The Pakistan
accountant
April - June 2019
Magazine of The Institute of Chartered Accountants of Pakistan

Crowdsourcing

Real Estate Investment Trust
A primer for Pakistan

Review of Federal Budget 2019-20

Debate
Entrepreneurs are born and not trained

Chartered Accountants can play a role in balancing technology and trust in an Artificial Intelligence powered world

Benami Law and Amnesty Scheme

CA PAKISTAN | Signature Qualification that Empowers to Lead

Editorial Office:
Chartered Accountants Avenue Clifton, Karachi-75600 (Pakistan).
Ph: 99251648, 99251636-39
Email: publications@icap.org.pk Website: www.icap.org.pk

contents

Editor's Letter

Crowdsourcing has grown exponentially in recent years, fueling innovation and collaboration in research and development to create and increase collective knowledge, community building, creativity and innovation, together with crowdfunding and civic engagement across businesses, societies, and governments.

Crowdsourcing is not only limited to industrialised countries, where it is often characterised by high-tech data solutions and business applications, but is also finding a home in developing countries, where it's primary application is in the areas of professional consultations, election monitoring, constitution drafting processes and tactical mapping of crises. It is also a major enabling technology in tracking and reporting on, and coordinating, relief efforts in the context of natural disasters and civil wars, as well as reporting human rights abuses and violence.

The potential for crowdsourcing can thus not be underestimated, especially in Pakistan, where mobile networks have grown exponentially during the last ten years, bypassing all other infrastructure development in the country. Like other countries, in Pakistan also, online crowdfunding platforms are working in sectors like health, Islamic microfinance, education, flood relief, food and shelter through various successful organisations, which include: the Edhi Foundation, Shaukat Khanum Cancer Hospital,Transparent Hands, Seedout, Pink ribbon, Care Foundation, Door of Awareness and The Citizen Foundation (TCF) among others.

Currently, however this is an entirely unregulated technology, with there being no legislation or regulation to assess related risks, provide counter-measures for its misuse and prescribe penal consequences where misuse is in fact established. The Securities and Exchange Commission of Pakistan (SECP) has issued some advisories cautioning individuals against investing directly in unregistered businesses. The government is also in the process of formulating regulations to maintain a balance between deterring fraud and reducing business risks, but the investment in understanding the scale and potential and the benefits and limitations of crowdsourcing remains a much needed requirement.

As this issue of The Pakistan Accountant will also reveal, I truly believe that there lies huge untapped potential in this area. The resources capable of being harnessed by tapping into the unutilized potential of crowdsourcing will herald the advent of a new era of innovative business. As professional accountants, the onus lies on us to explore the crowdsourcing technology and ecosystem to generate new ideas, think out of the box and develop unique business models and new opportunities for people around the world. The future is exciting and beckons our participation!

Muhammad Awais, FCA

President's Page

If we analyse history of human development, we notice one definite direction of that development: less use of human body and more use of human mind. In our age, mechanisation has reached a level where physical stress has been reduced to an extent no human being living this planet only even fifty years ago could imagine. But last thirty years are phenomenal in another respect. During this age, even human mind has transcended its basic level and technology has lead the humans to use their higher intellect. The opportunities available to humans in modern time were unimaginable for the past generations of humans. The nations who are part of this revolution and who understood the importance of it and embraced modern technologies and means of learning and sharing are developed nations of the modern era. What shape our lives will take in the next ten years under the influence of these technologies is still a matter of speculation.

The dynamic operating environment today calls for innovative solutions and an agile approach from businesses and other organisations. The traditional methods that have served the organisations well for decades are no longer the only option available, rather a cheaper, better and faster option is emerging as an alternate choice for the organisations – Crowdsourcing.

Crowdsourcing offers a way for organisations to find quicker, faster and innovative solutions by engaging with a wider pool of talent available beyond the geographical limitations. It also creates new opportunities for individuals to change the way they work, learn new skills and earn rewards wherever they are, even in remote corners of the planet.

Crowdsourcing is not just about greater access to talent. It is also about tapping into new sources of data and deeper pools of knowledge that cannot easily be accessed. Alongside new technologies, crowdsourcing looks set to play a pivotal role in future business. It will affect the way that workers and organisations interact, the way that businesses engage with their customers and, ultimately, the productivity and diversity of economy. Crowdsourcing is part of an ecosystem of rapidly maturing technologies and methods that look set to play a fundamental role in the future of commerce and society. A crowdsourced economy, which relies on multiple sources, can pave the way for strong economic growth.

Crowdsourcing in the near future will probably play a more important role in boosting the entrepreneurs' and the startups in Pakistan. With a large percentage of our population comprising of young millennials tuned on to technology as well as one of the fastest emerging markets to entrepreneurship, there seems to be potential as well as promise. However, before that it is vital to develop and encourage reliable platforms to enable effective working.

I would like to draw your attention to the fact that no matter what the future brings, one thing will always remain in great demand – intellect. The value that chartered accountants bring due to their intellect may open more avenues due to Crowdsourcing which will be exciting to see. There is no doubt that technological developments will continue to shape the demand and expectations from the businesses but at the same time we also need to prepare not just ourselves but also appropriate mechanisms of governance for the new methods. This is a relatively new phenomena and we the chartered accountants along with the business should be prepared to remain agile and keep ourselves updated with the developments for further improvements.

Jafar Husain, FCA

Crowdfunding: A Case for Pakistan

The Evolution of Conventional Funding

Samir Ahmad

Ever wonder what a bank's primary function is? No, it is not to take your money and put it in their safe.

As societies evolved, a modern take on the early ages' barter system, where you could exchange goods with the ones you wanted in a transaction mutually agreed by the two parties, was developed through the use of currency. Governments used this currency for taxation purposes and hence, coins were introduced. Banks stepped in to 'look after' the coins.

Over time, the transactional nature has become more sophisticated and human needs became more refined. Banks stepped in to fill diverse needs, and acted as intermediaries. They were meant to pass on people's savings to those seeking loans to ensure the economic wheel kept moving forward. As their role became more important, banks started to get regulated, and now play

a vital role in any country's financial stability, and are or should be the primary source of lending. That is what they are supposed to do.

Regulations as well as innovation sometimes gets triggered by recessions, depression or even an economic slowdown. Policymakers, as well as people, tend to change their habits after dramatic events.

A customer, essentially a lender, puts their money in a bank such that they have open access to their funds, but the intermediary – the bank – is supposed to forward it to loan-seekers who have proved they will be able to return the principal amount while making the interest payments.

Down the road, banks started to do more than they were originally designed to. They started to invest, put the money where they could make returns, while keeping a safety net for depositors looking to withdraw. But like most innovations, regulations were not able to keep up with the evolving dynamics. The Great Depression of 1929 partially helped bridge the regulation gap, though. As stock prices crashed, demand for debt and credit reduced as well, resulting in a slowdown that would last several years.

Policymakers realised a strong systemic framework was needed to mitigate the inherent risks of any banking system, and enacted a series of financial reforms. Fast forward to the current day, now we have regulations in place, a central bank that manages money supply in the market, determines the interest rate, and a government that puts forth economic policymaking to manage expectations.

Why is all this relevant? It provides context that regulations as well as innovation sometimes get triggered by recessions, depression or even an economic slowdown. Policymakers, as well as people, tend to change their habits after dramatic events. As an example, the 2008 global financial crises also triggered policy actions meant to enhance risk management framework of the financial system, reduce conflicts of interest, and stabilise the banking system.

The need and motivation for crowdfunding

And now to the issue of crowdfunding.

The concept is still a relatively new one even though the first known project occurred in 1997 when a British rock band, Marillion, raised $60,000 through its loyal fans when they were unable to tour the US. The reason why crowdfunding is often attributed to this project is because this was the first famous case that drew people's attention, and caused people to think, 'this can be done.' Since then, the concept has grown in leaps and bounds.

In 2000-01, 'artistShare' – the first documented crowdfunding site for music – was developed, and later followed by a few others. Michael Sullivan, founder of FundaVlog, is believed to have coined the term, 'crowdfunding,' in one of his articles where he describes the process in 2006.

The 2008 financial crisis triggered many changes in the system. Regulations became tighter, more stringent, and lending found itself in the midst of closer scrutiny.

The size of the global crowdfunding market was estimated to be in the region of $400-plus billion in 2017 by a UBS Group Innovation White Paper. There is no doubt that the concept of a crowd coming together to raise funds – be it for a social cause or funding an investment – has picked up in recent years.

As technology paved way for innovation, connecting people across the globe, and banks became conservative with their lending policies, crowdfunding became a viable alternative solution.

Concept of crowdfunding

The size of the global crowdfunding market was estimated to be over $400-plus billion in 2017 by a UBS Group Innovation White Paper. While these estimates may vary, depending on which region one looks at, or how you categorise crowdfunding, there is no doubt that the concept of a crowd coming together to raise funds – be it for a social cause or funding an investment – has picked up in recent years.

Social media and internet penetration – in other words, global connectivity – has meant the ecosystem is becoming increasingly popular.

In a Deloitte article titled, 'Understanding the basics of Crowdfunding,' the authors argue that crowdfunding has become popular "probably because it offers, at a very low

entry cost, an easy alternative to traditional financing and investing."

This argument goes back to how the banks, in the aftermath of the global financial crisis of 2008 and greater regulation, paved the way for a new solution.

The authors also argue that now, "investors can choose projects they like – projects they feel emotionally connected to – and decide to sponsor them. Crowdfunding is furthermore strongly connected to social and impact investing."

This argument has weight since businesses, venture capitalists, and angel investors want to make money. They put money where they can see returns. Sometimes, however, some projects do not exist to make money. They exist purely because they are needed. They exist because either the government has failed or businesses don't find value in creating a product.

Pakistan has a huge portion of an undocumented economy. While Pakistan economy is officially around the $300-billion mark, but various economists and experts have said that close to a similar number is undocumented, splitting the economy into a neat half and half between documented and undocumented sectors.

The gap has meant that there will be mainly three types of crowdfunding, split across their purpose and the manner in which they raise capital.

First is the rewards/donation type of crowdfunding, followed by debt, and lastly, equity crowdfunding.

Pakistan's case

Pakistan has a huge portion of an undocumented economy. While Pakistan economy is officially around the $300-billion mark, but various economists and experts have said that close to a similar number is undocumented, splitting the economy into a neat half and half between documented and undocumented sectors.

While it is difficult to get data on Pakistan when it comes to crowdfunding, there are some examples of success stories that remind us how the country has not lagged behind when it comes to such initiatives.

While it is difficult to get data on Pakistan when it comes to crowdfunding, there are some examples of success stories that remind us how the country has not lagged behind when it comes to such initiatives.

Edhi, the ambulance service, started with one man, Abdul Sattar Edhi. He didn't have resources of his own, and did not come from a home where education and career were prioritised. Yet, he will go down in history as one of the most celebrated person and influential individuals that shaped Pakistan's healthcare industry.

His work now means that Edhi has now become an institution, synonymous with charity in Pakistan, which motivates and encourages people to pitch in to help the less fortunate. Edhi is not just a success story to convey how crowdfunding can work, but a lesson across multiple mediums.

He is a reminder to the government that a man can help when the state won't. Edhi didn't need social media or technology. His message was enough.

Edhi is not just a success story to convey how crowdfunding can work, but a lesson across multiple mediums. He is a reminder to the government that a man can help when the state won't. Edhi didn't need social media or technology. His message was enough.

When it comes to the types of funding, Pakistan takes the lead in social projects, and donations. Mosques are built through crowdfunding, and NGOs benefit from people's generosity.

Even though it turned out to be a massive failure, a crowdfunding initiative the former chief justice of Pakistan took – building a dam that would address Pakistan's water shortage – was another example of how the country has time and again tapped into the generosity of the

people.There is a reason why Pakistan is among the most charitable nations in the world. While it is something to cherish, it should also serve as a reminder that the need exists because of massive inequality among Pakistan's masses.

A large part of the small and medium enterprises, most of which are part of the informal economy, are initially funded through debt as family members, relatives pitch in to kick-start the crowdfunding journey.

When it comes to other types of funding, debt crowdfunding remains a huge component in Pakistan mainly because banks have always remained conservative.

A large part of the small and medium enterprises, most of which are part of the informal economy, are initially funded through debt as family members, relatives pitch in to kick-start the crowdfunding journey. Contracts are, however, informal and notarised through 'word of mouth.' Repayments are made out of convenience, and there is very little formal structure to the entire deal.

Some crowdfunding channels exist on social media, but lack of trust means people remain unwilling to finance projects until they have seen or contacted the fundraiser. This limits the scope of crowdfunding, and the inability of law-enforcement to ensure that it will look out for public interest makes matters worse.

Equity crowdfunding hasn't picked up pace in Pakistan either, and that boils down to a lack of trust as well. People believe that if they have to crowdfund, they may as well invest in banks and other risk-averse assets. Real estate, savings schemes, banks and precious metals take the lead when it comes to Pakistan's investment avenues.

Potential exists

A few years ago, a start-up came up with the idea of crowdfunding and use it in real estate investment. When it comes to property, prices remain beyond the reach of the common man. It made sense for the start-up to say, 'Hey, we can make that happen by giving you a platform' to invest in property through crowdfunding. In return, one would own 'share' in a property, and could divest when willing to. In other words, it was the informal way of Real Estate Investment Trusts (REITs). What happened was that the regulator immediately issued a statement, warning people not to invest in real estate through crowdfunding. Its argument was that regulations do not allow for such an investment, and people should be aware that their money could potentially go down the drain.

What are Careem and Uber? They were essentially a crowdsourced platform where car owners let their vehicles – during the time they were unused – be driven around as taxis. Regulators are just now comprehending and accommodating the implications of such a platform and legislating accordingly.

The question then is, 'regulations don't exist because this is a new idea. Why don't you revise the regulations, amend them or add new provisions.' This is how you cater to innovation.

CHAIRS
HIGH RESILIENCE MOULDED FOAM

Orthopedically designed for extended Usage

PRESIDENT SERIES

REMEMBER!

A saggy sitting surface fails to support the spine, hip joints, thighs, causing BAD POSTURE, resulting in BACK PROBLEMS, STRESS & STRAIN

PRIME SERIES

ONLY!
HIGH RESILIENCE MOULDED FOAM

Produced from high quality imported moulds designed & developed by skilled professionals

AUDITORIUM SERIES

PIVITOL SERIES

SYSTEM SERIES

PETITE SERIES

WAITING AREA SEATING

TWI FURNISHINGS
email: twi-furnish@cyber.net.pk

Karachi Head Office
C-7, Shaheed-e-Millat Rd.
Baloch Colony Flyover
Karachi Pakistan.
Tel: 3454 8693, 3454 9691
Cell PABX: 0300-2087019
Fax: 92-21-3454 8692

Northern Headquarters
84-Peshawer Road
Rawalpindi Cant.
Tel : 5563000
Fax : 92-51-5584511

CHAIRISTER– EVERY CHAIR HAS A CHARACTER

email: twi-furnish@cyber.net.pk, sales@twichairister.com.pk

chairister
OFFICE CHAIR SPECIALISTS

Public policy can rarely be first. It will always be the idea, followed by popularity and then regulation.

What are Careem and Uber? They were essentially a crowdsourced platform where car owners let their vehicles – during the time they were unused – be driven around as taxis. Regulators are just now comprehending and accommodating the implications of such a platform and legislating accordingly.

Similarly, REITs – where a big block of property is broken down into shares so that small investors can own them – is another way to look at crowdfunding. In Pakistan, REITs regulations were developed relatively late, but are now in place for some years and in fact, one rental REIT called Dolmen City REIT had an Initial Public Offering (IPO) and is actively traded on Pakistan Stock Exchange.

There is huge potential in this area. Regulations may not exist right now, but this is how innovation takes place. A gap is identified, an individual person looks to fill it, and the idea catches on. If there are issues or potential to misuse/abuse, the government steps in to make regulations. This is how the economy works. Public policy can rarely be first. It will always be the idea, followed by popularity and then regulation.

Potential misuses

So far, we have presented the positive picture of crowdfunding. However, there is a darker side, making the need for regulation paramount. Regulations keep businesses/entrepreneurs in check. They ensure society remains answerable and accountable. If left unchecked, the 2008 crisis should serve as a reminder of what could transpire.

Money laundering is one potential misuse for crowdfunding. With terrorism keeping bank officials as well as the government on their toes, crowdfunding initiatives that pass through without scrutiny can be a massive issue.

According to the Deloitte article, crowdfunding can help improve access to finance for businesses and those projects that otherwise won't see the light of day. However, like with all innovation, there are downsides and risks in addition to the limitations of such an endeavour.

Since there are no regulations currently in place, crowdfunding remains susceptible to fraud schemes. The Deloitte article added that money laundering is one potential misuse for crowdfunding. In Pakistan's case, this is a huge issue since the government is engaged in a battle to resolve the issue. With terrorism keeping bank officials as well as the government on their toes, crowdfunding initiatives that pass through without scrutiny can be a massive issue.

Since the crowdfunding platform means money will come from different investors, it remains difficult to inform all contributors of the scope of the project, its actual cost, and progress made on it so far. It can lack transparency, and means there will be potential to abuse and misuse these funds.

The authors in the Deloitte article say, "funds received electronically under the guise of a legitimate crowdfunding offering would be easier to integrate into the financial system than if the transaction were conducted in cash."

In addition, this can also result in financing inflated projects, added the authors. Since the crowdfunding platform means money will come from different investors, it remains difficult to inform all contributors of the scope of the project, its actual cost, and progress made on it so far. It can lack transparency, and there can be potential to abuse and misuse these funds.

Like all online platforms, where information asymmetry exists, crowdfunding has its downsides. When one makes a donation or contributes towards a charity, it is often down to goodness, and intentions with little or no follow-ups. This is not the case with investment or venture capital funding.

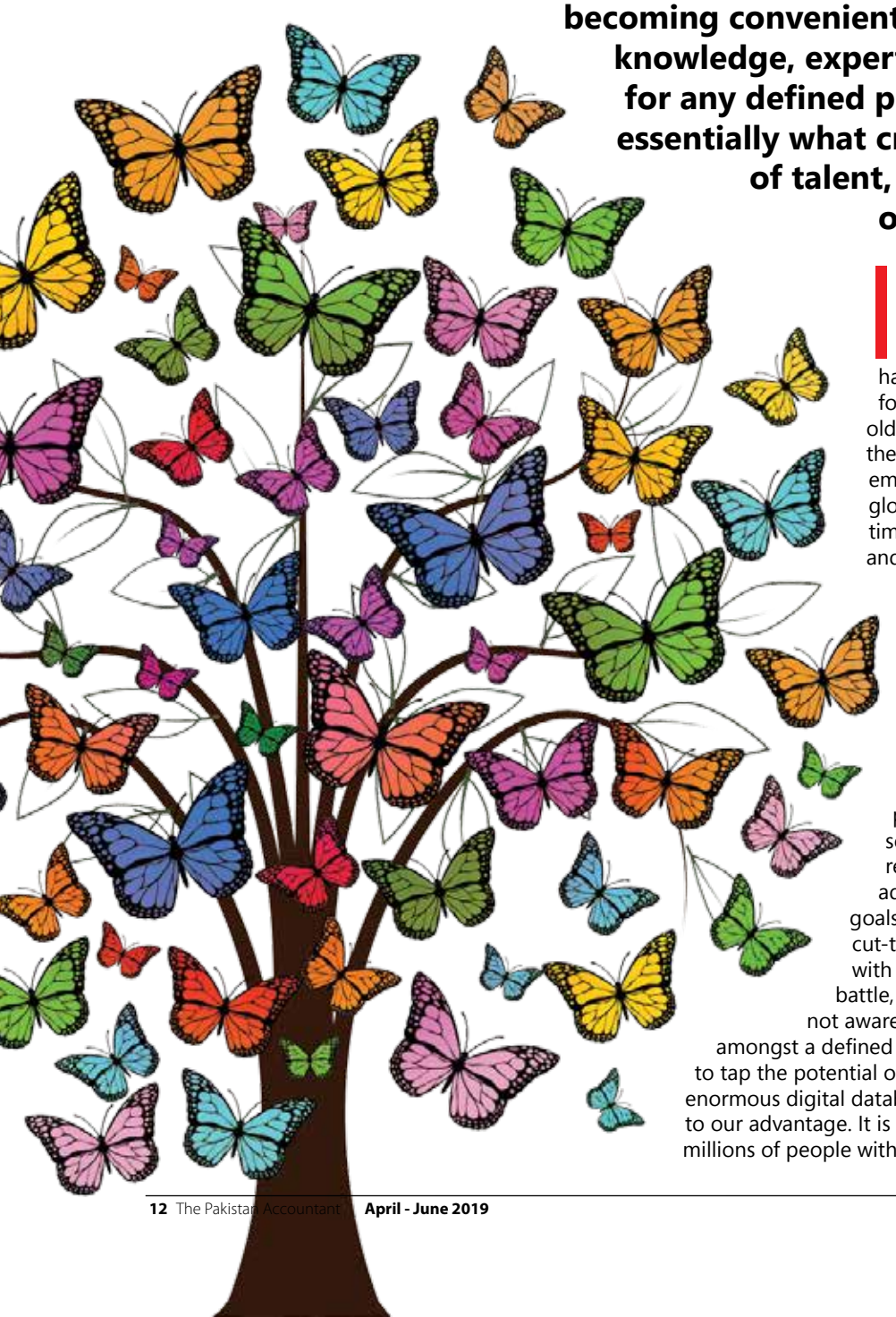
However, like all platforms and online mechanisms, there are potential risks and limitations. One should not ignore the possible advantages, and instead, look to limit the risks while introducing regulation and rules to control the risks. No one can say Pakistan hasn't taken advantage of crowdfunding. Edhi, the Diamer-Basha dam, and many other charities have run on the concept. However, there is much scope when it comes to business activities, and financing initiatives or even start-ups.

Samir Ahmad is a working journalist who specialises in financial markets and taxation matters.

How is Crowdsourcing shaping today's business?

Hina Kazi **FCA**

With globalisation and more connectivity, it is becoming convenient to collectively contribute knowledge, expertise, skill as well as money for any defined project or objective. That is essentially what crowdsourcing is: a sharing of talent, ideas, skills and resources over global tech platforms.



Is it a new concept, which evolved as a result of disruption caused by digital technology? Or is it one of the inventions of the social sciences? Crowdsourcing has always been in existence in one form or the other and is therefore an old concept. Its recent appeal is owing to the creation of a proper platform with the emergence of internet and an increasing global technological awareness. There was a time when people used to gather in groups and share ideas and thoughts; that practice has now become more structured and organised when such groups gather through high tech platforms of social media, electronic commerce and smartphone apps in the digital world.

Crowdsourcing, in today's world, will take companies to the new world of innovation and revolution as they get to interact with people belonging to different cultures and socio-economic backgrounds, and the input received from such a diverse 'crowd' will add value towards achieving organisational goals and resolving problems. In a world of cut-throat competition, the need to come up with something unique in order to win the battle, some new tactic that your competitor is not aware of, is essential. Instead of brainstorming amongst a defined set of people, crowdsourcing allows us to tap the potential of technological resources and utilise an enormous digital databank of knowledge, skills and resources to our advantage. It is a much cheaper way to reach out to millions of people with little or no labour cost and with defined

deadlines encompassing 360 degree levels of creativity and engagement from a wider group of people.

Global accounting and audit firms are using crowdsourcing web programs and tools to provide client services and crowdsourcing consulting strategies are being used to solve client problems.

Crowdsourcing is not 'Outsourcing'

Crowdsourcing is often confused with 'outsourcing.' In outsourcing, one company or individual is selected out of many for a particular task originally performed in-house by the company. In crowdsourcing, a specific task or a problem is given to many people online and ideas and solutions are solicited from all who are interested in contributing, either as paid freelancers, or voluntarily without any payment.

How is crowdsourcing applied by business today?

The research and development departments of companies are no longer solely responsible for giving new ideas or devising strategies for new products, logo design, product testing, launching new marketing campaigns, creating new brands or to funding any new project. With this state-of-the-art model, the main task is divided into small ones and given to the crowd for their response. Immense data and information, in the form of strategies or approaches or solutions, can be collected from customers or the general public, or even the company's own employees, once a well-designed crowdsourcing program is developed and implemented. With such a program in action, the company must of course have the potential to handle and examine huge volumes of data, and the need for strong information technology systems is therefore essential. Some of the ways crowdsourcing may be utilised in today's world is worth consideration. The crowd (customers, employees, general public, etc.) can be assigned tasks, such as choosing the name of a new brand, and based on their responses, the decision is taken for the option which wins the maximum vote from the crowd. Also, a specific crowd (e.g. marketing students in a university) can be given a task in the form of competitions to make electronic advertisements or to make a business plan for a certain company, with the winner given monetary rewards or other incentives. Innovative ways for new business methods or processes may also come to light as a result of this exercise. New businesses and other risks could be identified and the kinds of controls the company should put in place to mitigate those risks, could be given as a task to the crowd to find solutions.

Customers can also be invited to give feedback on products and services they use in order to bring about an improvement in them. This also serves to create a personal connection and a sense of ownership of the product/service. Employees can be engaged in similar schemes which, in turn, will motivate them and make them feel that they have a 'say' and are an important resource of the organisation and they may also be incentivised for their contribution. Internal crowdsourcing within the organisation should be treated like a suggestion box where all new ideas and thoughts by employees should be welcomed and encouraged. When stakeholders are involved this way, their loyalty and commitment to the company increases, thus, resulting in increased customer satisfaction, motivated staff and higher profit margins.

With crowdsourcing tasks, information is passed on to the public, and this way, the more visible the company becomes, the better is its reputation and standing for potential investors and customers.

Accountants and financial experts are also able to generate relevant data from internal as well as external crowds for their financial forecasts and advisory, budget-making and investment decisions. Global accounting and audit firms are using crowdsourcing web programs and tools to provide client services and crowdsourcing consulting strategies are being used to solve client problems. Many credit rating agencies assess the creditworthiness of their clients not only by analysing historical data, but also through reviews of current information available on social media accounts like Facebook, LinkedIn, etc. Chief financial officers (CFOs) these days are required to find technical and strategic solutions to their companies financial issues, not traditionally, but in an innovative manner through crowdsourcing platforms. With crowdsourcing tasks, information is passed on to the public, and this way, the more visible the company becomes, the better is its reputation and standing for potential investors and customers.

At the start of a new business venture when start-up capital is limited, new entrepreneurs can easily get marketing and financial advice from crowdsourcing and would not need to hire marketing and finance specialists immediately.

This activity is also very useful for new entrepreneurs. At the start of a new business venture when start-up capital is limited, new entrepreneurs can easily get marketing and financial advice from crowdsourcing and would not need to hire marketing and finance specialists immediately. This results in significant cost savings and avoiding the hassles of a traditional approach. Care needs to be given as to what information is relevant, as crowdsourcing results in data overload and intelligent analysis is required in order arrive at effective strategies and solutions. Crowdfunding, is another aspect of crowdsourcing, and involves the collection of funds from a larger group of people at cheaper cost, and with more diversified options rather than relying on conventional banking systems and their stringent terms and conditions. Non-profit or community service organisations use this platform in order to promote their events and activities and collect donations both locally and internationally.

Crowdsourcing is a prospect, a vision or an outlook which, if applied in the right direction can lead to a successful journey for any business.

Implementation in Pakistan

In a developing economy like Pakistan, there are immense opportunities for crowdsourcing – a resource available at a very low cost giving returns of unlimited ideas and

solutions from human resources all over the world. In a country where there are emerging industries and businesses and affordability is an issue, this kind of model is a lottery for those who know to how best utilise it. Not only new, but existing entities going into losses, should also undergo this exercise at least once, before giving up completely, to obtain ideas and develop strategies on how to reinvent their business processes and identify the possible causes of losses. There are many successful examples of crowdsourcing in Pakistan such as:

- Edhi Foundation, one of the biggest NGOs in the country is a perfect example here. Over many decades, it has relied on complete voluntary services of people and more than that, is one of the best examples of crowdfunding at a local as well as international level, and is ranked amongst the top 10 crowdfunding platforms in Pakistan. Other than this, there are a few others like the Transparent Hands Crowdfunding website (first online crowdfunding platform in the health sector) providing free surgical treatments to the under privileged class; the Care Foundation, which helped reconstruction and rehabilitation work in the flood affected areas in 1988; and The Citizens Foundation (TCF) Pakistan, which aims at providing education to the poor.

Crowdfunding, is another aspect of crowdsourcing, and involves the collection of funds from a larger group of people at cheaper cost, and with more diversified options rather than relying on conventional banking systems and their stringent terms and conditions.

- At the government level, there is a successful example of Diamer Bhasha Dam Fund in which every local and overseas Pakistani is invited to contribute along with nations worldwide. Bank accounts have been opened so that money could be easily collected and used for this purpose. As per the screenshot of the funds page on the Supreme Court's websites shared by prime minister of Pakistan on March 12, 2019, the country has able to raise Rs. 10 billion for the dam as of now.
- A crowdsourcing strategy undertaken by the previous government through a project, Increasing Women Participation in General Elections 2013 (and beyond) in Pakistan, was in force for a six months, where the main objective was to enhance women participation in the elections. Both pre-and post-election activities were carried out with the focus on achieving maximum outreach amongst women voters. For this purpose, a full-fledged crowdsourcing framework was implemented whereby 60 Community Based Organisations were trained on the voter education handbook, in order to facilitate positive election campaigning. Along with this, both male and female students of reputable educational institutes carried out awareness sessions through theatrical events, students' balloting and competitions in order to improve women turnout.

In a country where there are emerging industries and businesses and affordability is an issue, this kind of model is a lottery for those who know to how best utilise it.

Conclusion

Crowdsourcing is a prospect, a vision or an outlook which, if applied in the right direction can lead to a successful journey for any business. This model is capable of being used across any type of industry or business be it engineering, information technology, marketing, finance or any community service entity. In such a competitive environment, one must be well equipped with adequate resources in terms of skills, insights, talent, experience and money, which is not possible for all to manage, especially medium to small-sized companies. Here, crowdsourcing is a solution which opens doors to pool of assets available at a relatively lower cost and could be tailored according to the specific needs and circumstances of the company. Crowdsourcing is certainly the future. However, as we progress into a more globalised world in the 21st century, getting ideas and inputs from a bigger global audience won't be difficult. The challenge will be, whether we can make those ideas work in what are usually not very ideal circumstances or an ideal environment.

Hina Kazi is working as partner Audit and Assurance at Parker Randall – A.J.S. Chartered Accountants.

Crowdsourcing for Democracy

Saad Gul

Could crowdsourcing be a solution to many of the public issues in an overly legislated country like Pakistan? The Anti-Terror Act 1997 has been in existence for over two decades but most of it was not enforced in reality. Nor was the act able to prevent proliferation of extremist ideologies or execute people found involved in acts of terror or extremism.

Do the existing over 12,000 laws provide the requisite relief to the citizens in a situation wherein the judiciary just doesn't seem to get a grip on execution and implementation? Can our ruling elite join hands for drafting a constitutional draft to this effect through an open and inclusive crowdsourcing process?

With the advancement of Web 2.0 and growing accessibility of the internet, governments across the world are progressively utilising crowdsourcing as a 'knowledge search' and 'citizen engagement' method in legislation and policymaking. Why? because it is an attempt to harness collective intelligence to create more robust laws and policies, designed by cognitively diverse participants; through an open and inclusive crowdsourcing process.

Could crowdsourcing be a solution to many of the public issues in an overly legislated country like Pakistan?

This sense of psychological ownership amongst participants generates feelings of 'mine' and it is necessary to create a sense of ownership in Pakistani people. Crowdsourcing, thus, is not a method for direct democracy but essentially a supplemental method of traditional representative democracy. It provides more chances for public engagement in the political process and nurtures open government principles, rules and regulations which may result in more practical rather than political decisions.

There is also an expectation gap between what people think elected representatives do (developmental work) and what they are actually supposed to do (legislative work). It is a hard fact not to be overlooked because, all indications suggest that a disconnect does exists between governments and their citizens who believe that, and are often frustrated over this, that elected representatives don't listen to them. Often constituents complain of being excluded from decision-making and getting ignored by their representatives. But that could change if federal and provincial governments could introduce and encourage crowdsourcing as a way of **collective wisdom gathering**.

World over, legislation, or the legislative process, has undergone a logical evolution; it is not what it used to be and citizens are transitioning from passive observers to active participants to provide inputs on issues related to society, economics and politics. There seems to be a growing perception that knowledge is not exclusive to experts, MPs, or academics alone but is rather dispersed among individuals. Technology can now locate scattered information, gather and process complex data. This is what is happening in many functional democracies through, for example, public hearings to inform the legislative process.

Finnish citizens have been empowered to design their government policies, thanks to two proposals launched this year: a constitutional amendment requiring every proposal with fifty thousand signatures be voted on by the parliament, and a recent approval by that parliament of a secure online platform that makes it that much easier for eligible voters to insinuate new laws.

Often constituents complain of being excluded from decision-making and getting ignored by their representatives. But that could change if federal and provincial governments could introduce and encourage crowdsourcing as a way of **collective wisdom gathering.**

Pakistani laws were mostly formed under the British Era Criminal Procedure Code (CRPC) 1898, which is the most comprehensive statute on proceedings of criminal courts in Pakistan. The Code contains all the procedures and provisions which are necessary to regulate the criminal justice system.

The British rulers, according to Dr. Shoaib Suddle, former multiple inspector general Police and ex-federal Tax Ombudsman, designed the CrPC essentially to control – not to govern – local populations i.e. the subjects so that they don't revolt and rebel, but that was then and this is now. Why

haven't we had upgrades and revisions even over a century later?

Why can't we figure out, particularly based on the people involved in pending litigation, as to what are the most abused or invoked laws? Current litigants can provide a good collective opinion on how certain provisions of CrPC result in protracted litigations.

World over, legislation, or the legislative process, has undergone a logical evolution; it is not what it used to be and citizens are transitioning from passive observers to active participants to provide inputs on issues related to society, economics and politics. There seems to be a growing perception that knowledge is not exclusive to experts, MPs, or academics alone but is rather dispersed among individuals.

Moreover, it is pertinent to ask how can crowdsourcing help with the application of laws? Crowds will happily, one would assume, participate in the process because they want to affect the law for reasons that do not necessary include a direct benefit for them: for example, protection of nature as a selfless commitment and out of sociotropic reasons, which are intrinsic motivation factors. So once people frame the law in this way, they will also want to feel included in the outcomes, results or application of the laws that they designed. The crowd's genuine hope, and ever so light expectation that they can make a difference should pressure policymakers to use the crowd's input. If the public input is not used, policymaking will likely increase citizens' skepticism.

In short, crowdsourcing may likely increase the ownership of laws, particularly those that concern the collective lives.

Successive governments have promised changes. PTI's law minister also promised on May 2, 2019 that amendments to CrPC are underway. The push from the public – which suffers the most because of a dated criminal justice system – has been massive but no government has been correspondingly responsive.

The answer could potentially lie in crowdsourcing for democracy. Can legitimacy and accountability in Pakistan be enhanced systematically through greater citizen e-participation rates in the administration of public affairs. But the modus operandi for institutionalising public participation in policy-framing may be tricky. It will also first require determination of questions as to who decides which issues to bring to people and through what medium; Parliament itself, the government or the government through public hearings? The entire issue pre-requisites a grand national consensus which can enrich efficacy and efficiency of the process.

How can we even conceive an idea like crowdsourcing democracy, legislation and policy-making when we don't have a holistic IT strategy? Internet penetration and smart phone user rates are still low, and we may be at a potential risk of pre-mature deindustrialisation? It can be done with the right focus and long-term solutions-based mindset. Historically, all great accomplishments started in the mind, with the inception of an idea. This – crowdsourcing in Pakistan – is also the birth of one.

Crowdsourcing may likely increase the ownership of laws, particularly those that concern the collective lives.

Drawing on practical examples from Finland, we can conclude that "democratic value is created by growing transparency, accountability, inclusiveness and deliberation in crowdsourced policymaking." The 'Finnish Experiment' examined the demographic features, motivation factors for participation, and expectations of participants in a

crowdsourced lawmaking process. The motivation factors driving the crowd's participation were seizing the possibility to influence the law, civic duty, and peer learning and deliberation.

Can legitimacy and accountability in Pakistan be enhanced systematically through greater citizen e-participation rates in the administration of public affairs.

Economic value is created when crowdsourcing makes knowledge search in policymaking process more efficient and empowers the government to produce policies that address citizens' requests and social issues better.

What will it take to pull this off? While tackling myriad governance, structural, political, social and economic challenges and specially because nearly sixty percent of the country is youth, we must design a multi- pronged strategy that places a special focus on IT.

Historically, all great accomplishments started in the mind, with the inception of an idea. This – crowdsourcing in Pakistan – is also the birth of one.

Firstly, we need to promote and improve the quality of education to create an educated critical mass.

Secondly, providing easier access to technology, particularly for our young men, women and children, as well as develop interactive technologies that enable the collaborative participation of citizens.

Thirdly, shift our mindsets through education and learning programs about how the development of the sharing economy has changed the conventional model that is based on top-down regulation. Citizens feel that they should be involved in the rule-making process.

Fourth, citizens, institutions, and businesses alike should be more involved in the agenda-setting share of legislation, either in formal (e.g., referenda, public hearings, petitions) or more informal ways (e.g., social media).

Economic value is created when crowdsourcing makes knowledge search in policymaking process more efficient and empowers the government to produce policies that address citizens' requests and social issues better.

Fifth, legislators ought to embrace the fact that new law-making procedures should be more comprehensive. It requires a change of mindset, one that is open to new ideas.

Although exciting, this approach is not without its limitations, which can nevertheless, be improved by developing better mechanisms for harnessing the crowd's collective intelligence to policymaking. Particularly we need better systems for analysing and synthesising that input. There is no existing collection mechanism, which would meaningfully group and synopsise unstructured crowd input so it could be inculcated smoothly into policymaking.

Saad Gul has a business administration and marketing background and is an upcoming private entrepreneur in Islamabad.

Crowdsourcing: An alternative pathway to innovation and financing

Syed Huzaifa Musharraf **ACA**

Crowdsourcing, and the several subsets like Gig-Economics, Crowdfunding, Blockchain, etc., were transpired by the very basic idea of engaging any form of social network or space, in an immersive manner, attracting specialists from technology, economists and corporations. In many ways, this concept is not particularly new. We, as a human civilisation, have evolved and adopted several forms and shapes of this basic idea of resource sharing and shared decision making.

The idea of financial and technological crowdsourcing as an alternative horizon, as opposed to conventions in innovation requiring full-fledged research and development (R&D) setups or conventional financing requiring investment banks, private equity raises, syndications or loans, evolved strongly after its early benefactors shared significant stories of success. For example, Dell claimed that one of its online idea generation community, back in 2007, was able to gather over 24,000 ideas, with about 550 of them being exceptionally well-thought and feasible to act upon. Dell approximated the cost of generating these many ideas to be hundred times higher, had it internally spent for it. It realised how effective crowdsourcing was as opposed to conventional R&D.

21st century is where we can see people funding the projects that directly yield value for them. It has evolutions for the principles of taxation, so that the people can choose where they would like to see their tax money utilised.

It was this same year that the die-hard TV viewers of a detective agent show Veronica Mars, were left heartbroken when the American channel, CW Network, announced cancellation of the show after season 3. Ever since then, these fanatic viewers prayed for revival of the TV show, amidst production houses showing lack of interest. Warner Brothers also rejected an offer to bring the detective story on screen. And then, in 2013, came another success story as the fans crowdfunded the very movie Veronica Mars to the tune of $1 million within 12 hours over Kickstarter (a crowdfunding platform) with as many as 91,000 backers with some individuals paying as much as $2,500.

However, given a few genuine success stories, most of the crowdsourcing efforts have succumbed to tragic endings. Highlight of these failures involves corporates or project partners not doing enough to cultivate individual contributors. There is not enough reciprocal relationship that exists over these crowdsourcing or crowdfunding platforms.

To start with, organisations or project partners that decide to venture into open innovation or alternative funding platforms should first make sure they have the necessary resources ready to devote to the process right from the outset. It should be kept in mind that it is the early stages that are the most decisive and play a significant role in boosting or bursting any crowdsourcing or crowdfunding initiative.

When it comes to crowdsourcing or crowdfunding, there are cautionary tales too. Collective wisdom is not always the best judge of things and circumstances.

As the process has now caught much attention, it will be sooner than later that we can see the actual scalability of such crowdsourcing or crowdfunding beyond the limited success stories. Infrastructure is the next magic domain that is ripe for application. It is about time that the government-civilian relationship makes use of this technology. Before 19th century, only the wealthiest individuals and philanthropists could have funded infrastructure. In 20th century, state funds and government wealth erupted as the vehicle for infrastructure. 21st century is where we can see people funding the projects that directly yield value for them. It has evolutions for the principles of taxation, so that the people can choose where they would like to see their tax money utilised. Therefore, newer technologies are expected to evolve to enable such public scrutiny of its tax money utilisation and to further advance the public private sector economics. Technology will enable a better understanding of how people live and work, what type of services are required, their movements around cities/states and what will make all of it efficient.

When it comes to crowdsourcing or crowdfunding, there are cautionary tales too. Lessons learnt from the several tragedies in this space leads to understanding of an inherent risk in following the crowd. It is equally important to recognise that the best ideas, worthy of genuine appreciation, do not always come from the crowd. Most of them are hidden gems waiting for a chance to become popular, but they never do. Similarly, collective wisdom is not always the best judge of things and circumstances, as we regularly get to see on pop shows like American Idol or X-Factor, where the show winners don't always get success in real life. This, therefore, creates a need for adequate supervision and regulations to ensure such platforms do not yield crowd-biasness.

Syed Huzaifa Musharraf is a financial consultant currently working in an audit & advisory firm in Dubai International Financial Centre (DIFC), Dubai.

Crowdfunding: How startups, SMEs can & should take advantage

Samir Ahmad

Cost of doing business has increased with rupee depreciation, and lending rates have moved upwards as well.

Interest rates are rising, inflation is on its way up, and consumers will soon start to spend less if they haven't done so already. Cost of doing business has increased with rupee depreciation, and lending rates have moved upwards as well.

The central bank's discount rate, also defined as the key interest rate that helps determine – in plain simple words – the amount of instalment you will pay on your loan has climbed from 5.75% to 12.25% in the last three years. This has put a severe strain on the budgets of those seeking finance for house-building, consumer durables, expansions or operating expenditures.

As this cost of doing business increases, it would result in one of the two things. Businesses that require loans will pay a higher amount of interest moving forward, increasing their cost which would be passed onto consumers to result in higher prices. Conversely, they could avoid plans to approach banks and look for an alternative. The worst outcome for the economy would be if plans to increase productivity are put on hold altogether, which would, and in all fairness does, result in slower economic growth.

When it comes to seeking loans in Pakistan, especially by startups and small- and medium-sized enterprises, banks are usually not always the preferred option. Their high mark-ups, processing times, paperwork, and now outright high costs as well as the need for a collateral, mean entrepreneurs look at alternatives. Of late, venture capitalists, angel investors and private equity funds have been looked at with greater interest. But this again requires a certain level of, dare I say, sophistication, research, and contacts that get you through the door and back out after securing a deal that doesn't take away at your idea or stake in the business.

When it comes to seeking loans in Pakistan, especially by startups and small- and medium-sized enterprises, banks are usually not always the preferred option.

We need crowdfunding to pick up – not in terms of contributions – but in terms of awareness and providing a platform where information asymmetry can be reduced.

Whatever the reason, the concept may prove to be an avenue for those entrepreneurs who have either been turned away by banks, or find them too expensive for their appetite. At the same time, it gives them an avenue to raise money for purposes investors won't lend, finding them risky or non-productive.

Pakistan boasts many success stories that have picked up through crowdfunding. A lot more exist, but remain in the shadows.

In such a scenario, when most entrepreneurs are looking out to secure funding in an environment that is cut-throat for loan-seekers that includes government borrowing for official spending, you really could use an alternative.

Such is the nature of crowdfunding, and its usage. As technology prevailed, expanding across almost all aspects of our lives – mostly in a good way – money transfers and moving currency around became easier. Pakistan still lags behind in terms of digital technology adoption, but payments within the country are now comparatively much easier than they were a decade ago.

In such a scenario, crowdfunding can benefit those seeking finance for a project that seems too 'risky' by investment standards. It can even help those ventures that have strategic benefits, such as keeping state-owned entities in the hands of government for long-term gains. Some projects that are pivoted towards research gains can also be financed through crowdfunding. Whatever the reason, the concept may prove to be an avenue for those entrepreneurs who have either been turned away by banks, or find them too expensive for their appetite.

At the same time, it gives them an avenue to raise money for purposes investors won't lend, finding them risky or non-productive. For example, healthcare emergencies – when people pitch in for noble causes and out of the goodness of their hearts to save lives – can and are being crowdfunded. Edhi is a perfect example. Ambulances were not bought out of the pockets of investors. They were financed through crowdfunding. Now, it may seem like nothing more than donations, but the concept now entails the use of technology whereby anyone from literally anywhere in the world can pledge and contribute. You often come across these campaigns on social media, and see the target/amount received. The reason why I am, in a way, advocating crowdfunding to be the saviour is that otherwise, families that need to pull loved ones out of medical emergencies end up going to banks/loan sharks that take away assets/finances that have been built after years of hard work.

In Pakistan, budget constraints are a huge hindrance to funding healthcare.

Crowdfunding is a way to circumvent all those situations. It leaves finances available to families for education/other productive measures.

Monzo, a mobile-only bank based in the United Kingdom and now a success story, started off through crowdfunding after having raised £2.5 million in March 2017. In a recent article, Bloomberg has reported Malaysia's government is turning to the wealth of the masses instead of banks, to help solve a $4.8 billion property overhang. According to the article, finance minister Lim Guan Eng said property crowdfunding offers an alternative for home buyers, and warned banks of action for rejecting housing loan applications without giving a reason for the refusal.

In Pakistan, where there is a huge informal economy, seeking bank loans isn't easy. Lack of formal education, which puts the entire financial market world out of the hand of the common man, and overreliance on family/friends for loans mean banks remain 'second choice.' Informal loans may work if you are opening a small fast-food outlet, but it will prove to be problematic if you are going for a slightly more finance-heavy project.

We need crowdfunding to pick up – not in terms of contributions – but in terms of awareness and providing a platform where information asymmetry can be reduced. Once trust is developed, and information is conveyed, there will be little hindrance to crowdfunding becoming a success.

Pakistan boasts many success stories that have picked up through crowdfunding. A lot more exist, but remain in the shadows. Crowdfunding can help shed light on those.

Crowdfunding

As an Alternate Source of Finance

Shahrukh Malik

Since the industrial revolution and upto 2005, early-stage companies had a huge economic impact due to their innovative approach to solving technological and social problems of society. These companies disrupted the business world and restructured how the markets looked at startups. They found success by growing large enough to be considered equal to their corporate counterparts. However, not all startups have had this success and many remained unable to gain access to the banking sector, being left to the mercy of venture capitalists and angel investors that take away portions of their equity in exchange for reasonable amount of money.

Most founders do not want to give away their share in the pie at the start, when the valuation of their companies is quite low; therefore, to address this need for finance, they started looking at alternate ways of financing and very soon found the solution in crowdfunding. While banks may not fund innovative ideas due to the high risk of the venture, low level of investment, the lack of credit history or liquid assets of the founders, the public was more than willing to hand over money to any person who would solve their problems.

Crowdfunding is usually done through online platforms that act as an intermediary between the business and the general public.

It has been a well-known practice of business founders of touching base with relatives and friends to ask for funds to start a new venture. This generally takes the form of an interest-free loan that must be returned at some future date. Crowdfunding allows this practice to be extended to people outside of one's social circle and the offer is given out to the general public at a global scale.

Since attaining this reach was made possible through the internet, crowdfunding is usually done through online platforms that act as an intermediary between the business and the general public. In the modern age, crowdfunding works as follows:

1. A person starts a business and posts their requirements to get started with their venture or project on a crowdfunding platform.
2. The crowdfunding platform then hosts a page, to promote the business, on which anyone can contribute money that is received by the crowdfunding platform.
3. Once the fund-raising timeline expires, the business receives as much money as was deposited by the public (minus any management fees).

The exact terms and conditions vary from platform to platform where some restrict funding to be passed on the business only if they meet the minimum amount set for the campaign, while others may restrict going above the ceiling set. Either way, funds are submitted to the business along with a list of who funded the venture/project. This list helps the business give back to the sponsors, if something was promised in return – which can be pre-sales of commodities at a discounted rate, reports of achievement of a social cause or shares in a company.

Essentially, crowdfunding calls out to many to contribute small amounts rather than a few people to put in larger amounts. In return, each funding party receives a smaller reward, but their risk is almost nominal, which is the main driver in addressing the high-risk nature of most crowdfunded projects.

Some of the early campaigns of crowdfunding were – a Japanese band raising money from their fans (2000), freelancers in the UK raising money to ward of laws that threatened them (1999) and a movie studio raising money for their film (2009). The internet-enabled crowdsourcing formally started in 2008; funds raised through crowdfunding in 2015 exceeded USD 34 billion (as per research conducted by Cambridge Center for Alternative Finance) and is expected to reach over USD 90 billion by 2025, according to a research by the World Bank.

The largest crowdfunding project ever has been EOS, a cryptocurrency designed to support large-scale applications, which raised over USD 4 trillion in 2018 and is a blockchain based operating system that allows deploying commercial applications on the Ethereum blockchain rather than using the Cloud or a traditional server model. The second place is taken by Filecoin, a decentralised data storage system raising over USD 257 million.

Some of the most notable crowdfunding platforms are Kickstarter, Patreon, Indiegogo and GoFundMe. Each of them has a different business model and allow collecting funds from the public in unique ways, while supporting multiple payment methods. Some offer one-time payments only while others allow monthly or annual subscriptions.

Essentially, crowdfunding calls out to many to contribute small amounts rather than a few people to put in larger amounts.

Apart from receiving funds, crowdfunding provides other benefits to businesses as well. The project gains a lot of visibility, especially if their fund-raising campaign goes well in the start – as people are likely to follow crowd psychology and perceive a project exceeding funding goals to be good without checking for themselves, leading to exponential growth in social media coverage (all of which ultimately leads to achieving or even exceeding the funding goals).

Furthermore, businesses can engage directly with their customers, as it is likely that people are funding a project in return of discounted commodities. In this way, businesses get to communicate with their potential customers and make them a part of the project execution, all the while receiving constant feedback.

In many cases, funds raised through crowdfunding is against 'sales' rather than 'equity,' which not only makes it a

very low-cost method of raising finance, it also creates the market of the business's commodities.

A compromise between freedom and oversight is needed so that Pakistani start-ups can avail such innovative financing models and have more opportunities to scale.

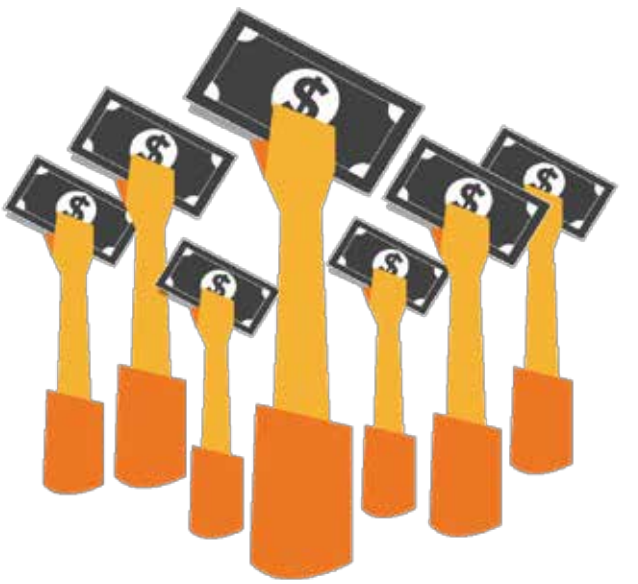
There are some risks associated as well, the most notable of which is the reputation. If a project fails to raise finance through crowdfunding, it represents that the market is not supportive of the project. Additionally, projects that involve creative or technical work may have to disclose some details to the general public to inform them of what's being built; this may lead to plagiarism and protecting intellectual property could be tricky.

Finally, the aspect of storytelling becomes more important and it may be easy to get funding for projects that people can easily understand rather than technical projects that require specialised knowledge to make sense. Since the pool of sponsors in the crowdfunding space would be limited, if they are sold out to projects with good stories, projects that have a higher impact but poor marketing campaign would be left out.

Humans seem to have come to a realisation that without each other's help we cannot survive, and they now seek to make this help available in various forms.

Benefits accrued to investors are the reduced cost to invest, resulting in increased potential for investment into multiple industries. However, performing due diligence is almost impossible, especially when the funding is done through the internet. Intermediary platforms cannot undertake verification procedures either as it is costly to verify projects across borders and things can become too intrusive for the businesses to consider listing themselves with such platforms.

Since this give individuals and companies an opportunity to exploit the general public into investing into fraudulent schemes in the name of crowdfunding, the Securities and Exchange Commission of Pakistan (SECP) issued a press release in 2017 stating that crowdfunding is illegal.[1] Furthermore, laws such as Section 27A of the Banking Companies Ordinance 1962 (which prohibits invitation of deposits from the general public) and Regulation 3 of the Public Offering Regulations 2017 (which restricts issuing of shares to the public to companies that have been operating for at least three years and have operating profits for the past two years) prohibit start-ups form performing any fundraising through crowdfunding. As a result, companies registered in Pakistan cannot utilise crowdsourcing as an alternative source of finance without routing it through foreign channels. While the regulators have promulgated these laws to prevent fraud and assist Pakistanis in making the right business choices, a compromise between freedom and oversight is needed so that Pakistani start-ups can avail such innovative financing models and have more opportunities to scale.



As the world moves forward in utilising modern technologies, we see people helping each other more often, bypassing the larger intermediaries and corporations. From sharing data through peer-to-peer technologies like torrents, maintaining data in decentralised networks like blockchain and funding each other's projects and needs through crowdfunding, humans seem to have come to a realisation that without each other's help we cannot survive, and they now seek to make this help available in various forms.

Reference: [1] www.secp.gov.pk

Shahrukh Malik is an entrepreneur.

BUDGET 2019-20

Key Highlights

Scaling down of tax exemptions and concessions to broaden the tax net.

Tax rates increased for salaried and non-salaried persons.

10% cut in cabinet member salaries.

The corporate tax rate has been fixed at 29%.

IT based interface between taxpayer and tax collector to minimise point of contacts.

Duty on more than 1600 tariff lines, being raw materials and intermediaries exempted.

New division of Poverty Alleviation and Social Safety called Ehsaas has been established.

Sehat Sahulat, a health insurance scheme for the poor has been launched.

Review of Federal Budget 2019-20

Dr. Waqar Masood Khan

Federal Budget is the most significant policy statement of the government during a fiscal year. It reflects the challenges facing the economy and sets the direction for their resolution. Business and people are affected by various measures adopted in the budget. The features of the budget that are particular interests are taxation proposals, economy of expenditures, level of fiscal deficit and the manner of its financing. Taken together, sound decisions in each of these elements determine how effective is the fiscal policy adopted in the budget.

This article, would make a detailed review and assessment of the budget with respect to each of the above four elements; and would also identify the challenges faced by the economy which the budget was supposed to address. An important consideration in budget making is to keep in view the understanding reached with the fund in the staff level agreement. Toward the end, this article would also identify the risks associated with the realisation of the budget objectives.

Economic Challenges

The economy was facing the following challenges. First, this fiscal year, there would be a record budget deficit of 7.6% of GDP, highest in many years. Both revenues and expenditures have missed their targets. On the revenue side, it seems the year would record the most dismal collection performance in country's history. Optimistically, the actual collections would be Rs. 3900 billion compared to the target of about Rs. 4400 billion, missing the target by a massive Rs. 500 billion and perhaps recording a negative growth. Even with a growth rate of 3.3% and inflation of nearly 8%, there must have been a 11% growth in revenues to keep the debt to GDP ratio constant. However, we have been generous in giving away the tax in exemptions and concessions, besides a supreme court order that stopped collection of tax in the telecom sector.

Second, the expenditures over-runs have been significant particularly in debt servicing despite a major cut in the development expenditure. Third, a massive build-up of borrowings from the State Bank of Pakistan (SBP) has distorted the profile of public debt and contributed to rising inflation, besides constantly violating the relevant provisions of laws. Fourth, there is a menacing rise in the circular debt in the power sector, which is also rearing its head in the gas sector. Together, they are a major threat to fiscal stability. Finally, the cut in development expenditure has been a major reason behind low growth, so its protection is critical for ensuring moderate growth.

In the short-run, immediately after budget, there would be further pressure on prices because of new taxation measures adopted in the budget. But mercifully, the international oil prices, the main driver of inflation, are coming down and hence we may expect the inflation to come down much earlier than expected.

Budget Targets Reduction in Primary Deficit

There is a curious shift in fiscal adjustment in the budget. Let us explain it. The fiscal deficit for 2019-20 is estimated at Rs. 3137 billion or 7.1% of GDP, and that too based on a hefty surplus of Rs. 423 billion or nearly 1% of GDP. Ordinarily, it is unthinkable that an International Monetary Fund (IMF) program would allow such a large fiscal deficit to be incurred. A closer examination would reveal that the program has changed the target of fiscal deficit away from the overall deficit to primary deficit. The latter is worked out after subtracting from it the interest payments. The debt dynamics teach us that if the primary deficit is positive (surplus) then notionally it is possible to not just cover interest payments but to partially retire a portion of the principal amount of debt. Thus, it is a situation where the borrower is not pushed to borrow even to cover interest payments. If there is a primary deficit, some interest payments are also paid through borrowing. Under this condition, the debt accumulation path is explosive.

What is laudable is that new tax measures are not dependent on increase in the tax rate of existing taxes.

During the last three years, primary deficit has risen sharply. It was 0.3% of GDP in 2015-16, then rose to 1.6% in 2016-17, 2.2% in 2017-18 and 2.0% in 2018-19 (which is the revised estimate and is likely to go up). The fiscal deficit during these periods were recorded at 4.6%, 5.8%, 6.6% and 7.2%, respectively. If we subtract the primary deficit from these fiscal deficit numbers, we get 4.3%, 4.2%, 4.4% and 5.2%, respectively, which is the burden of interest payments during these years. The challenge on the fiscal side, therefore, was to arrest this rising trend in the primary deficit and turn it into a primary surplus. This year it has been targeted to bring down primary deficit from 2% (revised estimate), or Rs. 880 billion, to 0.6%, or Rs. 264 billion, which gives an adjustment of 1.4% or by Rs. 616 billion.

In the following years, there would be a primary surplus, which would begin to lower the interest payments. But more significant reductions in debt servicing burden would come only after interest rates start coming down. This would happen when inflationary pressures abate. In the short-run, immediately after budget, there would be further pressure on prices because of new taxation measures adopted in the budget. But mercifully, the international oil prices, the main driver of inflation, are coming down and hence we may expect the inflation to come down much earlier than expected. Surely, the base effect of higher inflation during this year would also kick-in.

The most remarkable feature of the budget is the financing plan for the deficit of Rs. 3137 billion.

Taxation Measure

The brunt of fiscal adjustment in primary deficit is falling on the taxation side, which is billed at Rs. 5550 compared to the revised estimate of Rs. 4150 billion (which is an over-estimate since only Rs. 3300 billion have been collected in eleven months and hence final collection of Rs. 3900 billion would be a major achievement). The proposed increase is about 32% (which would be 42% if the base is Rs. 3900). This is a phenomenal increase but considering the fact that the loss of Rs.500 billion during the year was primarily a result of poor policy actions or court intervention, it is not an unachievable target. This lost tax revenue is in the system but was either given in exemptions or stopped by a court order. Since these distortions have been removed, this lost amount should be taken in the base. Adding the autonomous growth during the year relative to nominal growth in the GDP would leave only a manageable tax effort of Rs. 500-550 billion, which is what is budgeted for the next year.

The most significant is the freezing of defence budget at last year's level, which has easily saved at least Rs. 110 billion (0.25% of GDP). The reduction of Rs. 30 billion by the civil government is also a right step.

What is laudable is that new tax measures are not dependent on increase in the tax rate of existing taxes, particularly such as the increase in GST rate or maximum rate of income tax, which many had apprehended. A number of measures are base-enhancing though in many cases rate of taxes have been increased where room existed, most notably through additional duties in chapters that carry finished products. This was also balanced by giving significant concessions in duties on raw materials for industries. Furthermore, removal of exemptions and elimination of special schemes and ad-hoc procedures such as Final Tax Regime (FTR) has been a significant focus of the tax measures. Another reform that would go a long way in strengthening the tax system is the elimination of the distinction between the filer and non-filer. Though complex at present, the law now requires a non-filer to buy immovable property or vehicles subject to becoming a filer within 45 days. This would contribute to broadening the base.

Economy in Expenditures

The expenditure side has limited flexibility in the short-run to help reduce the deficit. Yet, some decent moves have been made in this regard also. The most significant is the freezing of defence budget at the last year's level, which has easily saved at least Rs. 110 billion (0.25% of GDP). The reduction of Rs. 30 billion by the civil government is also a right step. Unlike these savings, the budget has made handsome increases in such important areas like development expenditure and social spending. The development expenditure is pitched at Rs. 700 billion compared to the revised estimate of Rs. 500 billion for the current year. Despite being a hefty increase, this is still below the spending level that the country had seen few years ago. However, given the massive cut applied during the year, it is a good beginning and more needs to be done in the next few years as the fiscal space becomes available.

Sizeable allocations have been made for the social protection, including Benazir Income Support Program (BISP) and other Ehsas programs, which would be helpful in partially mitigating the burden of adjustment on the poorest segments of the population. The government has also announced that it would stop additions in circular debt within two years.

Financing of Fiscal Deficit

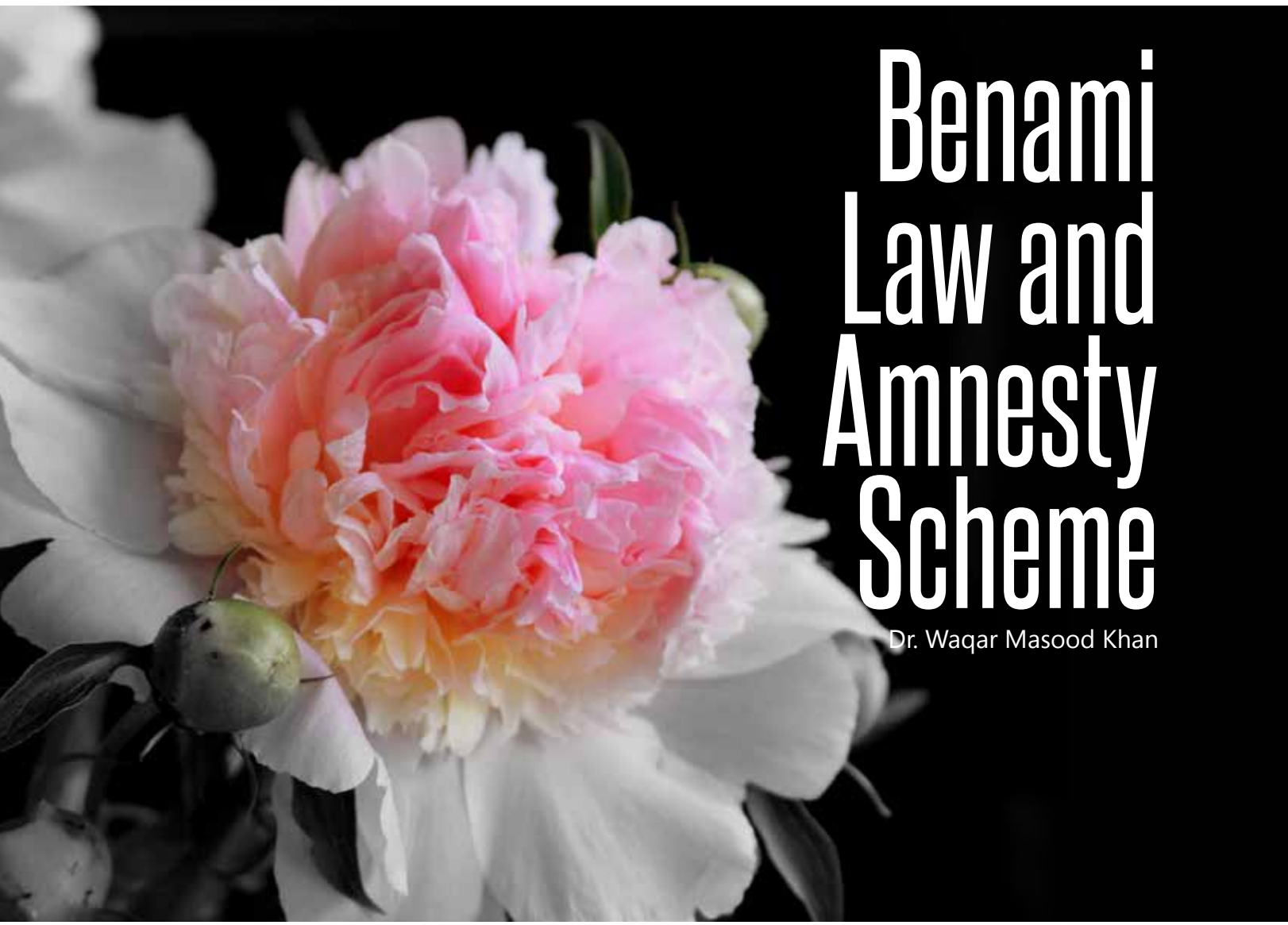
The most remarkable feature of the budget is the financing plan for the deficit of Rs. 3137 billion. More than half the financing would come from external sources budgeted at Rs. 1829 billion. This increased access to foreign resources would be made possible by continued adherence to fund program. Any disruption in the program would lead to suspension of budgeted foreign inflows. From domestic sources, the major financing would come from non-bank sources budgeted at Rs. 983 billion (of which Rs. 883 billion from national savings schemes and Rs. 150 billion from privatisation proceeds). From the banking sources only Rs. 339 billion have been budgeted, all of which would come from the commercial banks and none from the central bank. This is a major reform effort, as in the last three years, the government had accessed SBP financing without any restrained leading to a huge build of SBP borrowings of Rs. 8.6 trillion until mid-May 2019 from Rs. 1400 billion on June 30, 2016.

Let us underline the fact that this is a budget that is based on the understanding that the government has reached with the IMF.

Risks to the Budget

Before closing, let us underline the fact that this is a budget that is based on the understanding that the government has reached with the IMF. Several of its measures are the prior actions for program approval by the board. It seems the government has faithfully implemented the program conditionality as much as it was related to the budget. In our view, this is the easier part of the program because at this stage political leadership is fully alive to ground realities and has the necessary resolve to move ahead. But this is just the first step of the proverbial 'journey of thousands miles.' A great deal of energy and discipline is needed to implement the program over a three-year period with twelve quarterly reviews. For most of the programs, economic managers and political leaders alike have failed to muster such resolve. The budget is imminently deliverable, and so are the other program targets so far known. It could fail only on account of our perennial inability to carry reforms to the finish-line. The ownership of the program is relatively weak and communication, with businessmen and people, requires extra work. These shortcomings should be removed. Let's hope this team and leadership would prove that they are imaginative and resolute to complete the program with distinction.

Dr. Waqar Masood Khan is a former federal finance secretary, government of Pakistan and ex-Council member of The Institute of Chartered Accountants of Pakistan.



Benami Law and Amnesty Scheme

Dr. Waqar Masood Khan

Introduction

In developing countries, where the rule of law is quite weak, especially relating to tax laws, there are two practices that have become the way of life: One, businesses keep two sets of accounts, one real, the other fake, for tax purposes. Two, there is a large informal sector that operates completely outside the tax system and regulatory framework. Interestingly, both have succeeded in having access to the banking system, which until recently was not subjected to elaborate background checks on its users. The reason these two types of business flourished was the notion of benami transactions, accounts and even properties. The word *benami*, literally meaning 'nameless,' signifies use of the name of another person to conceal the real owner and beneficiary.

The widespread use of such devises would entail considerable economic loss as they would escape tax net as well as pose major challenges for determining ownership disputes in courts of law. Evidently, all such arrangements are entered into with a view to evade either tax obligations or hide assets from the debtors. In both cases criminal intent cannot be ruled out. Hence, there has always been a need to prohibit such arrangements so that economic transactions and assets are properly recorded in the name of real beneficiaries.

India had enacted the Benami law prohibition act as far back as in 1988. It is strange why Pakistan had been lagging behind in taking a similar action, particularly in view of the fact that our tax to GDP ratio is significantly

below that of India. Attempts were made during Pervez Musharraf era to fill this gap but those were not successful. It seems strong lobbies used their influence to delay such an enactment.

The Prohibition of Benami Transactions Act was passed in 2017 but had remained dormant for want of Rules for nearly two years. The prime minister had recently ordered early finalisation of rules, which were finally promulgated in March and afterward the law has become fully effective.

The Prohibition of Benami Transactions Act 2017

The law has far reaching implications for removal of informal economic arrangements made to evade taxes, conceal assets, maintain fake accounts or operate outside the pale of regulatory framework. It may promote documentation of the economy on a scale not witnessed in previous efforts. It is, therefore, important that this law is fully understood and its implications appreciated by all people in the country. In this section, we examine the main features of the law.

The word *benami*, literally meaning 'nameless,' signifies use of the name of another person to conceal the real owner and beneficiary. Evidently, all such arrangements are entered into with a view to evade either tax obligations or hide assets from the debtors.

To examine the law we begin with some key definitions. Section 2(7) of the Act defines 'benami property' as any property which is the subject matter of benami transaction and also includes the proceeds from such property. The definition of a 'benami transaction,' on the other hand, given in Section 2(8), is somewhat complex and requires an analytical presentation.

The transactions have been divided into four parts. Part one includes transactions and arrangements whereby a property is transferred, or is held by a person, and the consideration for the property has been provided, or paid by, another person; and, the property is held for the immediate or future benefit, direct or indirect, of the person who has provided the consideration. This is a classical manner of engaging in a benami transaction. Person A gives to person B a certain property with the sole purpose of concealing the ownership of A. This may be motivated for tax evasion or preventing creditors to stake a claim. Until recently, this was not an offense. The new law has drawn curtain on such transactions. However, there are exceptions which include cases of properties held in fiduciary capacity, such as by a trustees or directors of companies, or kept in the names of close family members, and the consideration is paid through known sources of income.

Part two relates to transaction of a property carried out or made in a fictitious name. This is the case of fake accounts, where the name of a fictitious person is used that in some cases would not even exist. Part three relates to a transaction of a property where the real owner is not aware and denies knowledge of the transaction. This is similar to fake accounts, but here the person exists but denies any knowledge of keeping an account. Part four is a transaction where the provider of the consideration is someone who is not traceable or is fictitious. This part essentially covers a person who would have gone missing, irrespective of whether he knew or not whether an account or property existed in his name. The holder, on the other hand, would be unable to prove the sources of consideration paid for the property.

If any person enters into a benami transaction or holds a benami property, he would commit an offense that carries a punishment of rigorous imprisonment for a term which would not be less than one year but may extend up to seven years. Moreover, the benami property would be confiscated in favour of the federal government.

Furthermore, Section 2(9) defines a *'benamidar'* as a person or fictitious person in whose name the benami property is transferred or held, and includes a person who lends his name. This last category where a person lends his name is curious. What it means is that nobody can rent his identity for the purpose of holding a property on someone's behalf solely for the purpose of concealing the identity of the owner. Lastly, Section 2(26) defines property in the broadest terms including both moveable and immovable assets, including monies held in bank accounts.

Given the above setting, Section 3 requires that no person shall enter into a benami transaction or hold a benami property. If any person enters into a benami transaction or holds a benami property, he would commit an offense that carries a punishment of rigorous imprisonment for a term which would not be less than one year but may extend up to seven years. Moreover, the benami property would be confiscated in favour of the federal government.

The process of dollarisation is a sure recipe for creating forex shortages especially when the country is facing an external account problem, as is happening at present.

An elaborate mechanism for identification of benami transactions and property has been laid out in the law that would allow due process of defense, appellate tribunals and appeals before the High Court, while special courts would be set up for trial of offenses under the Act.

Evidently, the law provides a comprehensive regime against concealment of assets by keeping them in the name of persons who are not their real owners. As we explained in the introduction, benami transactions are a rampant practice in the country. The law has now prohibited to enter into such transactions or to hold such properties. The law has also required, under Section-17, all offices dealing with transactions and registration of properties, including banking and financial institutions, stock and other exchanges, building authorities, police, tax authorities, civil armed forces, etc. to assist the authorities and tribunals, established under the Act, in discharge of their functions. Above all, once a benami property or transaction has been identified, and the holder is unable to prove his credentials of ownership, there is no scope of any bargain or remission of any kind. The property would have to be confiscated and the offender would face a minimum jail term of one year, extendable to seven years.

Coupled with the fast evolving Anti-Money Laundering (AML) and Countering Financing for Terrorism (CFT), this law is closing all avenues of evading taxation, laundering proceeds of crimes and facilitating terrorist financing. It is in our national interest that we bring transparency in our dealings with due protection of privacy.

While the country is moving toward documentation, it would be imperative to also remove a distortion that continues to plague our forex regime, namely the so-called Protection of Economic Reforms Act (PERA) 1991. This law provides an uncalled for facility to residents to maintain a Foreign Currency Account (FCA) and hold, deposit and remit foreign currency through this channel. This is a standing scheme for flight of capital and occasionally a source of causing balance of payments problems. Residents can buy dollars from money changers and deposit them in their FCAs. The process of dollarisation is a sure recipe for creating forex shortages especially when the country is facing an external account problem, as is happening at present. This budget should see closure of this avenue of instability.

Amnesty Scheme 2019

The law for prohibition of benami transactions has radically altered the economic landscape in the country. Those who were previously engaged in this business with impunity would face criminal charges for doing so. The law is so stern that once caught confiscation and minimum jail term of one year is unavoidable.

Given the widespread prevalence of this menace, it would be desirable to afford people the opportunity to terminate these arrangements without apprehension of being charged. Therefore, it was imperative that an amnesty scheme was introduced that would allow a one-time exemption from the application of new law for people to voluntarily declare their benami assets and regularise them after paying a small tax so that a clean start is provided.

It is in our national interest that we bring transparency in our dealings with due protection of privacy.

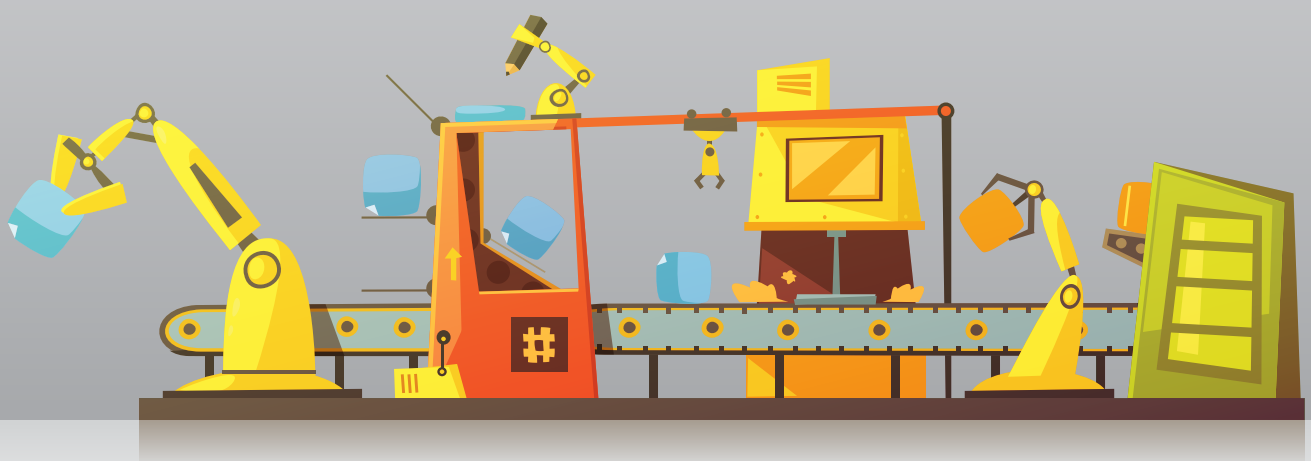
The Assets Declaration Ordinance 2019 was accordingly promulgated by the president on May 14, 2019. The law provides declaration of assets, sales and expenditures not previously disclosed to tax authorities in income tax, sales tax or excise duty laws. Those making the declarations would be exempt from the charges and the prohibition of Benami Transactions Act, penalties and other penal offenses applicable otherwise. There is an excluded class of people, such as 'public office holders,' as defined in 2018 scheme, who would not be eligible to take benefit of this law.

The applicable tax rates, for those who would make declarations up to June 30, 2019 are nominal varying from 1.5% for domestic immovable property to 6% for liquid foreign assets not repatriated. These are significantly less than the rates that were applicable under the previous scheme. The tax rates and default surcharge rises with declarations made after June 30, 2019 and up to December 31, 2019.

It is hoped that all those who are going to be affected with the new prohibition law on benami transaction would take advantage of this scheme and a new beginning of documented economy in the country would be made.

Misplaced Fear of Job-Stealing Robots

Stanford Business



At a Future of Work forum, experts say demographic shifts, not artificial intelligence, create the biggest challenges for today's workplace.

Some good news: The robots aren't coming for your job. Experts say fears that rapid advances in artificial intelligence, machine learning, and automation will leave all of us unemployed are vastly overstated.

But concerns over growing inequality and the lack of opportunity for many in the labour force – serious matters linked to a variety of structural changes in the economy – are well-founded and need to be addressed, four scholars on artificial intelligence and the economy recently told an audience at Stanford Graduate School of Business **Future of Work** conference.

That's not to say that artificial intelligence isn't having a profound effect on many areas of the economy. It is, of course. But understanding the link between the two trends is difficult and it's easy to make misleading assumptions about the kinds of jobs that are in danger of becoming obsolete. "Most jobs are more complex than (many people) realise," said Google's chief economist, Hal Varian, during a forum on the future of work, sponsored by the Stanford Institute for Human-Centered Artificial Intelligence.

Today's workforce is sharply divided by levels of education, and those who have not gone beyond high school

Automation doesn't generally eliminate jobs. Automation generally eliminates dull, tedious, and repetitive tasks. If you remove all the tasks, you remove the job. But that's rare.

are affected the most by long-term changes in the economy, says David Autor, professor of economics at the Massachusetts Institute of Technology. "It's a great time to be young and educated. But there's no clear land of opportunity" for adults who haven't been to college.

The robots aren't coming for your job. Experts say fears that rapid advances in artificial intelligence, machine learning, and automation will leave all of us unemployed are vastly overstated.

When predicting future labour market outcomes, it is important to consider both sides of the supply and demand equation, says Varian, founding dean of the School of Information at the University of California, Berkeley. Most popular discussion around technology focuses on factors that decrease demand for labour by replacing workers with machines. However, demographic trends that point to a substantial decrease in the *supply* of labour are potentially larger in magnitude. Demographic trends are also easier to predict, since we already know, aside from immigration and catastrophes, how many 40-year-olds will live in a country 30 years from now. Comparing the most aggressive expert estimates about the impact of automation on labour supply with demographic trends that point to a workforce reduction, Varian finds that the demographic effect on the labour market is 53% larger than the automation effect. Thus, real wages are more likely to increase than to decrease when both factors are considered.

Automation's Slow Crawl

Why hasn't automation had a more significant effect on the economy to date? The answer isn't simple, but there's one key factor: Jobs are made up of a myriad of tasks, many of which are not easily automated. "Automation doesn't generally eliminate jobs. Automation generally eliminates dull, tedious, and repetitive tasks. If you remove all the tasks, you remove the job. But that's rare," Varian says.

Consider the job of a gardener. Gardeners have to mow and water a lawn, prune rose bushes, rake leaves, eradicate

Jobs are made up of a myriad of tasks, many of which are not easily automated. Even the auto industry, which accounts for roughly half of all robots used by industry, has found that automation has its limits.

pests, and perform a variety of other chores. Mowing and watering are easy tasks to automate, but other chores would cost too much to automate or would be beyond the capabilities of machines — so gardeners are still in demand.

Some jobs, including within the service industry, seem ripe for automation; however, a hotel in Nagasaki, Japan, was the subject of amused news reports when it was forced to "fire" its incompetent robot receptionists and room attendants.

Jobs, unlike repetitive tasks, tend not to disappear. In 1950, the U.S. Census Bureau listed 250 separate jobs. Since then, the only one to be completely eliminated is that of elevator operator. But some of the tasks carried out by elevator operators, such as greeting visitors and guiding them to the right office, have been distributed to receptionists and security guards.

The robots may not be taking over just yet, but advances in artificial intelligence and machine learning will eventually become more of a challenge to the workforce.

Even the auto industry, which accounts for roughly half of all robots used by industry, has found that automation has its limits. "Excessive automation at Tesla was a mistake. To be precise, my mistake. Humans are underrated," Elon Musk, the founder and chief executive of Tesla Motors, said last year.

The Pace of Change

Technology has always changed rapidly, and that's certainly the case today. However, there's often a lag between the time a new machine or process is invented and when it reverberates in the workplace. "The workplace isn't evolving as fast as we thought it would," said Paul Oyer, a Stanford GSB professor of economics. "I thought the gig economy would take over, but it hasn't. And I thought that by now people would find their ideal mates and jobs online, but that was wrong too."

Consider the leap from steam power to electric power. When electricity first became available, some factories replaced single large steam engines on the factory floor with a single electric motor. That didn't make a significant change to the nature of factory work, says Erik Brynjolfsson, director of the MIT Initiative on the Digital Economy. But when machinery throughout the factory was electrified, work changed radically.

The Rise of the Service Sector

Employment in some sectors in which employees tend to have less education is still strong, particularly the service sector. As well-paid professionals settle in cities, they create a demand for services and new types of jobs. Autor calls these occupations "wealth work jobs," which include employment for everything from baristas to horse exercisers. The 10 most common occupations in the U.S. include such jobs as retail salespersons, office clerks, nurses, waiters, and other service-focused work. Notably, traditional occupations, such as factory and other blue-collar work, no longer make the list.

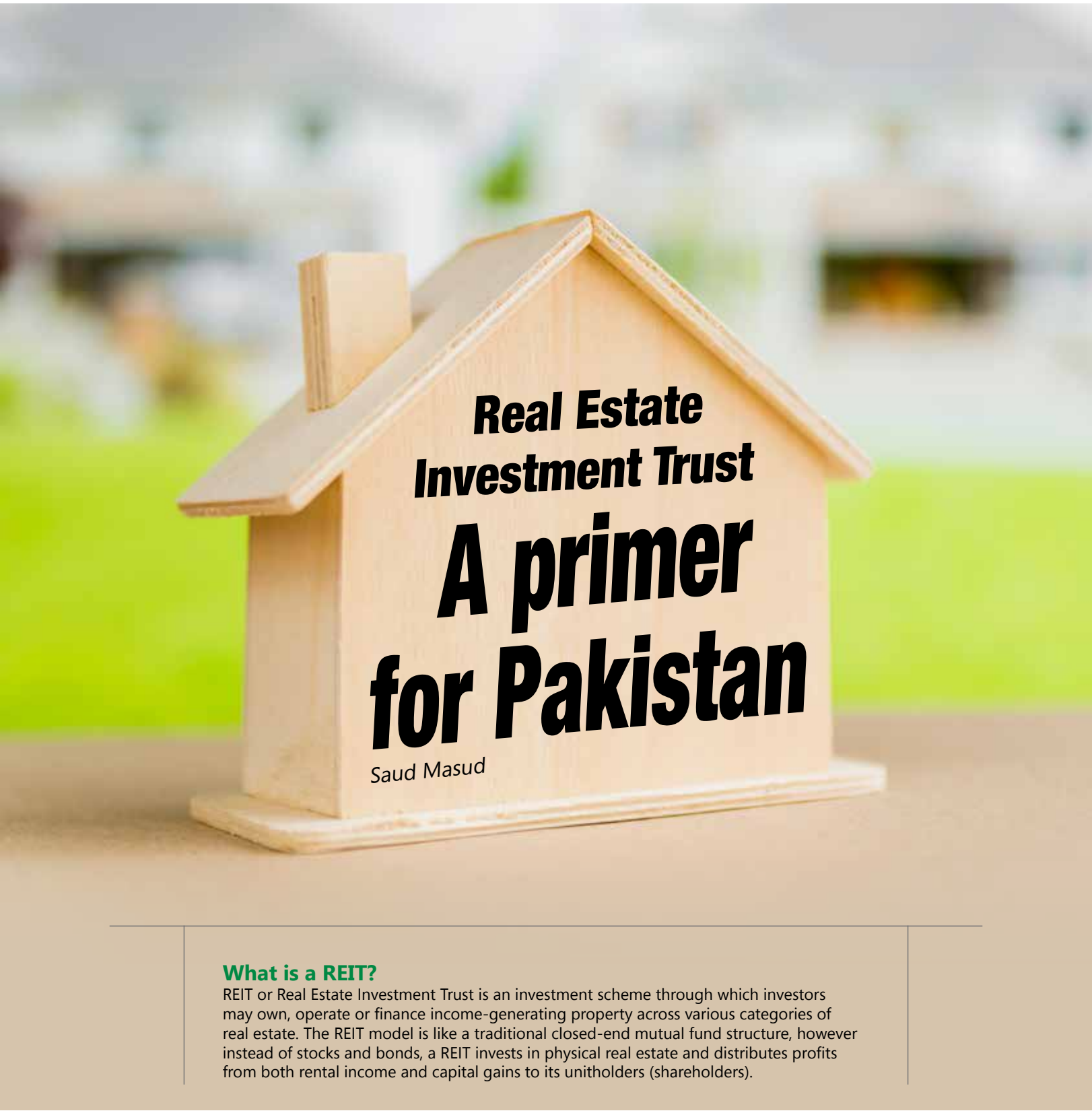
Looming over all of the changes to the labour force is the stark fact that birth rates in the U.S. are at an all-time low, says Varian. As has been widely reported, the aging of the baby-boom generation creates demand for service jobs but leaves fewer workers actively contributing labour to the economy.

Even so, the U.S. workforce is in much better shape than other industrialised countries. The so-called dependency ratio – the proportion of people over 65 compared with every 100 people of working age – will be much higher in Japan, Spain, South Korea, Germany, and Italy by 2050. And not coincidentally, says Varian, countries with high dependency ratios are looking the hardest at automating jobs.

As the country ages, society will have to find new, more efficient ways to train and expand the workforce – immigration will be a key – and work to better accommodate the growing number of women in the workforce, many of whom are still held back by family and household responsibilities.

The robots may not be taking over just yet, but advances in artificial intelligence and machine learning will eventually become more of a challenge to the workforce. Still, it's heartening to be reminded that, for now, "humans are underrated."

Courtesy: Insights by Stanford Business.



Real Estate Investment Trust A primer for Pakistan

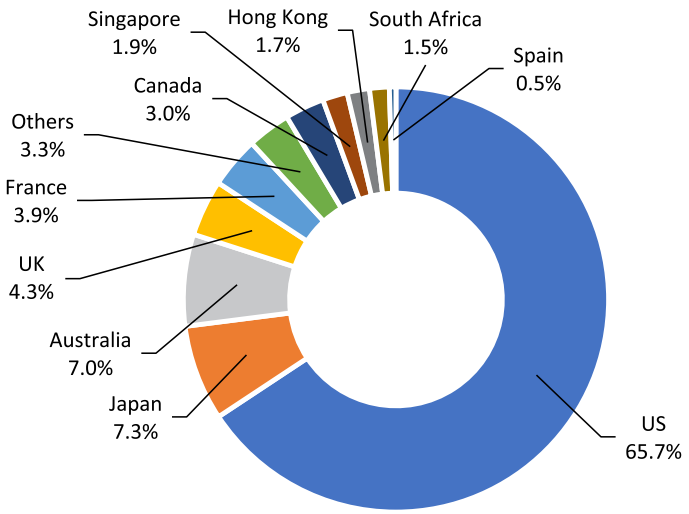
Saud Masud

What is a REIT?

REIT or Real Estate Investment Trust is an investment scheme through which investors may own, operate or finance income-generating property across various categories of real estate. The REIT model is like a traditional closed-end mutual fund structure, however instead of stocks and bonds, a REIT invests in physical real estate and distributes profits from both rental income and capital gains to its unitholders (shareholders).

The global REIT market is approximately $1.7 trillion[1] with the US market accounting for $1.15 trillion or 66% of total capitalisation (Chart 1).

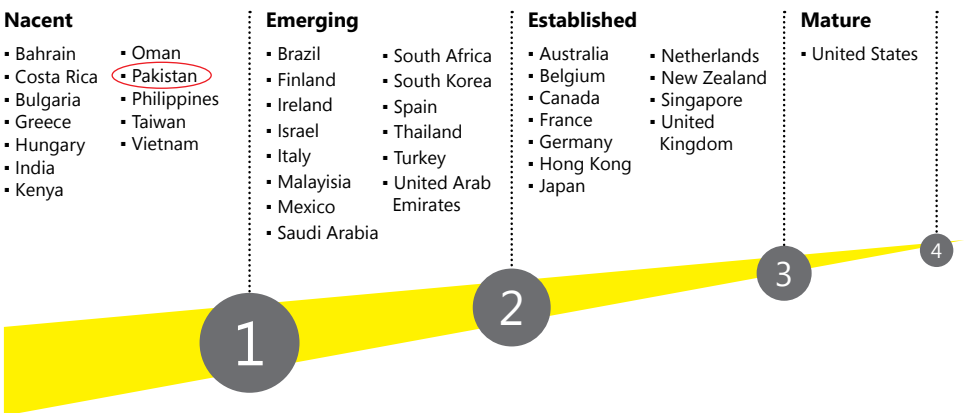
Chart 1. Global REITS Country Allocation



Source: Schwab, Morningstar Direct – Allocations as of December 31, 2016

Under the Companies Ordinance 1984, the Securities and Exchange Commission of Pakistan (SECP) rolled out the Real Estate Investment Trust Regulations in 2015. Pakistan is considered having a nascent REIT market per classification below with only one REIT currently in the public domain, i.e. Dolmen City REIT (DCR)[2] and several others in review or development stage:

Chart 2. REIT Stages of Market Maturation



Source: EY

According to SECP, three types of REIT schemes may be launched in Pakistan:

- Rental REIT – a scheme that invests in residential or commercial properties for the purpose of generating rental income (e.g. DCR managed by Arif Habib Dolmen REIT Management Company Limited).
- Developmental REIT – a scheme that invests in construction or refurbishment of residential, commercial or industrial properties.
- Hybrid REIT – a scheme that may include a mixed portfolio of rental and development properties.

Rationale for REITs

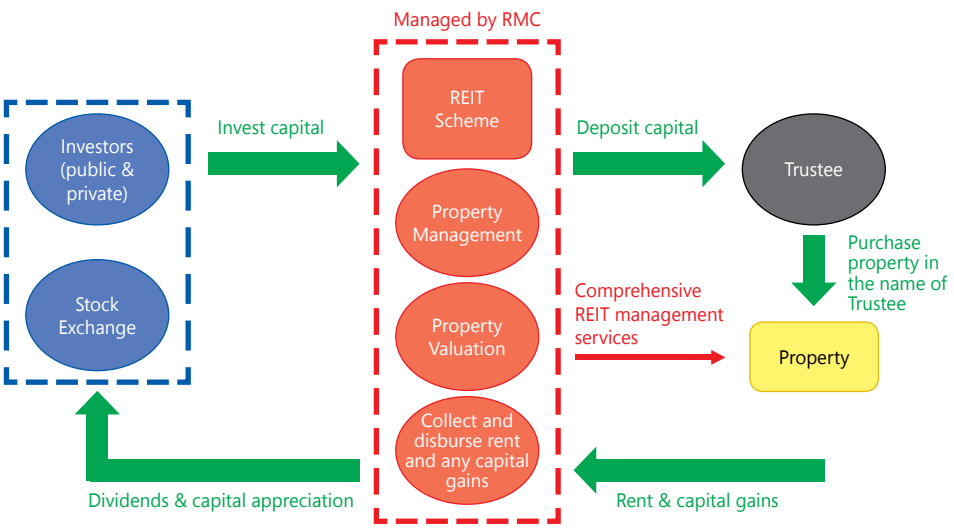
REIT offers a wide variety of benefits to its unit holders including:

- Generally **higher dividend yields** compared to broader market.
- Access to **recurring income** (dividends) to meet recurring expenses – at least 90% of taxable income is distributed to unit holders annually.
- **Exposure** to capital-intensive yet attractive yielding infrastructure like commercial and industrial properties without directly buying or managing the real estate asset.
- **Greater liquidity** than traditional real estate given most REITs are publicly traded on stock exchanges allowing for daily market pricing.
- **Enhanced transparency** since a REIT is regulated by primary regulatory authorities with high requirements for disclosures.
- **Tax efficient returns** – generally exempt from corporate taxation.
- **Greater diversification** proposition given low correlation to stocks and bonds.
- **Lower perceived risk** due to limited allowable leverage (debt) compared to other property investments.
- Investor is not linked to other assets in the owner's portfolio since there is a clear **separation of the property** invested under a REIT scheme.
- **Cost of capital may be lower** for the owner given high real estate project financing rates (Karachi Inter Bank Offered Rates (KIBOR) plus 3%-6%).
- Some REITs may also be deemed **Shariah-compliant**.

How does a REIT work?

The following chart highlights flow of funds and related responsibilities in a REIT structure:

Chart 3. REIT Process Flow



Source: Vector Partners (Pvt.) Limited

The primary operator, the REIT scheme, is a specialised entity known as REIT Management Company or RMC, which is incorporated under the Companies Ordinance 1984 along with the provisions of the NBFC (Non-Banking Finance Company) Rules 2003. An RMC is responsible for ensuring the launch, management and reporting of the scheme's operations including harvesting rental income and any capital gains.

REIT scope?

An RMC may manage multiple REIT schemes across the property sector including shopping malls, residential complexes, offices, mixed used plazas, healthcare centres, schools, warehouses, etc.

Chart 4. REIT Sector Scope

Source: Vector Partners (Pvt.) Limited

In chart 5 below, we identify, for illustrative purposes only, and select assets across various property types that may be suitable for REIT financing. These properties may or may not be deemed suitable upon further evaluation, however we only point out the relative size, economies of scale and scope of a REIT transaction. Each property must be thoroughly vetted for SECP's clearance to be investable under a unique REIT scheme. For example, in addition to land title and other requisites, a rental REIT requires a property to be at least 80% occupied.

Chart 5. Preliminarily Identified Assets for REIT Evaluation

Malls Shopping Centres	Lodging Resorts	Offices	Apartments	Industrial Commercial
▪ World Trade Centre (Islamabad) ▪ Centaurus (Islamabad) ▪ Packages Mall (Lahore) ▪ Fortress Square (Lahore)	▪ Pearl Continental ▪ Mrriott ▪ Serena ▪ Avari	▪ ISE Towers (Islamabad) ▪ Ufone Tower (Islamabad) ▪ MCB Tower (Karachi)	▪ Silver Oaks (Islamabad) ▪ Creek Vista (Karachi)	▪ Heavy / light manufacturing sites ▪ Large warehouses ▪ Chain of showrooms

Source: Vector Partners (Pvt.) Limited

Launching a REIT in Pakistan

We may divide the launch phase into three sub-phases as follows:

- **Establishing entities**
  - This phase starts with acquiring an NBFC license for an RMC.
  - The RMC appoints the Trustee, Property Manager and Property Valuer.

- **Registering the REIT scheme**
  - RMC works on business plan, engineering design, title clearances and any related NOCs (No-Objection Certificate).
  - Valuer completes property valuation report using Income Capitalisation, Sales Comparison and Cost Approaches.
  - RMC appoints auditor, legal counsel, rating agency, shariah advisor and transaction/ financial advisor.

- Any co-investors are explored for participation in the REIT rollout – these may include but not limited to banks, Development Finance Institution (DFIs), pension funds, corporates and individuals.
- RMC submits all required documents as per SECP regulations for detailed review and approval by SECP.
- Transfer underlying asset to trustee and issuance of units to owner in return.
- SECP may grant license for specific REIT scheme or request applicant to revise various aspects of the submission including document verification, business plan, pre-IPO capital structure and post-IPO strategy.

- **Fund raising and IPO (Initial Public Offering)**
  - Once REIT scheme is approved, the RMC engages any pre-IPO investors and sponsors.
  - RMC has a minimum 5% stake while strategic investors have 20% stake in the REIT.
  - RMC then works with financial advisors and brokerages to issue 25% of the total REIT's units to the public marketplace via an IPO.

REIT Economics

To gauge the economic viability of a REIT scheme, we compare a traditional rental income model versus one driven via a REIT scheme in table 1.

Note: Following is for demonstrative purposes only highlighting key differences in expenses and taxes associated with a REIT scheme resulting in a relatively more economically attractive proposition:

Key assumptions:

a. Asset: 10 storey commercial tower
b. Rentable units per floor: 10
c. Average occupancy rate throughout the year: 85%
d. Average monthly rent per unit: Rs. 200,000
e. Average annual expenses % of rent: 20%
f. Average annual REIT expenses % of rent: 2.5%
g. Income tax: 25%
h. Dividend tax: 15%

Modeling out rental income and related expense and tax regimes on tradition and rental REIT models, we arrive at the following peer-comparative P&L (profit and loss statement).

Table 1. Traditional vs. Rental REIT P&L Comparison

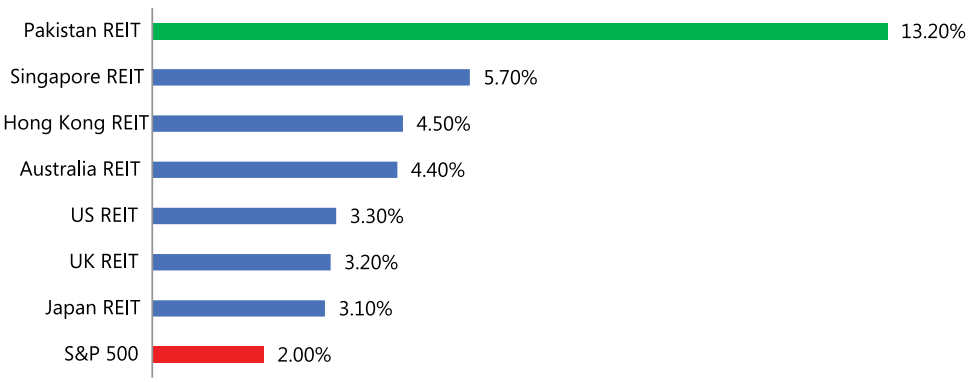
Description	Details	Traditional (PKR)	Rental ROT (PKR)
Rent income (Revenue)	R = a x b x c x d x 12	204,000,000	204,000,000
Operating expenses	E = 20%(e) x R	40,800,000	40,800,000
REIT expenses	RE = 2.5%[f) x R	-	5,100,000
Profit before tax	PBT = R- E or R - E - RE	163,200,000	158, 100,000
Income tax	T = 25%[g) x R	51,000,000	-
Profit after tax	PAT = PBT - T	112,200,000	158,100,000
Dividend tax	DT = 15%(h) x PAT	16,830,000	23,715,000
Profit after dividend tax	PADT = PAT - DT	95,370,000	134,385,000
Net profit % of revenue	**NI% = PADT/R X 100%**	**47%**	**66%**

Source: Vector Partners (Pvt.) Limited

Since the REIT does not have to pay income tax, it boosts its profits past the traditional model all the way to the bottom-line, e.g. Net profit of 66% vs. 47%.

Shifting to the dividend, as per chart 6, REITs typically offer higher yields compared to the broader market (S&P 500). It may be noted that while Pakistan may be offering sharply higher dividend yields (DCR) compared to its Asian counterparts, it is inline with the inherent economic risks.

Chart 6. Dividend Yields Comparison



Source: Colliers International, Arif Habib Dolmen REIT Management Company Limited, Vector Partners (Pvt.) Limited.

Risks

Like other asset classes, REITS have exposure to both unsystematic and general risks:

- Since REITS are linked to the underlying property asset, a decline in the value of the asset and/or its rental capacity will directly impact the REIT's NAV (Net Asset Value).
- A REIT may benefit from higher interest rates if driven by economic growth but under periods of stagflation, a REIT may underperform.
- In addition to interest rates, REIT's dividend yields may fluctuate based on local rental dynamics, occupancy, footfall and expense levels, a general downward shift in equity market sentiment due to macroeconomic or regulatory drivers, etc.
- Quality of RMC may significantly affect ability to raise capital and generate market support.

Conclusion

As Pakistan's real estate market matures and more sophisticated and transparent investment instruments are developed, REITs adoption will likely increase. A REIT scheme is not a one-size-fits-all proposition, instead, it is a customised opportunity developed for a specific real estate venture. The marketability of such a venture must be intricately and strategically planned since multiple public and private stakeholders are involved.

References:
[1] Global Perspectives – 2018 REIT Report by EY
[2] https://www.arifhabibdolmenreit.com

Saud Masud is a consultant with more than two decades of experience in finance and management across Wall Street, Silicon Valley, Middle East and Pakistan. As a visiting faculty, he also teaches business courses at various universities.

Chartered Accountants can play a role in balancing technology and trust in an Artificial Intelligence powered world

Chartered Accountants Worldwide

Accountants can play a valuable role to ensure broad public trust in technologies like Artificial Intelligence (AI). At the same time, accountants also need to upskill to stave off the threat of automation replacing the process-driven parts of their jobs.

Those were some of the talking points from a panel debate in Dubai on June 17 2019, attended by the CEOs of the member institutes from Chartered Accountants Worldwide, along with invited guests of senior business and finance professionals. Moderated by Dubai-based business journalist and presenter Richard Dean, the theme of the discussion was 'The Future of Trust: new technology meets old-fashioned values.'

The hour-long discussion tackled themes like the impact of AI on the accountancy profession, and whether it's possible to trust a 'black box' system whose reasoning may be hidden from view.

Accountants' oversight

Michael Izza, chairman of Chartered Accountants Worldwide and CEO of ICAEW

Furthering trust in technology could be a job for accountants, suggested Michael Izza, chairman of Chartered Accountants Worldwide and CEO of Institute of Chartered Accountants in England and Wales (ICAEW). "AI only works if you've got data, and lots of it," he said. Some of the world's largest technology companies are gathering data at an unprecedented scale, and the lack of trust is prompting authorities like the European Union (EU) to put checks on some of that power.

He then commented that this issue was highly relevant to the accountancy profession and to chartered accountants in the future. "Somebody has to opine on whether or not the data is accurate and complete; and whether or not the data on which the world is building so many of its engines can be relied upon. And, I think one of the roles of chartered accountants in the future is as the guardians of data," said Izza. The United Nations (UN) has previously called for the accountancy profession to perform this kind of assurance role, he added.

Immense opportunity

David Haveron, an AI expert of PricewaterhouseCoopers (PwC's) emerging technology practice in Dubai, gave a brief demo of the concepts and ideas behind AI. There are many good reasons for a business to adopt the technology, such as staying competitive in a market, innovating with new products, or driving internal efficiencies in a company. He presented an example of an AI tool or neural network that has been trained to understand certain patterns that can help firms to decide whether a new client is a high or low risk.

David Haveron, an AI expert of PwC's emerging technology practice in Dubai

Haveron said the innovation that's going to happen in the next few years "will be profound, and nothing like we've witnessed before." He added that there is an immense opportunity at a global and at a regional level, to start understanding how AI is going to be used in businesses to help us make better decisions. "Algorithms are becoming increasingly prominent in everyday life, whether you're looking at insurance industries or audit and accounting, leveraging AI will be on everyone's agenda in the next couple of years."

The key to bridging the gap of trust is for developers to ensure transparency by making AI systems better at explaining their reasoning using natural language. "A lot of development is being made in this space to make us trust AI a little bit more," he said.

Technologies like blockchain and new collaboration models have the potential to redistribute power that resides with governments and large corporations today. "This is going to be a really interesting story to watch... You've got to be an optimist and hope that these technologies will be taken back by the people and leveraged to solve some of our most important problems."

Technology's threat to employment

SAICA chief executive Freeman Nomvalo

South African Institute of Chartered Accountants (SAICA) chief executive Freeman Nomvalo brought an African perspective to the discussion, noting that the technology's threat to jobs has particular repercussions in poorer parts of the world. "The challenge is

that it displaces employment, and for a growing economy that has faced poverty over the years, that becomes an important issue for policymakers to respond to" he said. "Society has got to embrace technology because it will help us advance, but these issues begin to raise questions: should we trust this technology when it comes to take our jobs?"

Bryan Stirewalt, CEO of the Dubai Financial Services Authority, noted that technological innovation is a necessary component of financial services. It has enabled auditors to sign off accounts faster than ever and allows for earlier warnings about the risk. It has also created disruption in the market, which should force professions to start thinking about the effect it could have on their roles.

In a nod to the arrival of technologies like robotic process automation into finance functions, he joked: "We're fighting to keep the four letters 'robo' out of our job title." On a serious note, he said he expects a human element of accountancy and audit work will remain, but it will need to change. "If your job can be reduced to a process map, you probably won't have a job. So the end of the process map is where the future of the industry lies, and that's where people need to be trained and skilled… You can't think of today's job and what technology does to that; you must think of tomorrow's job and where technology meets that," he said.

The human factor

Sabbir Ahmed, member Council at the Institute of Chartered Accountants Bangladesh

Sabbir Ahmed, member Council at the Institute of Chartered Accountants Bangladesh (ICAB), said human decision making and relationships remain important for business, even as tools like AI augment their ability to gain insights. "Machines cannot drive change – they will give you the prediction, but it's the human being that will drive the change," he said. "One area where AI needs to match with is Emotional Intelligence (EI). Human beings cannot be replaced by machines. That human element and human empathy is core to trust," he said.

It is also important for accountants to question assumptions that technology may be based on, Ahmed added. "We trust a black box to the extent that we can understand how that black box has calculated something. One element in our core DNA as an auditor is professional scepticism, so are we doing enough to challenge the model that AI has provided?"

Closing the discussion, Michael Izza said that the accountancy profession has a lot to think about. "There is no doubt that technology will have a significant impact on process-orientated, or compliance-orientated roles, where technology will be able to do it better, more accurately and more quickly. At the same time, it offers huge opportunities for the profession to move up the value chain, and to play a role as data guardians in a world where we are drowning in data and starving in insight."

Courtesy: Chartered Accountants Worldwide

Procrastination & Chartered Accountants

Muhammad Amin **ACA**

In simple words, procrastination is our act to delay or postpone something or rather procrastination is the deliberate delay of our tasks out of laziness. When a person enters the profession of chartered accountancy, his/her sub-conscious mind automatically procrastinates as at the back of the mind a prospective chartered accountant has made a provision that this qualification will take him at least seven years or more and then he/she starts reacting according to that time frame.

In the initial days of studies, a student puts-off his study for the last few days before examination, relaxed that there are six more months to go before the examination.

In the next phase, a trainee delays his task thinking the deadline is after six weeks, and this delay in tasks becomes a habit for most of the chartered accountants by the time they qualify and become an Associate Chartered Accountant (ACA).

Once a chartered accountant enters the industry nerves are tested with strict task deadlines and daily reporting to the bosses unlike audit firms where the bosses just meet towards the end of the project. A chartered accountant then begins to realise that his/her productivity is being compromised due to his/her habit of procrastination. Therefore, if a chartered accountant does not find effective ways to fight against procrastination, it has the potential to completely derail his/her path to success. So what should be done? Here are some simple tips to plug in your daily routine:

1. **Plan each day in advance:** Plan your day every morning and assign a sequence to outstanding tasks. If the morning gets wasted, be sure to restart at 2 pm to avoid wasting the afternoon as well. It's better to give yourself a second chance in the middle of the day.

2. **Change your thinking:** If you change your thinking, you will change your life. We should pull ourselves away from the temptation of procrastination by saying the words: 'Do it now.' When someone repeats the words often, it will be stored in his/her sub-conscious mind and act as a trigger to get things done right away.

3. **Do the worst task first:** By default, we want to leave the worst tasks at the bottom of the list, leaving insufficient time and energy to complete that task and then end up in panic. You should prioritise your hardest task in the first place to devote enough energy and time for that task.

4. **Create challenging task:** If your tasks are too simple, you will lose enthusiasm, which is vital to complete any task. You should create hard and fast deadlines to make your tasks challenging for you.

5. **Focus on the most important:** Time keeps ticking with important and unimportant events coming your way, so you should manage the sequence of events and keep your focus on the most important ones instead of whatever comes your way. Most important events should be those which have the most immediate and beneficial impact in your life at a given point of time.

6. **Assess the consequences of each task:** Before starting any task, you should assess the consequences of doing or not doing this specific task. If the consequence of not completing any task is irrelevant then focus on the other tasks which have an immediate serious consequence.

7. **Avoid distractions:** In today's digital world, distractions from the digital devices are playing a pivotal role in hampering the efficiencies as well as effectiveness. A person is always distracted with e-mails or notifications on the mobile. It is imperative that the person should ignore these and not be distracted while engaged in doing important tasks.

The pace of this modern world is getting fast with each passing day and we as chartered accountants should keep in mind that if we don't run with the pace and don't organise ourselves to deal with this, we would be lagging behind people of other professions. A chartered accountant should plan his/her day well in advance along with the contingency plans in place so that if any important task pops-up, he/she will know how to deal with it without compromising on the planned tasks.

To conclude, I would say that the productivity of a chartered accountant can only be enhanced by excluding acts of procrastination from his/her daily life. He/she has to start the day in a way he/she is able to utilise time in the best possible way. As Benjamin Franklin, American polymath and one of the founding fathers of the United States, once said: "If you fail to plan, you are planning to fail."

Muhammad Amin is working as finance manager in Otsuka Pakistan Limited.

How Virtual CFOs reshape growing businesses?

Meer Suhail **ACA**

In an ever changing market conditions you never know when great opportunities knock at the door of your growing, struggling or stagnant business. Imagine a best-case scenario where your business is growing at a fast pace. You find yourself in a need for a quick and reliable picture of your financial position. Any delayed or miscalculated decision may lead to lost opportunities or making commitments that should rather be avoided. It's never been more critical to have ready access to useful financial information and to keep up with multiple accounting tasks.

The business is growing more complex with each passing day and the impact of your timely decision making is getting bigger and critical. You do understand the accounting process and the need for sound accounting team but at the same time want to invest more towards sales growth and operations rather than hiring big finance team.

It's time for you to not hire but 'rent' accounting team, specifically a Chief Financial Officer (CFO).

What is a Virtual CFO?

A Virtual CFO (outsourced CFO) has all the skills of a full-time CFO with one key difference: he/she is a financial expert that provides you the right amount of guidance at a very affordable cost, mostly part time. You are effectively 'renting' his/her expertise.

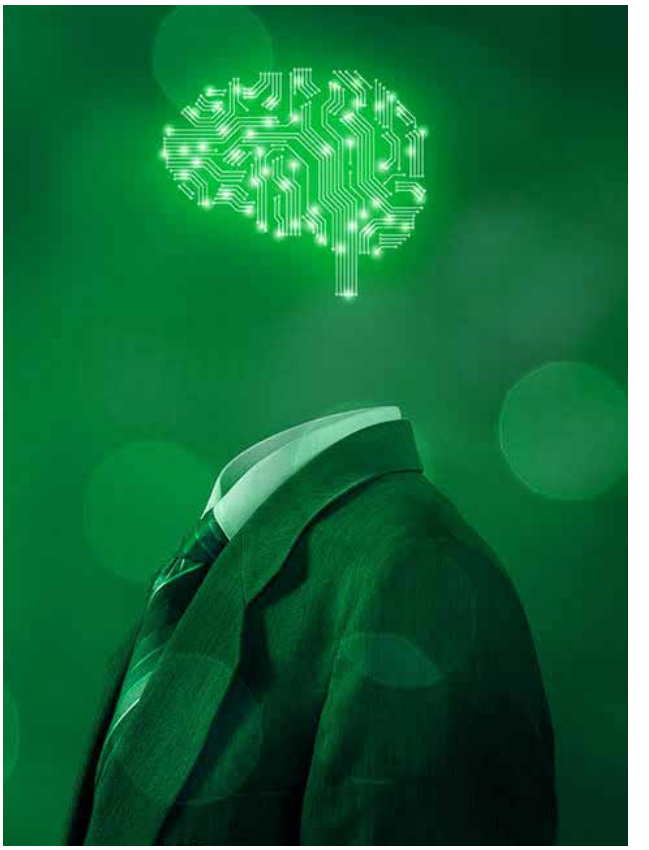
This helps you to get the support you need now. You can continue to deploy your capital to your enhanced sales activities and have an expert parallelly working with you who validates what you think and helps you execute your business strategy.

What services a Virtual CFO provides?

Normally, an outsourced CFO offers many different opportunities to take your business to the next level i.e. from helping you understand the financial health of your business to providing you with the valuable financial projections. In current market conditions coupled with growth in business, he is there to assist you from enhancing adaptive financial model with related processes to giving your entire team strategic advice to align themselves with the right direction.

Below are some of the major services Virtual CFO offers best:

- Explain your financial position: Walks you through your financial statements and discuss profits (or losses), assets you own, outstanding liabilities as well as your cash flow.
- Set up an accounting system, team and tools: Evaluates and recommends improvements for existing account system and the related processes in place.
- Forecast cash flow: Creates 12 month cash flow projection to ensure you have sufficient cash you need to cover future obligations.
- Manage cash flow: Understands the sources of your money and points of cash outflows and accordingly plans and manages funds to fulfill impending commitments.
- Create budget-to-actual reports: Sets goals for the year and evaluates them periodically to see if they are on track to meet your business goals; in case not, digs down to the minute level to find the reasons for such variations e.g. why expenses are higher than the projected figure.
- Work directly with lenders and investors: Liaises directly with financial institutions and potential investors to provide the required financial documents to prove you are a good credit risk.
- Profitability analysis: Analyses break-even and variable and fixed costs, manages labour cost efficiency, identifies areas of improvements, recommends updated financial strategy and implements it for profit maximisation.
- Key Performance Indicators (KPIs): Devices and implements relevant KPIs ad periodically reviews and follows them for business owners to see what is happening today and what is going to happen in coming future.
- Confidential financial projects: Serves as a best option to hire when you have a financial project that needs to be completed within limited budget or it involves information that you don't want to share with others.



Benefits of hiring Virtual CFO

From startups to small, medium or rapidly growing businesses, the advantages of hiring Virtual CFO outnumbers the advantage of having a full-time in-house CFO.
Some benefits of hiring a Virtual CFO:

- You get experienced strategic partner who reduces enterprise risk and adds value to your bottom line.
- He/she brings industry experience (which otherwise costs a lot to consult or hire) and helps you in enhancing cash flows and freeing up your time so that you may focus on business growth.
- He/she brings flexibility to the business and can switch to a full-time CFO when the time is right.

Are you ready to hire a Virtual CFO? Or still deciding?

Virtual CFOs are in high demand and hiring a right Virtual CFO is one of the best business decisions you can make right now.

Meer Suhail is working as managing partner at Marks Consulting, UAE.

What Do We Mean by Finance Leadership & Development?

IFAC Global Knowledge Gateway

Finance leadership and development involves ensuring that professional accountants in business– or finance professionals, as they are often called– respond to the continually changing expectations of their organisations, the financial markets, and society.

'Professional accountants in business' have diverse roles, and support their organisations in a wide range of job functions at various levels. These include:

- Leadership/management: chief executive officer (CEO); chief financial officer (CFO)/financial

director (FD); chief operating officer; director of governance or operations; treasurer
- Operational: business unit controller; financial or performance analyst; cost accountant; resources manager; business support manager; systems analyst
- Management control: business assurance manager; risk manager; compliance manager; internal auditor
- Accounting and stakeholder communications: group controller; head of reporting; investor relations manager; financial or management accountant

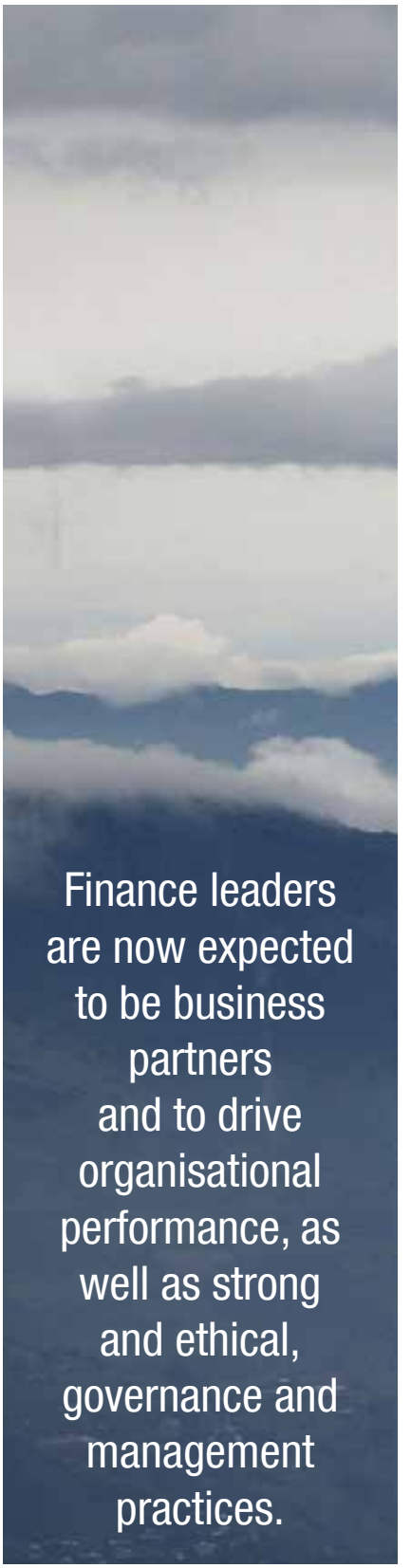
Finance leadership and development includes:
- Finance and accounting (F&A) function design and effectiveness;
- Preparing for, and enhancing, finance leadership; and
- Finance professionalism and talent management.

Finance leadership is needed in all the various areas covered by F&A, including:
- Transactional and operational finance and accounting;
- Strategic and operational decision support;
- Governance, risk management, and internal control;
- Corporate finance, tax, and treasury; and
- Investor relations.

Why is Finance Leadership and Development Important?

Many accountants aspire to finance leadership roles, such as CFO, controller, or chief accounting officer. These roles are often responsible for all financial aspects of the organisation, and require increasingly specialised knowledge and technical skills in areas such as financial reporting, tax, and treasury.

Organisations focus on finance leadership and development to ensure that F&A activities support the development and performance of the organisation. To add value to their employers and maintain relevance and public trust, professional accountants must fulfill their traditional responsibilities – while increasing their support of strategic and operational decision making. These roles require leadership, strategy, business, management, and interpersonal skills.



Global Perspective on Finance Leadership and Development

The past several decades have witnessed significant growth in the demands on, and expectations of, finance leaders – particularly as they have become key to helping their organisations navigate an increasingly complex business world. Finance leaders are now expected to be business partners and to drive organisational performance, as well as strong and ethical, governance and management practices.

Many organisations have conducted F&A transformation programs to reorient their F&A functions to enhance their contributions and productivity. Organisations that have enhanced their F&A capability typically have demonstrated clear benefits in terms of improved organisational performance.

Developing finance leadership and professionalism extends to government and public sector organisations, where there is a need for enhanced finance leadership and public financial management to improve the quality of public service accountability and outcomes. The transparency, financial stability, and performance of governments and public sector organisations are closely linked with the quality and professionalisation of the CFO and the F&A function. At the same time, organisations have embraced leaner F&A functions, driven by shared services models, outsourcing, and the

impact of technology. These changes have increased efficiency, but have also created potential challenges– such as balancing cost-reduction pressures with service delivery quality. They have also created challenges in managing talent, and in some cases have fragmented career pathways.

The Role of Accountants and the Accountancy Profession

In their various roles, professional accountants provide:

- Stewardship of financial and non-financial performance information. This information is necessary to fulfill compliance with financial reporting standards, risk and internal control requirements, and other regulatory, legal, and market requirements. Stewardship responsibilities have become ever more complex, particularly where they deal with different accounting, tax and treasury, regulatory, and legal environments across multiple jurisdictions.
- Business-partnering. Professional accountants focus on supporting strategy development and execution and facilitating sustainable value creation. Effective business partnering involves managing collaborative relationships and potential conflicts, and being a trusted and proactive partner in decision making.
- Aligning the F&A function with delivering the organisation's objectives requires an effective talent recruitment and management strategy to attract, develop, and retain finance talent and the skillsets required to support stewardship and business partnership responsibilities.

Key aspects and challenges of both stewardship and partnership roles include:

- Demonstrating ethical leadership and business integrity

The accountancy profession has a critical role to play to ensure that professional accountants acquire and leverage the necessary technical knowledge and professional skills, and perform in finance leadership and broader finance and accounting roles.

- Balancing short-term concerns and pressures, such as managing cash, liquidity, and profitability, with long-term vision and sustainable organisational success
- Ensuring effective compliance and control and responding to ever-increasing regulatory developments, including financial reporting, capital requirements, and corporate responsibility
- Providing strategic leadership and ensuring the F&A function supports the business at a strategic and operational level
- Driving and managing change and innovation
- Engaging and communicating effectively with colleagues, investors, customers, suppliers, regulators, and other internal and external stakeholders

Professional accountants aspiring to become finance leaders need to move beyond carrying out only core F&A responsibilities. To effectively operate as a key member of a leadership and management team, they need a broader perspective and a wider set of capabilities and skills.

The accountancy profession has a critical role to play to ensure that professional accountants acquire and leverage the necessary technical knowledge and professional skills, and perform in finance leadership and broader F&A roles. It facilitates education, life-long learning, and development of professional accountants, and helps them promote their competence and versatility to employing organisations. Professional accountancy organisations (PAOs) have a key role in ensuring that, in partnership with their members and students, professional accountants develop the right mixture of skills, experiences, and attitudes to succeed in finance leadership and F&A.

Courtesy: Used with the permission of International Federation of Accountants (IFAC) Global Knowledge Gateway (GKG): www.ifac.org/Gateway

Strategic Significance of Funds Transfer Pricing & its Governance in Banks

Kashif Zafar

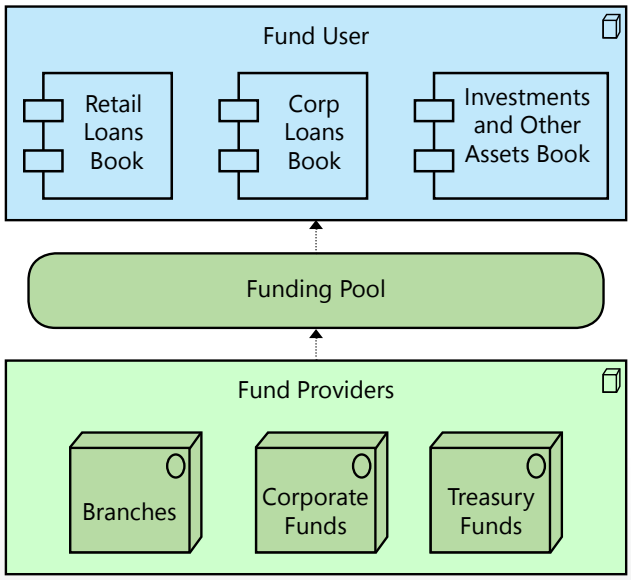
It's a common and valid notion that profit comes from profit earning assets and saving on cost. It has and will always be true but banks need to look on the other side of the balance sheet as driver of profitability.

Pricing in any industry is challenging but in financial industry it is not only complicated but at times perilous. Currently, most of the Financial Institutions (FIs) simply price loans and deposits in response of market peers. Consider a bank having 10% of market share (which has different strategy, risk appetite and operating cost structure) dictating the pricing policy. Due to such reasons a CFO fails to answer the CEO's question that why the company is doing the same and fails to match the bottom line.

In today's complex world, financial industry that appears to have a golden wand uses Funds Transfer Pricing (FTP) as key initiative to create strategic edge over the market.

What is FTP

In a modern bank, liquidity pricing policy is a main driver of business model. Any division when making a lending decision looks at the price at which it raises funding from treasury. Prices at which funds are transferred within a bank should reflect the true economic cost of funds at each maturity bucket.



Banks make money on levering on its risk appetite of interest and liquidity. Liquidity risk is the building block of FTP while matched maturity as most common method used. FTP is a method of pricing funds where pretense funds are bought by fund provider in an open market and sold to fund user in an open market; both parties are intelligent and aware of the risk involved and act at arm's length. Price represents the intrinsic value of the market price which depends on the following key elements:

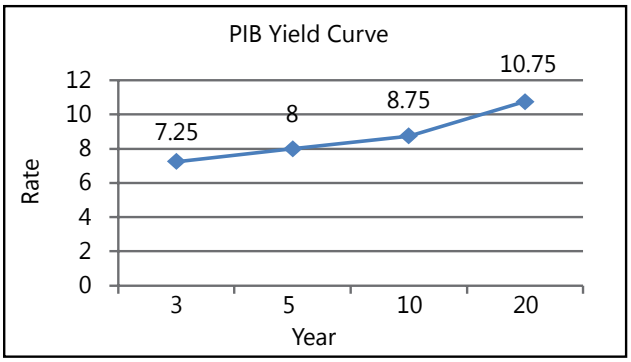
- Real interest cost;
- Cost of risk associated;
- Operating cost;
- Return required on capital employed; and
- Regulatory compliance cost.

We understand that, if we can assign a numerical value to a thing, we can manage it. A robust FTP system gives the 360 degree risk and return view of FI. FTP system should cover:

1. Business unit, product and customer profitability.
2. Pricing of risk.
3. Pricing of assets and liabilities.
4. A model for accountability of Net Interest Margin (NIM).

Each asset (like investment or loan) and fund source (like deposit or borrowing) is 'linked' to each other on matching basis using yield curve. Yield curve is defined by Moorad Choudhry, formerly head of Business Treasury, Global Banking and Markets at Royal Bank of Scotland, as "Plotting the yield of bonds that differ only in their term to maturity produces a graph that is known as a yield curve."

Auction of Pakistan Investment Bonds was held on September 5, 2018. The coupon rates for 3, 5, 10 and 20 year bonds are 7.25%, 8.00%, 8.75%, and 10.75% respectively.

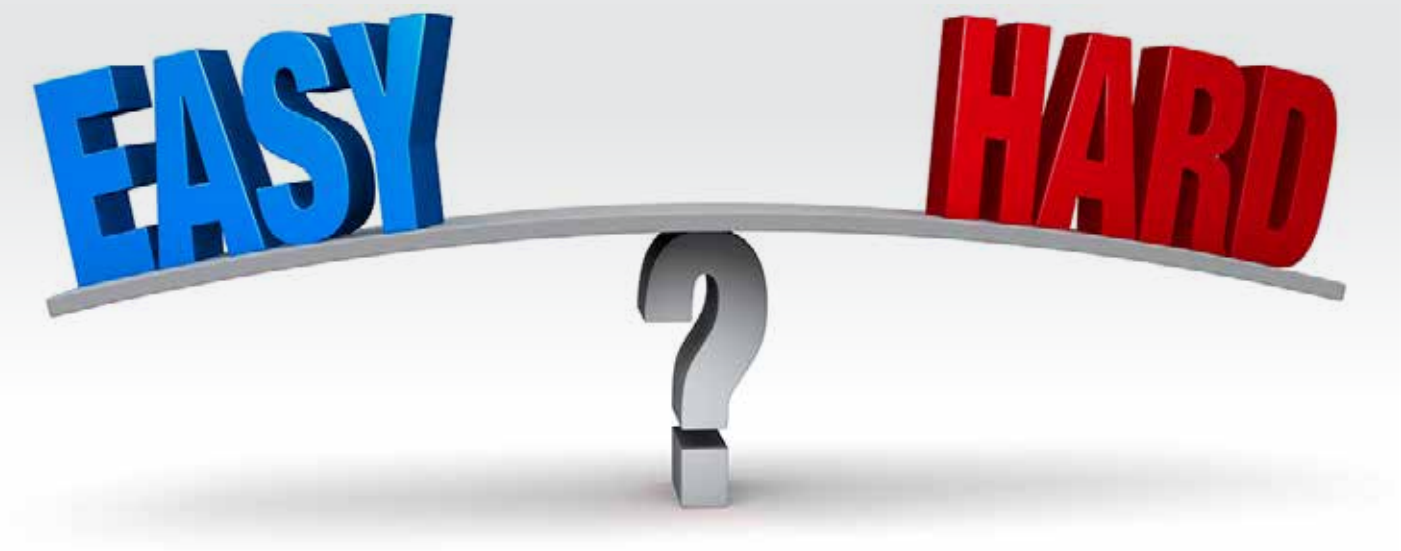


(Source: http://www.sbp.org.pk/ecodata/Auction-Investment.pdf retrieved on September 27, 2018)

Ideally, pricing of loan for 10 years to a government should be at 8.75%. Loan of similar nature of a corporate will be priced as:
Price of loan to a corporate = (Cost of fund + Credit risk cost + Operational cost + Required Return on Equity (ROE)) > 8.75%

In above equation (Credit risk cost + Operational cost + Required return equity) is the transfer rate and it allocates the FI's net interest margin.

There is no 'best practice' in modeling FI's FTP's. This is entrepreneurial decision that bankers make to earn profit. It should not be driven by individual but based on informed policy and robust system. FTP should take into account opportunity cost of the funds, marginal wholesale rates and driven from reliable and available data sources and should have understanding and acceptable to FTP users. Common users are loan seller, investment managers, managers providing liquidity and treasury. Ownership usually lies with the finance department.



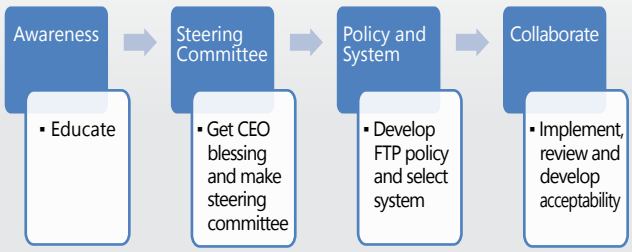
As highlighted above, pricing not only includes cost and/or value of funds but involve other considerations such as:

1. Operating cost.
2. Strategic objectives (like business expansion or specific ROE).
3. Risk imbedded in the transaction.

Ideal loan is priced as:
FTP with cost of funds + Lifetime operating cost for disbursement and servicing of loan + Cost of allocated economic capital + Expected ROE

Economic capital can be defined as the methods or practices that allow banks to consistently assess risk and attribute capital to cover the economic effects of risk-taking activities.
Source: https://www.bis.org/publ/bcbs152.pdf

There are four key steps towards strategic implementation of FTP:



1. **Awareness:** Educate all the parties involved. Key players are:
   a. Chief financial officer: Captain
   b. Head of strategy: Manager of team
   c. Players: Treasurer, investment officer and credit guys (retail and corporate loan bookers)
   d. Chief information officer: Support guy

2. **Steering Committee:** A project steering committee includes CFO, head of Management Information System (MIS) and head of business.

3. **Policy and system:** FTP is an art not a science. There are many ways which can be used to implement FTP strategies, selection depends on strategic objective of bank. Decision on system should be driven by one person only. Return on Investment calculations should be provided by vendors.

4. **Collaborate:** Collaboration wins always. It is about keeping everyone happy. But it is difficult for a CFO because many times they are forced to press the paddle to meet deadlines but like every project, it is part of the game. Keep vendors on a timeline and all units to provide information and support.
   a. Decide the source and make the pricing curve(s).
   b. Build a data warehouse and customise FTP system.
   c. Get results from system and learn to implement it.

Conclusion: High rider financial institutions create a strategic edge on their robust FTP system to maximise net interest margin.

Kashif Zafar is working as head of Finance Islamic Banking at Sohar International Bank, Oman.

Uniqueness of Islamic Banking – Basics of Profit Distribution Mechanism

Muhammad Tayyab Raza **ACA**

The critics of Islamic banking invariably highlighted the similarities between the Islamic banking and conventional banking. There is no harm in having similarities if these resemblances do not violate Shariah principles.

One prominent factor that distinguishes Islamic banking from conventional banking is vulnerability in return paid to the Investment Account Holders (IAHs), i.e. depositors. Unlike conventional banking, Islamic banks and Islamic banking windows (herein referred to as Islamic Banking Entities (IBEs)) do not pay a fixed rate on deposits. The rate of return paid to IAHs may vary period to period depending upon the income from financing and investment activities earned by IBEs. The possibility, even remote, exists that IAHs do not receive any profit in a given period. This is unlikely in conventional banking.

Another factor that differentiates Islamic and conventional banking is the relationship between the customer and financial institution. In conventional banking, there exists only one relationship between the bank and customer, i.e. lender and borrower respectively. In contrast to this, the relationship between the customer and IBE varies depending upon the nature of the Islamic banking contract. The following table summarises the relationships between IBE and the customer under widely used Islamic contracts:

Islamic Banking Contract	Relationship	
	Islamic Banking Entity	**Customer**
Mudaraba	Fund manager (Mudarib)	Fund provider (Rab ul Maal)
Ijarah	Lessor	Lessee
Murabaha	Seller	Buyer
Musharaka	Partner	Partner
Wakala	Wakil	Muwakil

A. Introduction to vital profit distribution concepts and terminologies

Before we discuss the pool creation and profit distribution mechanism, let's familiarise ourselves with some fundamental concepts for better understanding of the process:

i. **Mudaraba:** This means an arrangement in which a person participates with his money and another with his efforts and shall include banks, unit trusts, mutual funds or any other institutions or persons by whatever name called. (SBP Essentials of Islamic mode of financing)

ii. **Investment Account Holder (IAH)/Depositor/Investor:** Investment Account Holder or Depositor/Investor is a person or legal entity that provides funds to be invested in Shariah compliant investment and financing activities.

iii. **Unrestricted Investment Accounts (URIA):** Profit sharing Mudaraba based investment accounts that provide authority over decisions with regards to the use and deployment of funds received by the Islamic financial institutions are treated as equity of investment account holders and presented as an on-balance sheet item in the financial statement of Islamic Financial Institution. (AAOIFI Financial Accounting Standard 27 – para 5)

iv. **Joint Pool of Assets:** The joint pool of assets refers to the pool of assets financed from funds received from the IAHs (received on Mudaraba basis) and the funds invested by IBEs. IBEs are allowed to commingle their funds with the funds received from IAHs.

The joint pool of assets may comprise of low risk assets generating low returns, medium risk assets generating medium yields or high-risk assets generating high yields.

v. **Profit Equalisation Reserve (PER):** This is the amount appropriated by the Islamic bank out of the Mudaraba income, before allocating the Mudarib share, in order to maintain a certain level of return on the investment for the investment account holders and increase owner's equity. (AAOIFI Financial Accounting Standard 11 – para 16)

vi. **Displaced Commercial Risk (DCR):** Displaced Commercial Risk refers to the market pressure to pay returns that exceeds the rate that has been earned on the assets financed by the URIA, when the return on assets is under performing as compared with the profit rate offered by the competitor IBEs.

To cater for DCR and to avoid fluctuations in the profits, IBE will maintain a certain percentage of profit as Profit Equalisation Reserve in line with the guidelines received from Shariah Supervisory Board (SSB). PER will be used to improve profits in the distress conditions and stop the potential outflow of funds.

vii. **Investment Risk Reserve (IRR):** This is the amount appropriated by the Islamic bank out of the income of investment account holders, after allocating the Mudarib share, in order to cater against future losses for investment accountholders. (AAOIFI Financial Accounting Standard 11 – para 17)

Investment Risk Reserve is used as a risk mitigation tool against risk of future investment/financing losses.

viii. **Utilisation Rate/Weightage:** Each category of deposits (i.e. Mudaraba Saving Accounts or Mudaraba Term Deposits, etc.) received on Mudaraba basis shall be assigned a specific utilisation rate/weightage depending on the nature of the account, the investment tenure and amount.

The profit allocation for each of the deposit categories is normally calculated based on weighted average balance of deposits in each of the deposit categories. The utilisation rate/weight assigned to such deposit category is used to arrive at the weighted average balance for such category. IBEs may set tiers based utilisation rate based on the amount in each category of deposit.

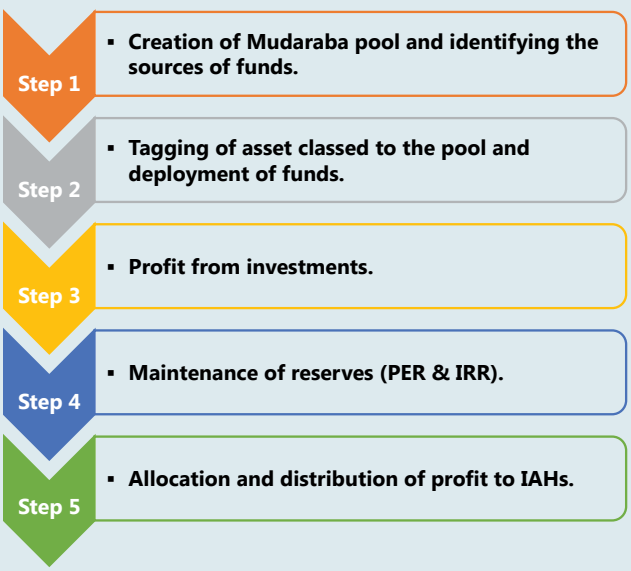
ix. **Profit Sharing Ratio:** This ratio, agreed at the time of entering of Mudaraba agreement, defines how much net profit will be shared with the customer and how much will be taken by the IBE as Mudarib fee. Profit sharing ratio is generally fixed for a certain period (i.e. month, quarter, etc.) can be changed at the discretion of IBEs subject to prior intimation to IAHs.

The determination of profit sharing ratio is dependent on many factors. Some of these are:

- Extent of allocation of expenses to the pool
- Tenure/category of the deposit
- Amount of deposit
- Market conditions

x. **Hiba:** Hiba is the donation to IAHs, in case of shortfall of the expected profit rate, from Mudarib's share. In the circumstances of low distributable profits to IAHs, the IBEs may reduce the Musaraib fee and give it as Hiba to IAHs.

B. Pool Management and profit distribution process

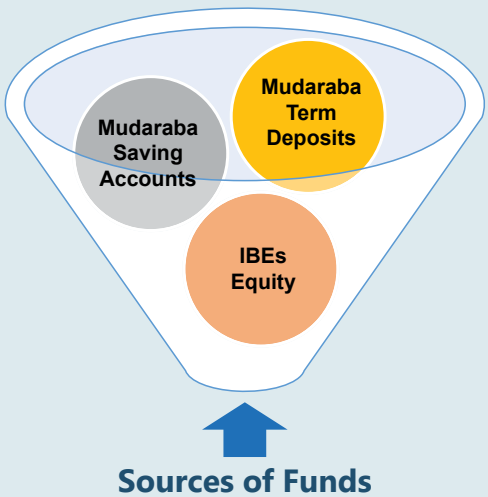


Step 1: Creation of Mudaraba pool

The creation of joint pool is the first and crucial step toward profit distribution mechanism. During this phase, sources of funds for the pool are identified and rules of profit distribution for each source are set. Typical sources of Mudaraba based pools are Mudaraba Saving Accounts and Mudaraba Term Deposits. This pool could be 'Pure Mudaraba Pool' sourced only by IAHs fund. However, IBEs normally commingle their equity with IAHs funds as a partner, which makes pool a 'hybrid pool of Musharka and Mudaraba.' Customer current accounts, being non-profit sharing account, are normally considered part of IBEs equity in the pool.

Also at this stage, assets classes are also identified and tagged to the Mudaraba pool. An asset class could be tagged to the pool in

entirety or certain percentage of the particular asset class can be tagged to the pool.



Step 2: Tagging of asset classes and deployment of funds
During this phase, pool funds are invested in Shariah compliant financing and investment activities to generate yield for the pool. The SSB or Shariah Advisor of the IBEs generally approves financing and investment products.

Any asset can be classified as 'Self-financed Asset' or 'Jointly Financed Asset.' Self-financed Assets are not part of the pool and normally financed through equity. Jointly Financed Assets are financed through commingled funds and tagged to the pool. Income from jointly financed assets is distributed between the IBE and the pool of investment accountholders.

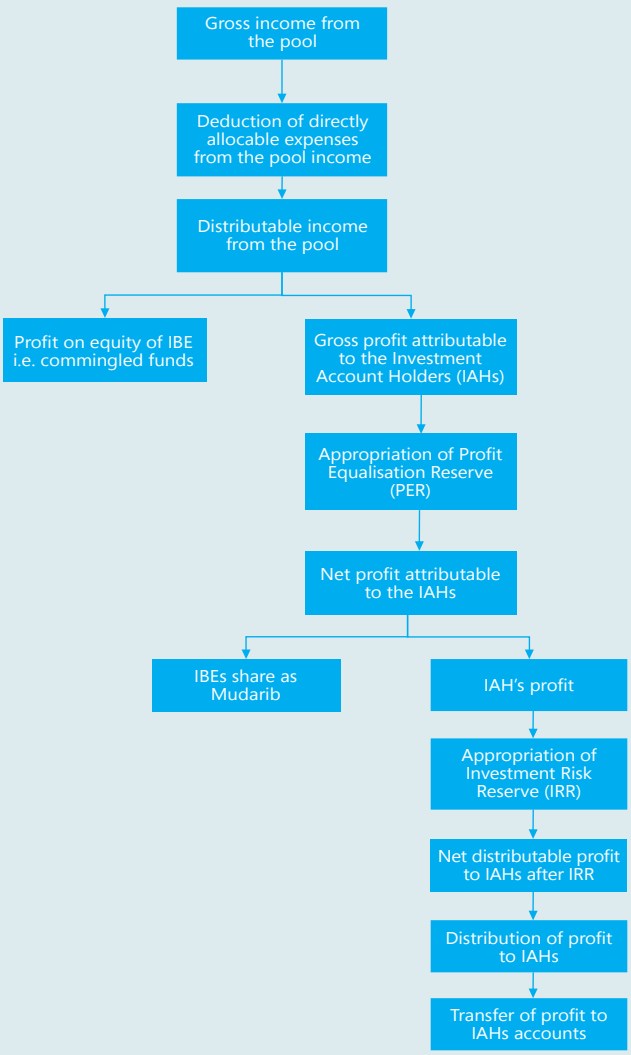
Step 3: Profit from investments
Profit generated by the pool assets is allocated to the pool. This allocation is linked to the % of asset allocation to the pool. If an asset category is 100% tagged to the pool, the entire profit from that investment portfolio will be allocated to the pool.

Step 4: Maintenance of reserves
Two types of reserves are generally maintained during profit calculation and distribution process.

Profit Equalisation Reserve	Investment Risk Reserve
▪ This reserve is appropriated from the gross profit of the pool before deduction of Mudarib fee to the IBE. ▪ The appropriation % is decided by the management of IBE in consultation with Assets Liability Committee (ALCO) depending upon the market conditions. ▪ As mentioned earlier, this reserve is used as risk mitigant of Displaced Commercial Risk.	▪ This reserve is appropriated from the net income attributable to the IAHs after deduction of Mudarib fee to the IBE. ▪ The appropriation % is decided by the management of IBE in consultation with Assets Liability Committee (ALCO) depending upon the impairment assessment. ▪ As mentioned earlier, this reserve is used as risk mitigant of investment impairment.

Step 5: Allocation and distribution of profit to IAHs
Allocation of gross and net profit from the pool to the IAHs is summarised in the diagram below. It is pertinent to emphasise that flow of distribution of profit is important to understand, notably the following points:

- Since IBEs are allowed to commingle funds with the investment account holder funds in the pool, therefore, the first allocation of profit should be between the IBEs and the IAHs.
- Appropriation of profit equalisation reserve to be done from the gross profit of the pool attributable to the IAHs before deducting Mudarib share.
- Appropriation of investment risk reserve to be done from the profit allocated to the investment account holders after deduction of Mudarib share.



Muhammad Tayyab Raza is working as senior manager Finance at Al Yusr Islamic Banking, Oman.

Debate

Entrepreneurs are born and not trained

Huzaifah Musharraf, ACA
Dubai

An exceptionally tricky topic in principle and a dilemma in practice. Few entrepreneurs who make it to the top, almost appear like they were born to be that very thing and nothing else. While all other entrepreneurs who fail, are advised to learn from their failures and try harder again. This very fact, that one must learn from failures, is what's probably the very essence of entrepreneurship and, therefore, suggests that anyone can learn or teach themselves to become an entrepreneur.

Most successful entrepreneurs have faced tough challenges and have recurringly been involved in a loop of fail-learn-apply-relearn-reapply. Apart from the inherent personality types, extroverts/introverts, which to some extent can be overcome, all other traits can be easily built into personality, such as self-confidence, speech, effective networking skills, presentation, etc. Putting oneself in the right surroundings with the right people and mentors can help anyone vouch their ideas and gain actionable insights. Access to easy funding and ability to take risks allows anyone with a moderately good sense of business to become an entrepreneur. And that moderate sense can easily be gained out of a quick business course or a long solitary walk at night or a random visit to the marketplace.

Muhammad Sajjad, ACA Karachi

Are entrepreneurs born? Yes, they are. Not from the mother's womb, but in the wombs of struggle, passion and grit. It is true that not everyone is an entrepreneur, but that never meant that you can't become one. Investments can't make you a good businessman, but learning skills and attitude to a business can. Is that not how everything works? From a school quiz to business worth billions, every victory has a backstory of failures and entrepreneurship is not different.

Many people argue why there are not many businesses. To this, I would say that it is because of our outlook to the world. From a very young age, all through schooling, our education system did not teach us entrepreneurship. More so, our society does not fully encourage it, especially in a country like Pakistan where ever changing government policies discourage people to strike out alone. According to a recent research paper, 85 percent of the startups and new businesses fail in the first few months. Investment is a big issue too. So yes, the stakes are high and it is hard. But those are the hardships through which entrepreneurs are born.

Mirza Fasihuddin Baig, ACA Karachi

Entrepreneurs are born, not made. It is a question that has been debated since many years, but yet there is no conclusive answer and different people will continue to have different views. I believe that yes, there are some entrepreneurial skills that you learn and polish along with time, but you must have something in you to work upon. And that something is what you are born with and is unique to you. Take the example of Facebook owner, Mark Zuckerberg; when he launched Facebook, he was just 19 years old. Obviously, being a teenager he didn't have any business experience. However, he had the desire to do something big and confidence to make his dream come true. Similarly, Robert Nay, founder of Nay Games, became a millionaire at the age of 14. With no sense of business or coding, he learned what he needed to know in a public library. Through research, he wrote 4,000 lines of code and built the famous game app 'Bubble Ball' in just one month. This game took over the most famous downloaded game app 'Angry Birds' in just a couple of weeks after its launch. Such mind grabbing examples of young entrepreneurs prove that you are born with entrepreneurial skills.

Muhammad Yaseen Lakha, ACA Karachi

Entrepreneurs are trained, and not born. Even though, we have prominent instances of business tycoons who were dropped out of the college to form successful big businesses, such as Bill Gates of Microsoft, Steve Jobs of Apple and Mark Zuckerberg of Facebook, but they are very much in minority. All the persons on this planet have countless business potential to be a prosperous businessman or businesswoman, therefore, the excellence of magnates is not inherent but it can be learnt through training and development, knowledge and experience. Therefore, higher schooling is a definite necessity and an asset in one's future. As per the report of Ernst & Young, nearly 700 business owners became entrepreneurs after a substantial period in the corporate world. While there are some who have a natural desire to establish ventures and have inborn abilities that make them effective entrepreneurs, but there is also a definite majority of people who learn and get themselves along the way.

Prem Kumar, ACA Karachi

Entrepreneurs are born or trained? This interesting debate keeps going on, but I would say, it could happen both ways, with major focus on trained, not born.

Even though some people are made to learn things from the very start of their lives by favourable surroundings, which makes their mind more business centric resulting in increased chances of being an entrepreneur in future, but that is not the only case. People have the capacity to change and as they grow and undertake new tasks, they become more confident and knowledgeable and learn more lessons. And as knowledge expands, other intangibles such as ability to calculate risk, perseverance, resilience and desire also grows. Entrepreneurs have a mindset that sees possibilities rather than problems created by change. To add some more weightage to the trained entrepreneurs, technological advancement has played a great role. It has immensely increased virtual business set-ups without the need of significant capital. Also, it has resulted into cost of doing business much lower, increased outreach, better communications alongwith lower risks.

Umair Haneef, ACA Islamabad

You can't train someone to become a good accountant if he has a keen desire to become a good seller. The persistence of strong desire is the basic ingredient to train a human mind. We tend to learn things rather quickly which are concurrent with our own thought process or belief system. Our underlying ambitions to lead the people and become successful entrepreneurs are generally responsive to the factors such as: Environment – where we lived in or grew up, People – whom we interacted with, and Experiences – what we have encountered in our lives.

However, we cannot deny the fact that most of the personality traits are inherited. The successful leaders are generally observed to be self-confident, more talkative, have greater aptitude and tranquility. All these traits can either be inherited or developed through persistent effort and training; but the strong conviction and desire will always remain obligatory. The answer to this myth is not straightforward, however, we can come to this general conclusion that not all human brains can be tailored to become good leaders nor every entrepreneur is gifted solely through genetics.

Shiraz Noordin, FCA USA

I firmly believe that an entrepreneurial skill set and acumen is something that one acquires through education and life experiences. It is not something that is manifested at the molecular level within one's DNA and hence, we are not born with it. If becoming an entrepreneur was something that we could attribute to a certain gene or a chromosome, then we would have long synthesised that piece of information and made a pill out of it that anyone could take and thereby become an entrepreneur. Rather, I believe that an entrepreneurial skill set develops through a person's interactions with society (education, socialisation, etc.), similar to our other skill sets such as communication skills, etc. Additionally, entrepreneurship is something that one continually improves on with experience and time. That is, it is a continuous and infinite ability. This is in contrast to something that we are born with, for example, our organs. The development of our organs such as the heart, brain, liver, etc. is a finite phenomenon. They are not something that continually develop during our lives, like the entrepreneurial spirit and skill set, which is an iterative process that we learn, grow, and evolve from throughout our lifespan.

Uzair Aziz, ACA Karachi

To date, science has progressed so much that it cannot be denied that certain behavioural traits are inherited through genes. However, it has also been exhibited by psychologists that the environment in which a person is raised, is also responsible for developing a plethora of traits including mental and physical capabilities.

We have seen many prominent magnates in recent past who have established their businesses without any apparent entrepreneurial DNA. Colonel Sanders, Steve Jobs and Jack Ma are a few names among the list. The common practice that these all have been observed to follow was to break the barriers, take initiatives, continuous struggle, predicting the future, making mistakes and persistence. Keeping in mind the scientific researches on human behaviour and expeditions of the renowned entrepreneurs who did not have any grandee's DNA, I believe that with proper set of training, opportunities and guts, anyone could become an entrepreneur.

Muhammad Amin, ACA Karachi

Yes, undoubtedly entrepreneurship is an inborn trait and cannot be learned through training. Everybody in this world wants to become an entrepreneur and to have their own business set-up; nevertheless, it is not possible for everyone to become an entrepreneur. If entrepreneurship can be learned through training, then the world would have been full of entrepreneurs.

In my opinion, the most important trait of an entrepreneur is the ability to take risk and that is something which cannot be learned through academic or practical trainings. We have seen entrepreneurs who have started their business set-up based on their trainings and practical exposure but most of them have ended up making a mess. Different studies on entrepreneurship have indicated that there is an 'entrepreneur gene' in some people. An 'entrepreneur gene' is a combination of certain characteristics which makes those people stand out from others and these characteristics are the personality traits which a person is born with. However, training and practical experience can further develop/polish the entrepreneurship skills but cannot make anyone an entrepreneur.

Aleem Aqeel Khan, ACA Karachi

Well, I disagree. Entrepreneurs are persons who set up businesses and take risks to earn profit. To achieve this, they need at least some knowledge and education. And you are not born with this. You learn it from seniors and elders. Be it formal education or informal. The trait theories of leadership penned the idea that leaders or entrepreneurs are born with certain traits, and it has long been discredited. The world has moved on. Today, we are aware that there are two main things you need in order to become an entrepreneur or a leader. Habits and mindset. These two are intertwined. Another perspective to look at these two things is: setting your inner-game; setting your outer-game.

You need the right set of core beliefs to begin with, which constitutes the mindset – your inner-game. Then, as you adopt the right set of habits – your outer-game, you will begin to see the effects/results which will strengthen your beliefs – your mindset. And this will initiate a healthy spiral towards becoming a successful entrepreneur. This framework provides everyone the opportunity to become an entrepreneur, a leader. So, entrepreneurs are trained and not born.

Amjad Waqar, FCA Karachi

Entrepreneurship is a mindset; few have those inherently like UK business magnate Richard Branson, American business investor Steve Jobs – these people are born with a desire to create ventures and have inherent qualities that make them successful entrepreneurs. Few people become entrepreneurs by recognising the importance of their ideas worth like Chinese businessman Jack Ma, American technology entrepreneur Mark Zuckerberg and innovative business ideas like Uber/Careem, Airbnb, etc. While on the other hand, few become entrepreneurs due to their family businesses and some with their learning and experience. People have enormous capacity for change, as they grow and undertake new tasks, they become more confident and decisive.

Most people have the dream to start a business and become an entrepreneur, whether on full-time basis or part-time, but majority of them doesn't proceed further due to the risk and fear that they may end up in financial trouble. Those who become entrepreneurs are able to take the risk and overcome the fear and proceed to realise their dreams.

Accordingly, in my view, it is the mindset of people which makes them entrepreneurs, as their mindset is unpredictably different from other people which is reflected in their psychological characteristics including greater resilience, passion and perseverance.

Adil Farooq Qureshi, ACA Rawalpindi

The whole statement wreaks of nipping creativity in the bud. Therefore, I strongly disagree with the current debate topic and vehemently confirm rephrasing as, 'Entrepreneurs are not only born but also trained.'

The very purpose of creation and process of development is based on growth through learning. Learning is measured by innovation and synchronisation with natural principles. The attributes that define successful entrepreneurs thus can be attained through gaining knowledge and earnest action in pursuit of those attributes.

No doubt, inherent qualities a person is born or inculcated with from an early age create a difference but a true entrepreneur, rather a true learner for that matter, does not become subservient to circumstances or challenges for progressing. Such a person creates opportunities and utilise resources in the best possible way for the attainment of his objectives, resulting in satisfaction for himself and betterment for others.

Therefore, we must assert, believe in and further transpire to next generations that there is nothing impossible in the world which they cannot achieve including becoming an entrepreneur.

Monthly

Newsletter

Governance, Transparency and Service to Members and Students

Read about the Institute's meets and events, members' news, technical update, students section and much more…

The Institute of Chartered Accountants of Pakistan

CA PAKISTAN

Chartered Accountant

A standard, the world follows

Chartered Accountants – the founders of the accountancy profession!

As one of the most sought after qualifications in Pakistan, today our CAs hold influential positions as business leaders and decision makers. From large corporations to multinationals, you'll find a CA shaping their success.

111-000-422 | www.icap.org.pk