

ACCA Pakistan technical e-newsletter



ACCA Pakistan
technical e-newsletter
ISSUE 6, Aug - Sep 2008

From the editorial desk

As we sit down to put the finishing touches to the latest issue of ACCA Pakistan e-newsletter, many events are unfolding around us. The holy month of Ramadan with its short working hours is nearing its end. Our typographic designer is inclined to postpone the designing of the e-newsletter until after Eid but we are trying our best to convince him to design it before Eid so that we can wish you Eid Mubarak through this e-newsletter.

At the global front, a global economic crisis seems to be an imminent possibility, with corporate collapses taking place in America and stock markets crashing all over the world. At the Ethics workshops for students and members in August, we talked about how accountants play an important role in preventing corporate collapses. How can accountants prevent millions of people suffering financial losses? An interesting discussion took place about the role of accountants as whistle blowers. In this context, Sarbanes

Oxley legislation was debated. The participants felt that accountants as stewards, as auditors, as advisors and even as accountants face a number of ethical dilemmas and challenges.

A question that stimulated intense debate was: who has a greater responsibility accountants or politicians to act in the public interest? The consensus was that accountants, unlike politicians, are professionals. They are supposed to act according to the rules of the profession. The public trust them as they trust other professionals such as doctors, lawyers and engineers; hence accountants possibly have an even greater responsibility to act in the public interest than politicians. Discussion forums on business ethics provide an opportunity to share experiences about best practices and explore solutions.

At the workshops, we discussed many ethical dilemmas and challenges faced by

accountants in their everyday work. In a future issue we might discuss ethics in greater detail, but for now it would be interesting to know your opinions on the questions raised at the ethics workshops.

Now, coming to this e-newsletter, we discuss sovereign wealth funds and Islamic finance two areas that are currently considered to be emerging issues. We give you an insight into what we and others think of these issues and look forward to hearing your views.

We hope you enjoy this e-newsletter. We will soon be launching the International Technical Policy and Research Update. All these initiatives are a reflection of our commitment to remain in continuous engagement with you.

On behalf of ACCA Pakistan, we wish Eid Mubarak to you and your family. Keep in touch...

Request for Opinion ACCA Complexity in Financial Reporting survey

ACCA is conducting a survey on the complexity and relevance of current financial reporting requirements. ACCA supports the development of global financial reporting standards and this survey is therefore focused on the application of International Financial Reporting Standards (IFRS) and/or IFRS equivalent standards. The survey will consider whether financial reporting requirements are disproportionate to their intended benefits and whether there are opportunities for improvement. ACCA will publish the results from this survey and report them directly to the International Accounting Standards Board (IASB). The survey results will also contribute to a broader study of complexity in financial reporting being carried out by the UK Financial Reporting Council (FRC). Your input is therefore requested, as it will directly influence the recommendations that both ACCA and the FRC make to the IASB. The survey will take around 20 minutes of your time. It contains three sections, the first asking some general questions about your experiences in preparing financial statements using IFRS; the

second, containing more detailed questions about three areas of financial reporting of which you have had experience in recent years, and the reasons why you believe they are complex; and the third asking some general questions about you as a respondent.

We very much hope you will participate in this important survey and thank you in anticipation of your contribution to the future development of global financial reporting standards.

Please click here: www.accaglobal.com/surveys/complexity_survey to launch the survey.

Please respond by 12 October 2008.

Should you have any problems accessing the survey, or wish to make any other comments, please e-mail: survey@accaglobal.com

Contents

Sovereign Wealth Funds – the next Wall Street?

4

Islamic Finance

6

Saving Schemes – A sneak peak

7

Accounting and Auditing Standards Update

8

Making Contact

The editorial desk can be contacted at
technical@acca.org.pk

Sovereign Wealth Funds - the next Wall Street?

Currently, sovereign wealth funds (SWFs) are valued at \$3 trillion. Morgan Stanley has estimated that by 2015 these funds could be worth more than \$12 trillion.

All countries around the world have foreign currency reserves, generally in dollars, sterling, euros or yen. When the current account balance of a country turns to surplus, and the central bank judges that its foreign currency reserves are more than its requirements for the current period, it has the option of creating a SWF. These are the assets held by the government of one country in another country's currency. Countries such as UAE, Saudi Arabia, Norway and Kuwait that are rich in oil, gas and other natural resources have mostly set up SWFs. Asian emerging markets, for example China, Singapore and Malaysia, have also set up SWFs as they have accumulated foreign currency reserves created as a result of continuous current-account surpluses.

Characteristics of SWFs

- SWFs are state-owned.
- They usually bear no liabilities.
- They are managed separately from the official foreign currency reserves of a country.

SWFs have been in existence since the 1950s but have come to attention recently, especially during the credit crunch¹ in the West, when some of the major SWFs rescued financial giants such as Barclays, Citigroup and Merrill Lynch by investing billions of dollars. SWFs have been estimated to invest more than \$60 billion in the Western banks during the last two years, which amounts to two-thirds of the total amount invested in them. Merrill

Lynch and Citigroup have been rescued by SWFs set up by the governments of Singapore, Kuwait and South Korea, which injected \$21 billion into these banks. China Development Bank purchased a \$3 billion stake in Barclays to help it recover from its problems. Recently, Siemens has approached Russia, seeking investment from its SWFs. Siemens' spokesman said in an interview that 'the talks with the sovereign funds are not about strategic stakes, but just about minor stakes of up to 5%' something equivalent to €3.4 billion (\$5 billion). Siemens is also in negotiations with Saudi Arabia, United Arab Emirates, China and Norway to obtain support from their SWFs.

Table 1: Top 10 Sovereign Wealth Funds of the world²

Country	Assets' Value (US\$ Bn)
UAE	400 - 800
Norway	373
Saudi Arabia	300
Kuwait	213
China	200
Singapore	130
Hong Kong	112
Singapore	108
UAE	20 - 80
Qatar	20 - 60

The increasing size and influence of SWFs has resulted in demands for regulation and transparency. A recent survey by the International Monetary Fund (IMF) has shown that one-fifth of SWFs are not accountable to their domestic legislatures. The International Working Group on Sovereign Wealth Funds (IWG), a body formed under the IMF, is in the process of formulating a set of principles for SWFs. These would include a legal framework as

well as guidelines on ensuring transparency and accountability, good governance, operational independence and clarity of mandate. Reservations have also been expressed about the ability of nations that have SWFs to purchase assets that are of strategic value to other nations, as well as about the flow of capital from developed countries to emerging and developing countries, i.e. from US dollars and euros to Yen and Yuan. There has nevertheless been no evidence that SWFs are abusing their growing influence.

Today, sovereign wealth funds hold an estimated \$3 trillion in assets. If the World Bank Group can help create the platforms and benchmarks, the investment of even one percent of their assets would draw \$30 billion to African growth, development, and opportunity.
Mr Robert Zoellick, World Bank President

The SWFs are all set to shape the future. Their increasing influence and size has forced analysts to describe them as 'the next Wall Street'. Developing economies such as Pakistan should create conducive environments for SWFs, to encourage them invest in these economies.

¹A sudden reduction in the availability of loans and other types of credit from banks and capital markets at given interest rates. The reduced availability of credit can result from many factors, including an increased perception of risk on the part of lenders, an imposition of credit controls, or a sharp restriction of the money supply.

²The Impact of Sovereign Wealth Funds on Global Financial Markets European Central Bank, July 2008

Islamic Finance

The global Islamic finance market has grown to over \$200 billion.

Following is the glossary of some of the commonly used Islamic finance terms.

Islamic finance refers to business dealings that are consistent with the principles of Islamic law (Shariah).

Islam permits investment of surplus resources to earn profit but the risk of loss should remain with the investor.

Modaraba

A form of partnership where one party provides capital and the other party provides technical expertise. The profit-sharing ratio is predetermined but the loss is borne by the provider of capital.

"I do not have any detailed knowledge of Islamic financial products, as I do not have a direct link with them in terms of my professional work. However, whatever little knowledge I have about them makes me think of these products as very much similar to conventional banking products in principle."

Partner of an SMP

Murabaha

A contract for sale in which a client requests a bank to purchase goods for him. The bank then sells the goods on to that client at a pre-agreed profit; the client pays for the goods on a periodic basis.

"I have a general idea but do not know the technicalities of Islamic finance. As per my understanding, banks are just playing around with the idea because they have to comply with regulations. Growth of Islamic banking largely depends on the cost offered by it in comparison with conventional banking."

ACCA Pakistan member working as a management consultant

Musharaka

A partnership between a bank and one or more other parties that combine their funds for business. All providers of capital are entitled to participate in the management of the business. Profit from the business is shared among the partners in a predetermined ratio but any loss is borne in proportion to the capital contributions.

Ijara

The Islamic form of leasing, whereby an asset is used by the lessee in return for a fixed rental amount.

Istisna

A contractual agreement for manufacturing goods or construction projects. The goods or services are provided in the future

although payment for these is made in advance.

Salam

A purchase contract with deferred delivery of goods. It is mostly used in agriculture finance where a sale is arranged in advance for the future production of crops.

Sukuk

An Islamic financial certificate, issued for a specific period, which represents a proportionate ownership interest in a pool of tangible assets that yield income and capital returns. A common example is issuance of sukuk bonds against a real estate property, where rental income from the property is the income of investors. The issuer of sukuk certificates buys them back at the end of term at their face value.

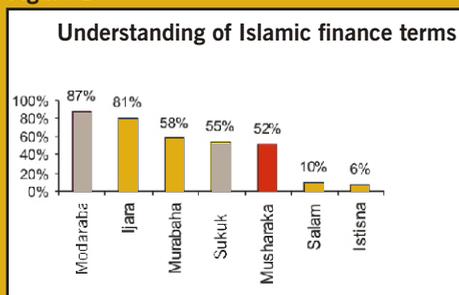
"I feel that there is a huge potential for growth of these products as these are riba (interest) free and thus the general public feels comfortable putting their money with them. Similarly, the banking sector of Pakistan is flourishing which, again, creates a significant growth opportunity for Islamic banking as well."

ACCA Pakistan member with a big four audit experience

Quick poll on Islamic finance terms

Islamic finance terms such as modaraba, musarka, and ijara are some of the commonly used terms in everyday business communication and discussion, but how many people actually understand these terms? We did a quick poll of about 50 accountants to find out how many of them had a general understanding of the Islamic finance terms modaraba, Ijara, Sukuk, Istisna, Salam, Musharika and Murabaha. Figure 1 outlines the results.

Figure 1



It can be concluded from Figure 1 that, among the accountants, modaraba and Ijara are the most popular Islamic finance terms, with 87% and 81% of accountants, respectively, confirming their understanding of the term. Similarly, 58%, 55% and 52% were the respective percentages of accountants who had an understanding of Murabaha, Sukuk and Musharika respectively, whereas only 10% accountants knew about Salam and 6% about Istisna.

Saving Schemes – A sneak peak

A sneak peak into some of Pakistan's saving option with their tax implications.

Voluntary Pension System (VPS)

- An individual can contribute a maximum amount of 20% of his/her net income to any of the approved private pension funds. Employers may also contribute to their employees' VPS accounts.
- The contributors' investments and gains are tax-free unless the amount is withdrawn.
- Unlike money saved in the gratuity fund and provident fund, the savings of contributors will remain intact even when the latter switch jobs.

For further information, please visit:
<http://www.secp.gov.pk>

Defence Savings Certificates

- This is a ten-year maturity scheme.
- The profit earned is exempt from withholding tax, provided that the total investment does not exceed Rs.150,000. If the total investment exceeds this amount, however, withholding tax at 10% is deductible at source from the profit earned.

For further information, please visit:
<http://www.savings.gov.pk/dsc.htm>

Special Savings Certificates (Registered)

- This is a three-year maturity scheme.
- The profit earned is exempt from withholding tax, provided that the total investment does not exceed Rs.150,000. If the total investment exceeds this amount, withholding tax at 10% is deductible at source on the profit earned.

For further information, please visit:
<http://www.savings.gov.pk/sscr.htm>

Regular Income Certificates

- This is a five-year maturity scheme.
- The profit earned on these certificates is subject to a deduction at source of 10% withholding tax.

For further information, please visit:
<http://www.savings.gov.pk/ric.htm>

Mutual Funds

- There are two basic types of mutual funds, closed-ended and open-ended. On the basis of their investment objectives they can be further classified into:

- 1) growth funds
- 2) income funds
- 3) balanced funds
- 4) money market funds.

- A closed-ended fund has a fixed number of shares outstanding and is traded just like other stocks, on an exchange or over the counter.

- The more common open-ended funds sell and redeem shares at any time directly to shareholders.

- Annual profits are distributed in the form of bonus units. Bonus units are not considered as income under the Income Tax Ordinance, 2001. When units are encashed, capital gains arising on disposal are exempted from tax till June 2009.

Sukuk

- Sukuk are shariah compliant 'bonds'. In their simplest form sukuk represent ownership of an asset.

- Sukuk can be of many types depending upon the types of Islamic financing and trade used in their structuring, but the most important and common are ijarah, salam and istisna.

Accounting and Auditing Standards Update

Cost of an investment in a subsidiary, jointly controlled entity or associate (amendments to IFRS 1 and IAS 27)

The International Accounting Standards Board (IASB) has issued amendments to IFRS 1 First Time Adoption of International Financial Reporting Standards and IAS 27 Consolidated and Separate Financial Statements.

For further details, please visit: <http://www.iasb.org>

Non-Current Assets Held for Sale and Discontinued Operations (amendments to IFRS 5)

It has been suggested that the following two changes be made in IFRS 5:

- On business combinations, non-current assets held for sale should be measured at fair value rather than at fair value less costs to sell

- On financial statement presentation, a converged definition of discontinued operations is being developed.

Converged disclosures for disposals of components of an entity are also being developed.

For further details, please visit: <http://www.iasb.org>

What to look for in the next issue

Our next issue is dedicated to analysing whether annual reports are still living documents used for making informed decisions by the users of annual financial statements.

TECH-TEN-006

ACCA Pakistan 61 C Main Gulberg Lahore 54660 Pakistan / +92 (0)42 111 22 22 75 / <http://pakistan.accaglobal.com>
An Association established under section 42 of the Companies Ordinance 1984