failures, or events that are outside the limits for risk taking could be a sign that an individual control or the internal control system is ineffective and needs to be improved.

I. The governing body, together with management, should periodically report to stakeholders the organization's risk profile as well as the structure and factual performance of the organization's internal control system.

About International Good Practice Guidance

International Good Practice Guidance (IGPG) issued by the PAIB Committee cover areas of international and strategic importance in which professional accountants in business are likely to engage. In issuing principles-based guidance, IFAC seeks to foster a common and consistent approach to those aspects of the work of professional accountants in business not covered by international standards. IFAC seeks to clearly identify principles that are generally accepted internationally and applicable to organizations of all sizes in commerce, industry, education, and the public and not-for-profit sectors. Previously issued IGPG are available on the *IFAC website,* including *Preface to IFAC's International Good Practice Guidance*.

About the PAIB Committee

The *PAIB Committee* serves IFAC member bodies and professional accountants worldwide who work in commerce, industry, financial services, education, and the public and the not-for-profit sectors. Its aim is to promote and contribute to the value of professional accountants in business by increasing awareness of the important roles professional accountants play, supporting member bodies in enhancing the competence of their members, and facilitating the communication and sharing of good practices and ideas.

About IFAC

IFAC is the global organization for the accountancy profession dedicated to serving the public interest by strengthening the profession and contributing to the development of strong international economies. IFAC is comprised of 167 members and associates in 127 countries and jurisdictions, representing approximately 2.5 million accountants in public practice, education, government service, industry, and commerce.

ISRS 4410:
The Standard for Today's Compilation Engagements

Highlighting the Value to SMPs and SMEs

As more and more smaller entities become exempt from audit requirements, small- and medium-sized practices (SMPs) will need to focus more on providing other services if their businesses are to survive and prosper. In addition, demand for non-audit services, in particular accounting and compilation services, is growing, as evidenced by the results of recent **IFAC SMP Quick Polls**.

Helping to meet the demands of this growing market is the release in March 2012 by the International Auditing and Assurance Standards Board (IAASB) of International Standard on Related Services (ISRS) 4410 (Revised), *Compilation Engagements*,[1] effective for compilation reports dated on or after July 1, 2013. The IFAC SMP Committee monitored the development of the standard and submitted comment letters at all key stages, from project proposal through to the release of the final standard. The standard, set out in an easy-to-read format, with objectives, requirements, and application and other explanatory material, can be used by professional accountants in public practice for a wide range of engagements for which assurance on the reported information is not required.

Small- and medium-sized entities (SMEs) often turn to professional accountants in public practice to provide financial reporting expertise. Assistance with preparation of annual historical financial statements is one common example. But ISRS 4410 (Revised) also provides the necessary flexibility for the practitioner to tailor the nature of the engagement to meet other needs, for example, the preparation of financial information for use by external parties, such as bank lenders, grant funders, in connection with a change of ownership, or simply for internal use by management.

A compilation engagement is not an assurance engagement. While the practitioner applies accounting and financial reporting expertise to assist management with the preparation and presentation of financial information, the practitioner is not required to verify the completeness or accuracy of the information provided by management. However, users will often value the involvement of a professional accountant in compiling the financial information.

Let us look in more detail at some of the key features of the standard:

Scope of the Standard

The standard deals with the practitioner's responsibilities for conducting and reporting on the compilation engagement. The issuance of a report, in the format prescribed by the standard, is the primary means through which the practitioner's association with the compiled financial information is communicated. Recognizing that a practitioner's involvement in assisting management with financial information may take many forms, the standard also helpfully sets out considerations to help the practitioner determine whether its application is appropriate to the circumstances.[2]

Selecting the Basis of Accounting

SMEs may face a variety of financial reporting demands. Therefore, flexibility to use an appropriate basis of accounting is needed when an accounting framework is not mandated. ISRS 4410 (Revised) allows for this, enabling practitioners to help clients select a framework that is appropriate for the users of the information.

The standard does not, however, permit an "anything goes" approach. In particular, the practitioner is required to have sufficient understanding of both the entity and the basis of accounting to advise the client if the selected basis of accounting is inappropriate for the engagement,[3] and the compiled financial information cannot be misleading.[4]

Communication

There is a focus on communication throughout the standard: from the engagement letter setting out roles and responsibilities, to communication of all significant matters to management, to a clear and concise practitioner's report.[5] As with any engagement, effective communication is the key to success.

Financial reporting requires judgment. Management may benefit from the practitioner's assistance in making such judgments, for example, in determining estimates for inventory obsolescence. The standard requires the practitioner to discuss with management all significant judgments for which the practitioner has provided assistance in the course of the engagement.[6] This communication is essential and must include sufficient detail for management to be able to take full responsibility for the compiled financial information.

Ethical Requirements

The practitioner must comply with relevant ethical requirements, and these include not knowingly being associated with materially false or misleading information.[7] The requirement for the practitioner to understand the entity's business and operations and the basis of accounting sufficiently to perform the engagement speaks to that.

During the compilation, a practitioner may become aware that the records, documents, explanations, and other information, including significant judgments, are incomplete or inaccurate, in which case the practitioner is required to request additional or corrected information from management. Likewise, the practitioner may become aware of a material misstatement or an inadequate description of the basis of accounting in the compiled information, in which case the practitioner is required to recommend changes to management to rectify the situation. If in the rare circumstance management does not provide the additional information or agree to the change recommended, then the practitioner would have to resign from the engagement in order to avoid being associated with information known to be materially false or misleading. The practitioner either completes the engagement satisfactorily or else the practitioner must resign.

Note that there is no requirement in ISRS 4410 (Revised) for a practitioner to be independent of the client, since the concept of independence related to non-assurance engagements is not addressed in the International Ethics Standards Board for Accountants (IESBA) *Code of Ethics for Professional Accountants*.[8]

Reporting

If a practitioner states compliance with ISRS 4410 (Revised), then a practitioner's report must accompany the compiled financial information to help users of the compiled financial information understand the nature of the engagement. The report required by ISRS 4410 (Revised) clearly identifies the compiled financial information, sets out the respective roles of management and the practitioner, and states that no assurance is being given.

Summary

With the growing demand for non-assurance services, ISRS 4410 (Revised) provides new opportunities for professional accountants in practice and their clients.

IFAC Resources

To learn more about the IFAC SMP Committee and access numerous SMP resources (all free of charge), visit the SMP area of the IFAC website: www.ifac.org/SMP.

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1 See ISRS 4410 (Revised) at www.ifac.org/publications-resources/international-standard-related-services-isrs-4410-revised-compilation-engagem. Readers are strongly urged to refer to the standard while reading this article.

2 4410 (Revised), paragraph 3

3 4410 (Revised), paragraph 28

4 4410 (Revised), paragraph 34c

5 4410 (Revised), appendix 2 contains five illustrative reports.

6 4410 (Revised), paragraph 30

7 4410 (Revised), paragraph 21

8 See www.ifac.org/publications-resources/2012-handbook-code-ethics-professional-accountants

Corporate Dividends: Policy and Pattern

Abdul Jabbar Kasim

It is appropriate and legitimate for shareholders to expect dividends, on a consistent basis, in sync with shareholders' desire that their investments bring a reasonable return. What is reasonable or otherwise cannot be put in a straight forward fashion. Rewards and returns are different while we consider a cross sector of the corporate world. Rewards differ from sector to sector, within the industry and also as far as the length of stay of a company in the business is concerned.

Traditional dividend policies have met with success yet corporate world and individual companies have followed a mix pattern. The most advocated policy based on business need for funds and the shareholders expectation of return is the *residual dividend model,* which essentially means to work out the retained earnings needed for the capital budget and pay out any leftover earnings (the residual) as dividends. This policy, as the advocates support, minimizes flotation and equity signaling costs, hence minimizes the Weighted Average Cost of Capital.

Mid eighties and early nineties witnessed an aggressive corporate policy on dividend distribution. The specter of perpetual business growth year on year, along-side capital investment in businesses still left enough with the companies to dish out cash to the shareholders. This trend continued for a pretty long time, just petering out as the business growth literally halted, and took a nose dive in the late nineties, in the wake of financial meltdown.

Companies in order to bulwark against the financial tsunami, protecting further losing ground went into a defensive mode in the process trying to retain cash and deferring pay-outs. Thus the pattern of consistent dividend, which saw growth over years almost, came to a screeching halt. These episodes and happenings led companies to carve a *de novo* approach: as how to balance a retention and reward on a tight rope. Strong and sustainable corporation have finally juggled to achieve the balance.

A consistent payout is a challenge and a shrewder decision keeping the expectation of shareholders in view and the need for retention for reinvestment for an improved bottom line and sustainability. As such dividend payouts can be: high or low stable or irregular dividends and also the consistency with which payouts are made. The underpinning factor is that each Board needs to have a first- hand view and decide as to what is best for the shareholders and for the company.

It usually does not come that easy. As a Chairman, of

one of the companies with 25 years in business said: "I want my members to enter the board room without any preconceived ideas and notions". It should be fair assessment and we must agree in every respect wholly."

As for the decision of payout is concerned, also depends on a variety of factors: on the market mood; bullish market trends usually see more frequency of payouts as against the bearish one. Companies who take *maximization of shareholders value*, very seriously and companies should keep this on their radar screen; usually favour a regular payout approach. Investors view dividend increases as signals of management's view of the future. This many refer as a ***traditional signaling theory***. Since managers do not like to cut dividends, they won't raise dividends unless they think the raise is sustainable. However, a stock price increase at time of a dividend increase could reflect higher expectations for future EPS, not a desire for dividends.

As Board sits to make payout v/s retention decision, it has to take an all encompassing view, mull over the near and mid to long-term perspective in the matter of payout capacity and capability. Many decision makers at the corporate level have admitted that they are influenced in their decision making, one way or the other by the market and analysts' expectation and likely want not to be far way from such scenario while they are put to the test for such a decision. They favour and view that sentiments need to be respected and not ignored and this is where such decisions need to be dealt subtlety.

It is important that the company put underpinning factors on the radar screen. There might be instances and occasions where the company decides payout differing from market and analysts' expectation in which case market value may take a dip and in the process hurting the market capitalization of a company. Board members cannot remove their eyes from such happening more particularly when the company is envisaging additional mobilization of fund.

Some companies maintain Dividend Equalization Reserve (DER) to mitigate situation of high rotate which essential means that they draw on DER, in a situation of such demand, to keep a regular pattern of payout. There is a trade-off both for the company and the investors. Companies have to weigh between pay-outs v/s retention, and shareholder between present sacrifice v/s higher return in the future. Companies have to make absolute sense, earnings retained in the business need to assure an improved bottom line and a consistent growth. Shareholders and market will wait till this waiting period is justified else will react negatively.

Another fact that needs concentration is that high net-profit figure does not necessarily mean availability of cash of the same magnitude. Whereas EPS might be stronger comparatively yet companies may not feel justified to borrow to make a cash payout. Hence the company management needs to focus on cash management as well since there is general feeling that if the bottom line of the company is good so are the chances of improved payouts. DPS usually falls behind EPS.

Some companies are ***autopilot dividend payer*** i.e: giving shareholders a token amount every quarter. Proponents believe that the major reason is that a totally rational dividend is also an unpredictable dividend. In good years companies earn a lot of money and make successive payouts. But economic and business conditions and hence profitability cannot be taken for granted. Hence a consistent pattern of payout is kind of difficult to assure and maintain.

Progressive Corp, USA for example pays a once-a-year variable dividend based on the same formula that it used to determine employee bonuses. That gives employees and owners a common interest, which is lacking in so many companies. In addition, Progressive pays an occasional extra dividend to give its shareholder the capital it feels it no longer needs for its business. Progressive pays dividend based on how its business and securities portfolio perform in a given year. It believes that this is the right way to handle dividends.

Less predictable but more sustainable dividends are preferred on many counts. It is also true that companies that commenced new ventures need to retain cash so as to develop their internal strength and have a good debt-equity ratio. Cash reinvested in such scenarios can likely bring long-term improvement in cost and ultimately an improved bottom line. Analysts do reckon such circumstances to make a sense out of their expectations whilst they analyze such companies. A critical factor in this respect is to judge the progress of the company and its expected performance over the years. A good test is comparing such performances to the averages of the industry and also the progress of the company over a time frame to justify cash retention.

Different groups of investors, or clienteles, prefer different dividend policies. Some want dividends while others want capital gains. Bird-in-hand dividend policy is also favoured by many that is an amount of Re1 in dividend now is worth more than Rs 2 in dividend later on. Firm's past dividend policy determines its current clientele of investors.

Recently companies more particularly, in the USA, who have stockpiles of cash have (Apple and Microsoft) now started buy-back of their shares, as they do not find avenues for additional investment. Intel, the maker of computer chips announced the largest buyback of US $ 10 billion in Jan 2011. Pfizer bought-back shares of US $ 5 billion in January 2011 as well. As one executive remarked: "Companies have lot of cash and they don't feel very confident investing it" Compared to boosting dividends the more traditional method of distributing excess cash, stock buyback are preferred by executives because they increase the value of their existing shares. As such the shareholders do not get cash and such benefits go to the executives of the company.

What than should be policy of the corporations in respect of dividends. A prudent policy is retain whatever you need and distribute the rest. Corporations are in business for long-term and the aim is to have a sustainable growth. In keeping with the needs of investors, more particularly investors who prefer a continuous payout companies have to keep a focus of their cash management. While an autopilot dividend policy may attract investors of such breed, yet over a period of time consistency of payment may not be assured as performance may fluctuate for a variety of reasons. Thus cash pattern can likely get disturbed to attain a regular payout.

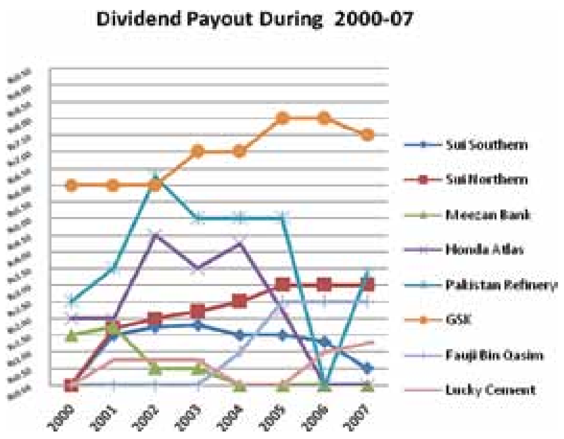
Investors are indifferent between dividends and retention-generated capital gains. As one of the authors has stated investors can create their own dividend policy: If they want cash, they can sell stock. Or else if they don't want cash, they can use dividends to buy stock as companies in USA do this for their investors.

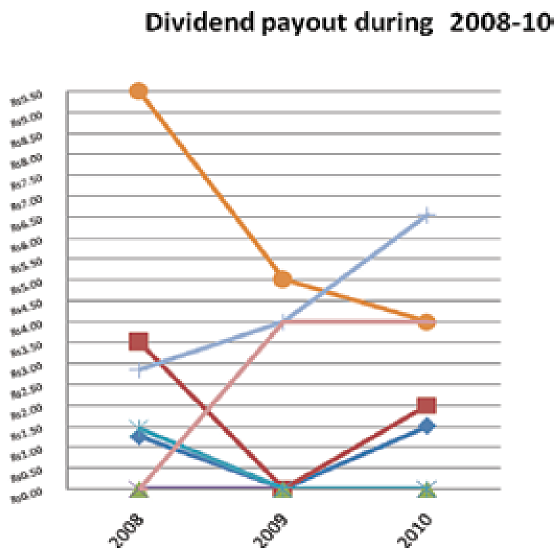
Payout: Trend and Pattern in Pakistan

A total of twelve listed companies have been selected in order to show pattern and trend of pay-out from a cross-sector of the economy. The periods of comparison are (a) year 2000-2007 where the Pakistan economy registered a reasonable growth rate and (b) year 2008-2010 during this period the Pakistani economy suffered from growth due to a variety of reasons and hence the Large Scale Manufacturing Sector performance was impacted, including the factor of elected government.

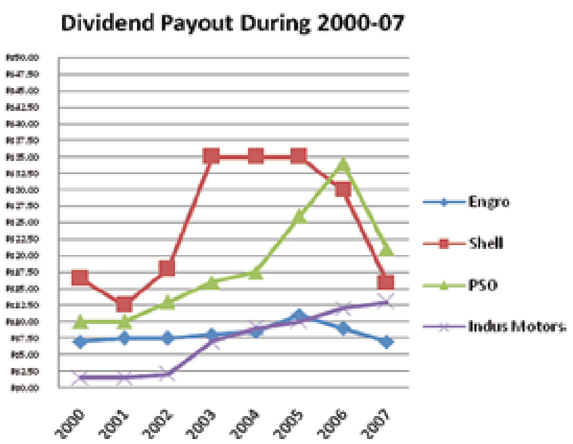
Companies that have given constant payout to the shareholders, during the period under review include GSK, Indus Motors, Engro, Fauji Bin Qasim (2004-10).

In the years 2008-2010, payout of most companies in the sample considerably declined despite this Fauji Bin Qasim, Sui Southern and Sui Northern payout was higher in the year 2010 compared to the year 2009. Indus Motor dividend per share increased from Rs. 10/= in 2009 to Rs. 15/= per share in 2010. Millat Tractors has paid dividend from Rs. 15/ to Rs. 45/= during the period 2000-09, skipped dividend in the year 2010.

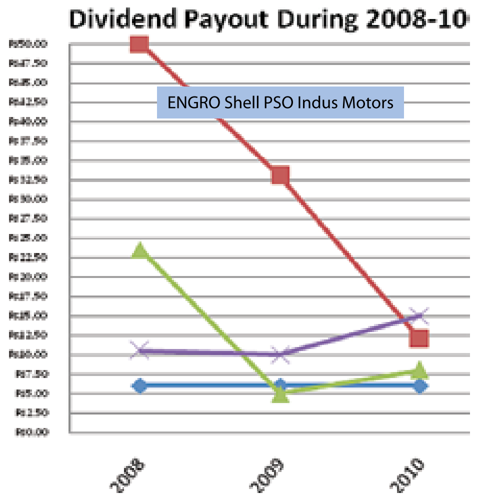




Engro has made payouts during the period 2000-10 consistently in the year 2009 it paid Rs. 33/= per share but payout went down to Rs 12 in the year 2010. PSO and Shell in the Oil Marketing companies sectors have rewarded the investors consistently however there is wide range in their payout.



Shell paid Rs 35/= per share continuously in the year 2003-05 and has not skipped divided during the review period however in the year 2010 the payout was Rs 12/= per share as compared to Rs 33/= per share in the previous year that is 2009. PSO has literally paid half on the average during the period 2003-



05 as compared to Shell. It improved it to Rs 10/= in the year 2010 compared to Rs 5/= in the year 2009. Indus Motor paid Rs 10/= in the year 2009 but increased payout to Rs. 15/= in 2010.

In the automobile manufacturing Indus Motors compared to Atlas Honda not only has kept an upward trend in the payout but has maintained a constant track record. Honda Atlas, in comparison has not payout dividends during the period 2006-2010. In the cement sector Lucky Cement has maintained a constant payout of Rs 4/= per share in the year 2009-2010, but it skipped dividends for four years during the period under review.

This analysis highlights as to how different listed companies have made payouts and range during the years 2000-2010. It is understandable that the need for retention may be one of the important factors yet majority of the companies under review during the eleven year period have maintained their payout trend. Incidentally there is wide variation in payout of companies in the same sector for example Shell payout is much higher than PSO. In the energy sector Sui Northern payout is much attractive as compared to Sui Southern. Engro and Fauji Fertilizer have moved in a decent band in their payouts.

Arguably, most advocate view the residual dividend model policy as the most appropriate and self-protective. The clientele and autopilot dividend models also serve to stand on good ground. Eventually it is the company image, shareholders interest and market price which in the long-term is the acid test as to what are critical factors that need to be focused while a company pursue to follow a certain dividend policy. If one policy fails to garner confidence and interest of investing public it is time for the Board to reassess and revisit dividend policy. In Pakistan as the data shows investors expectation, which differ from sector to sector and business to business, ultimately serve as a guiding factor for a dividend policy decision that is the most appropriate in the circumstances?

(The writer has been a CEO and taken board seat as a nominee director and has spoken at ICAP forum as well and is a regular contributor of articles on corporate governance, financial and corporate affairs)

End of Bank Reconciliation Statements!

E-Banking challenging decades old concepts

◗ Umair Ashraf, ACA

I was busy in my office when Mr Essam, our Finance Manager came to my room and told me that all the bank transactions of the Company have been processed and this is the latest funds position while handing me over the Daily Funds Statement of all the bank accounts of the Company. When I started looking at the Company's Funds statement, I found no balances outstanding under the headings of "Cheques issued but not presented" and "Cheques deposited but not cleared". These columns with zero amounts flashed my memory with the days when I was studying for the Foundation Stage of ICAP and the Bank Reconciliation Statements used to be a very important topic particularly for our examiners. I always used to confuse things around to reconcile bank balances with the book balances.

The zero amounts under these headings i.e. *Cheques issued but not presented* and *Cheques deposited but not cleared* made me think that how the advancement in IT on the banking front is challenging the decades old concepts of accounting. **The hot topics of the past are about to become extinct**.

Our group of Companies is based in Saudi Arabia and lately we have taken the decision in all of the companies of the group to fully exploit the online banking facilities being offered by our banks and do away with the traditional ways of processing banking transactions i.e. limiting the possibility to the minimum of using any paper like Cheques, letters to the bank etc for executing bank transactions. At the same time requests have been made to our corporate clients that all payments to us should be made directly to our accounts and not through cheques. To execute the transactions online, our bank has issued to all the users (as per the defined rights for each user), the **Log In** and the **Token Codes**. The combination of these two is used to process any banking transaction online.

The transactions that we are processing online are of variety in nature as detailed below:

- Payroll Payments
- Payments to Suppliers and Vendors both local and International
- Creating Letters of Credits, Bank Guarantees, Bid Bonds etc
- Payments to Government for Tax, Zakat, Social Security etc.
- Payments for Utilities like Electricity, Water, Telephone, Mobile phones etc.
- Collections from customers against invoices.

As a result of using online banking, the payments are being made almost in real time and so are the collections, leaving no place for payments or deposits to get stuck in the banking channels with the exception of overseas transactions. This development is not only making our lives more controlled, convenient and fast but at the same time leaving little funds in transit for the banking system to make use of. What is happening as a result is that there are not any more Cheques that are issued to suppliers that are yet to be presented to the bank and at the same time there are no Cheques that are deposited and are waiting to be cleared. **In other words, the funds getting stuck in the banking channels causing the books to be reconciled at a given date with the funds available in the bank are becoming almost nil**.

One can very well imagine what bank reconciliation statements would look like if these two main items for reconciliation are not there. We will be left with unknown debits and credits to the bank statement. In online banking, the bank charges are debited by the bank the same time the transaction is processed where as unknown deposits these days are almost non-existent.

Regardless, the employees working in the accounting department have direct access to bank statement of the company online and these unknown debits and credits can be taken care of immediately the moment they reflect in our bank account.

The online banking is a very well known phenomenon these days and is being used more excessively by the individual account holders to the bank rather than the corporate account holders. Individual account holders are using it mostly for paying utility bills, viewing the bank statement/history of transactions and transferring money between accounts etc. However, corporate clients are gradually shifting away from using the traditional ways of doing bank transactions to online banking but I believe there is still a long way to go.

Ever since we have started using the online banking as the only way of processing bank transactions, there are a lot of benefits that have accrued to the organization:

1. We can process any bank transaction around the clock from anywhere in the world. We are not slave any more to the bank timings and location to process any transaction. This is one of the biggest advantages we have experienced. We used to face this problem a lot that if one of the signatories to the bank goes on leave or is not attending office for any reason, how would we execute the bank transactions which sometimes are very urgent and land on your table out of nowhere. With online banking this problem is not there.
2. You can have complete information about the bank statement and about the status of all of your bank transactions while sitting in your office without paying a visit to the branch. You can download all information from your online bank account and use it for decision making.
3. It is cost-effective. We have reduced many overheads and as a matter of fact the job of a cashier has become redundant. You do not need to have a specific person to visit every day various branches to execute the bank transactions and you don't need to make cheques and letters to bank for this purpose which is resulting in saving both i.e. time and money. In fact I was thinking that if customers will not visit the banks (as all the information is available on line even for opening of the account), then why banks need to have their location based Customer Service Centers at all!!! It is saving on both sides.
4. Direct access to various investment options like shares, forex, gold etc. One can invest in these markets by creating direct access through online banking.

The question that comes to mind is that how the future will look like when online banking would be the name of the game. It's a matter of time when the accounting/book keeping applications being used at client's end would directly communicate with the applications used by the banks (in other words they would become one) to process transactions at both ends i.e. at clients end and at banks end. If that happens much of the accounting and banking would be IT and not individuals' dependent making further more jobs redundant at both sides.

Mediation Saves Time and Money

Hina Imtiaz Longi

With more than 1.35 million cases pending in the courts of Pakistan, dispute resolution procedures need to be altered. The IFC-World Bank 'Doing Business' 2011 report estimates that contract enforcement in Pakistan consumes 976 days and 47 procedures. Seeking access to justice usually means filing a case in the court of law. Thus starts a lengthy and expensive procedure which may take years to end. Businesses and entrepreneurs suffer greatly as assets remain frozen which ultimately hurts liquidity.

Dispute resolution trends across the world have evolved to include alternates to litigation. Arbitration is widely utilized by corporate and business organizations for contract enforcement purposes. However, arbitration is expensive while delays during this procedure can prolong the resolution process.

On the other hand, mediation is being widely availed for commercial disputes in developed economies. It is a relatively new concept in Pakistan. Mediation is a voluntary and flexible process which helps in resolving disputes quickly and inexpensively. However, mediation is unique in that the outcome is decided by the disputing parties themselves.

The process is conducted by a neutral third party called the mediator who is selected by the disputants. The role of the mediator is to remain impartial and to help the parties explore solutions favourable to both.

A successful mediation ends in an agreement signed by both parties. If the mediation is unsuccessful, the dispute goes back to the court.

Karachi Centre for Dispute Resolution (KCDR) started operations in 2007 with the support and assistance of Sindh High Court and International Finance Corporation, the private arm of the World Bank. KCDR offers mediation services to parties whose commercial cases are pending in a Court / judicial forum or who have not yet filed a case in the Court.

One of the biggest benefits of mediation is the low cost. Where litigation and arbitration can demand large sums of money upfront, mediation costs depend on the size of the claim. Mediation fees start from a minimum of Rs.7,500 per party. Financially disadvantaged disputants are offered mediation services on a pro bono basis.

Litigation and arbitration are notorious for being laborious in terms of time consumed usually due to the case backlog suffered by the courts. However, the average turnaround time for mediation is 3 days. This helps disputing parties in resuming business activity more quickly.

Confidentiality is a major concern during legal proceeding in courts. Mediation, on the other hand, guarantees complete confidentiality as the mediator is prohibited from divulging information and the session remains private.

Mediation at KCDR also serves a safe environment for women clients. Most women feel insecure going to the courts for justice. More than 300 cases have been mediated pro bono at KCDR for women who could not afford mediation fees.

Lastly, a simple mediation clause in contracts can helps organizations and business entities save time and money. KCDR can help reduce the effort needed to resolve contract violations, banking settlements, partnership dissolution, tenancy and property matter as well as other commercial disputes.

Report of 22nd SAFA Board

Attended by Abdul Rahim Suriya (SAFA Board Member) and
Rashid Rahman Mir (President, ICAP) June 2012 Colombo, Sri Lanka.

Abdul Rahim Suriya, FCA

Mutual Recognition

The SAFA Board suggested all SAFA members to consider the possibility of mutual recognition among SAFA member bodies.

Second SAFA Webinar

The 2nd SAFA-EFAA Webinar on the topic 'How can SMPs interact worldwide to help SMEs develop Businesses' is scheduled to be held on 15th July 2012. Mr. Giulio Veneri (CEO of Inter-professional Network Italy) would be speaker at the Webinar. During his presentation he would emphasize upon the role that SMPs can play in business dialogue in some specific sectors such as infrastructure, automotive, renewable source of energies etc. The Institute of Cost Accountants of India would provide the necessary logistics support for organizing the Webinar and would explore the possibility for maximum number of participants.

SAFA Representative on Consultative Advisory Group (CAG)

Mr. Nishan Fernando, Past President, CA Sri Lanka has been appointed as SAFA representative on Consultative Advisory Group (CAG) of International Accounting Education Standards Board (IAESB) in place of Mr. Lal Nanayakkara.

Summary of the Discussions in PAIB Committee of SAFA

Mr. Abdul Rahim Suriya from the Institute of Chartered Accountants of Pakistan mentioned that in order to become CFO in a listed company in Pakistan, prior working experience of 5 (five) years has been introduced by the SECP. He wished to know whether any other member country of SAFA bodies also has similar requirements. Representatives of the various Institutes were requested to intimate the status in their respective countries.

Project topics to be taken up by the Committee were revised. The committee reached a consensus on **"Sustainability** "as the topic for research and sub-topics were assigned to members as follows:

1. Financial Reporting Aspects for Sustainability & Integrated Reporting - ICA Sri Lanka
2. Business Failures - CMA Sri Lanka
3. Sustainability of Profession - ICA Nepal.
4. CSR Practices in Sustainability - Institute of Cost Accountants of India
5. International Scenario - ICA Pakistan.
6. Statutory Compliance with respect to Sustainability - ICA Bangladesh

Members of PAIB Committee of SAFA were requested to send their response/s to IFAC PAIB Committee exposure draft on "Eleven Principles for Implementing Effective Reporting Process' by 31st July, 2012 to the secretariat of PAIB Committee of SAFA.

Renaming the Award

The Governance Disclosure award is renamed as "SAARC Anniversary Awards for Corporate Governance Disclosures" and name of BCR Award has been changed to "Best Annual Reports Award".

New Addition to Criteria for Best Report

The Committee agreed to include in the new criteria some marks for "Evaluation of quarterly reports"

BPA Awards 2012

Event activities schedule:

S. No.	Activity	Agreed schedule date
1.	Nominations to be sent by each country	August 31, 2012
2.	Forwarding of annual reports to other member bodies for preliminary evaluation	September 10, 2012
3.	A teleconferencing meeting to review the progress of marking	September 30, 2012
4.	Finalization of preliminary marking	October 10, 2012
5.	Conference marking session to review the preliminary marking and to finalize the winners	November 8, 2012 in Lahore
6.	BPA Awards Ceremony	2nd Week of December 2012 (SAFA President would inform venue of the ceremony)

Marking Criteria:

Marketing criteria for BPA evaluation is revised to add marks for sustainability reporting as detailed below:

- **Sustainability Report** **2 Marks**
- **Independent Assurance Reporting** **2.5 Marks**

It was decided to have public sector banking institutions (including Co-operative sector banks) as a separate category in the BPA Awards 2012.

S. No.	Existing Categories	Revised Categories for SAFA BPA Awards 2012
i.	Banking Sector	Public Sector Banking institutions
ii.	-	Private Sector Banks (including Co-operative Banks)
iii.	Financial Services Sector	Financial Services Sector
i.	Manufacturing Sector	Manufacturing Sector
ii.	Communication and Information Technology Sector	Communication and Information Technology Sector
iii.	Service Sector (Excluding Financial Services and Communications and IT sector)	Service Sector (Excluding Financial Services and Communications and IT Sector)
iv.	Non-Governmental Organizations	Non-Governmental Organizations (including NPOs)
v.	Public Sector Entities (Excluding entities covered under Sectors/ Categories)	Public Sector Entities (Excluding entities covered under Sectors/Categories)
vi.	Corporate Governance Disclosure Award	SAARC Anniversary Awards for Corporate Governance
vii.	Insurance Sector (New Category)	Insurance Sector
viii.	Agriculture Sector (It will cover Plantation, farming, animal husbandry etc excluding food processing etc which will be covered in other sectors like Manufacturing) (New Category)	Agriculture Sector (It will cover Plantation, farming, animal husbandry etc excluding food processing etc which will be covered in other sectors like Manufacturing)

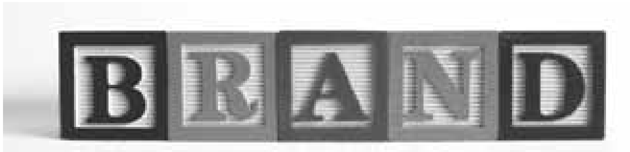
Future Events

South Asia Conference on Sustainability Reporting:

The Global Reporting Initiative (GRI) is organizing conference' on the theme 'Integrated Thinking for Mainstreaming Sustainability Reporting' on September 26, 2012 in India in technical collaboration with SAFA.

SAFA Summit 2012:

2nd SAFA Summit 2012 is being hosted by the Institute of Cost and Management Accountants of Pakistan on November, 9-11 2012 at Lahore, Pakistan on the theme 'Corporate Image of Pakistan'.



Perception Survey

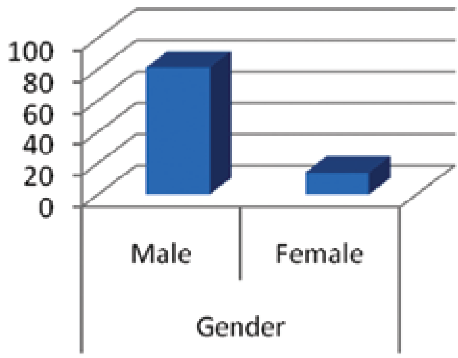
In Summer 2012, during the months of June, July and August a 'Brand Perception Survey' of nearly 1400 students studying in RAETs, ICAP Libraries and Firms all over Pakistan was conducted by the Marketing Department of ICAP. This survey was conducted in Karachi, Lahore, Islamabad, Peshawar, Faisalabad and Multan.

This survey conveys relevant information on various aspects of Brand Perception of CA by our existing students.

Demographics:

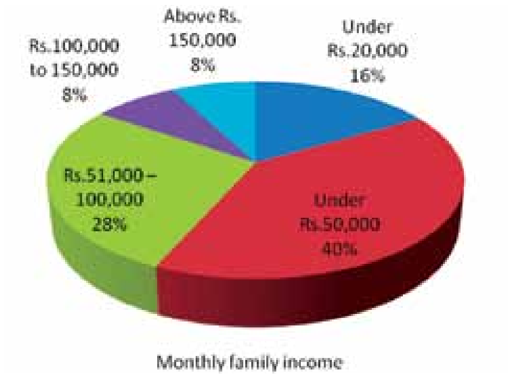
Personal information collected in this survey includes gender, last qualification obtained, monthly income and CA level of respondents.

81% of respondents that participated in the survey were male and 14% were female, remaining respondents did not mark gender.



The last qualification of 56% participants was FA/FSc/A-Levels, 38% were graduates, and only 6% were master's degree holders.

16% of the participants had monthly family income less than PKR20,000; 40% under PKR50,000, 28% between PKR51,000 to 100,000; 8% between PKR100,000 to 150,000 and 8% above PKR150,000.

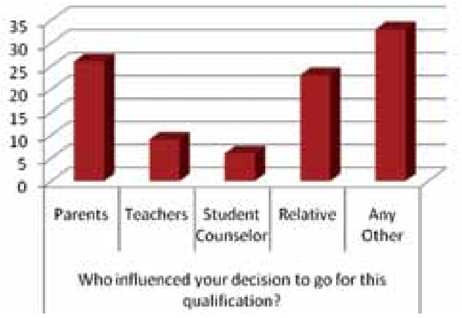


33% of the students that filled up the questionnaire were from CA Final level students, 33% respondents were Intermediate level students and the remaining were Foundation level students.

Findings:

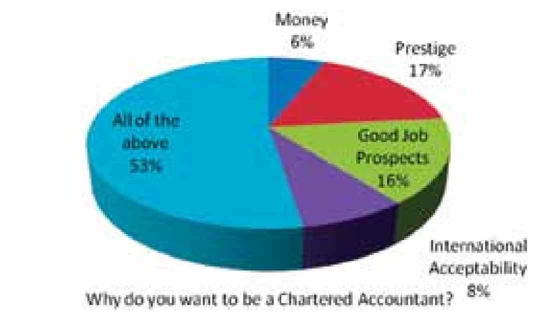
Key Influencer for Decision to Opt for CA:

Parents and relatives appeared to be the key people influencing the selection of this career. Teachers and student counselors did not play a very strong role.



Reasons for Selecting CA Profession:

Good job prospects, prestige & international acceptability were cited as key reasons for becoming a CA.



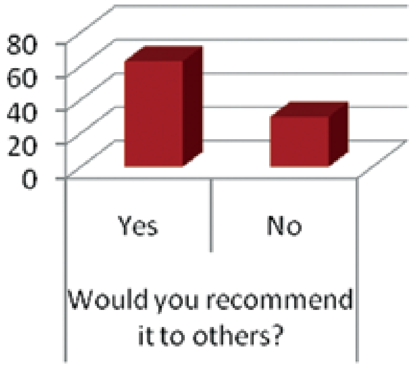
Top 3 Accounting Qualifications:

Majority of respondents rated CA as the top accounting qualification in Pakistan followed by ACCA, CIMA & ICMAP.

	CA	ACCA	CIMA	ICMAP	MBA-Fin.	M.Com.
	%	%	%	%	%	%
Rank 1	88	5	2	1	2	2
Rank 2	6	72	33	29	5	0
Rank 3	4	41	55	53	37	4

Would you Recommend it to Others?

63% respondents said that they will recommend this profession to others. 30% said that they would not recommend it to others. 7% did not respond to the question.

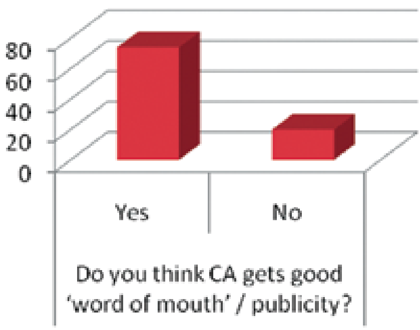


CA Offers the Best and Most Highly Paid Jobs:

75% respondents agreed that the qualification of CA offered the best and most highly paid jobs.

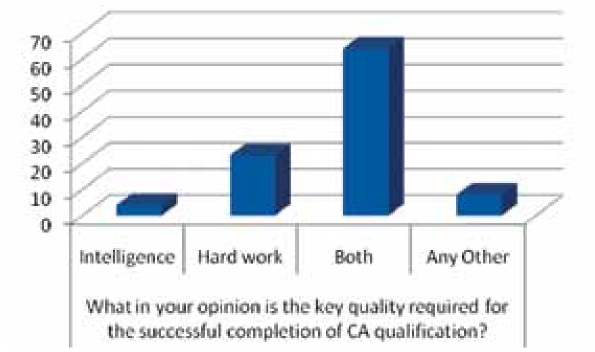
CA Gets Good 'Word of Mouth' / Publicity?

74% respondents agreed that CA gets good 'word of mouth' / publicity.



Key Quality for CA Qualification:

Hard work & intelligence were considered to be the key attributes for the successful completion of the qualification.



How Can 'CA' be Made More Attractive?

For the question 'How can 'CA' be made more attractive for future students' majority of replies concentrated on examination and education system. Almost all respondents suggested an increase in number of attempts. The other focus to make the qualification more attractive was introduction of proper course material, close monitoring of RAETs, improving quality of education and international acceptability of the qualification. Examination process was appreciated and a strong desire for organized study material was revealed by students.

Almost all respondents complained about tough passing criteria in examinations and a high rate of failure. Several respondents further complained about the length of time wasted in case of failure. Respondents suggested equivalence certificates in case of being unable to complete the qualification.

CA has been considered better than other accounting qualifications because of the prestige and honor attached with the name, availability of jobs and international acceptability, especially in Middle East. Rigorous training and practicality, in depth course work especially in audit were also suggested as important differentiators.

Students value the qualification of CA very highly and consider intelligence and hard work to be the key attributes to attain the qualification. They associate the brand with quality, prestige, good jobs and high social standing.

On the basis of the input received from the study, it is clearly demonstrated that the brand possesses immense goodwill among the students. ICAP needs to focus on development of organized study material and further culminate the value of hard work and consistency for the qualification. Career counselors and teachers can play an important part in convincing potential students to go for CA. Our respondents also felt that entering into the profession adds glory and opens up a host of possibilities in the job market.