

Regional Inspector General for Audit  
Singapore

**PRE-AWARD SURVEY OF  
THE FIRST INTERNATIONAL INVESTMENT  
BANK LIMITED, PAKISTAN**

Report No. 5-391-93-04-N  
December 8, 1992





U.S. AGENCY FOR  
INTERNATIONAL  
DEVELOPMENT

December 8, 1992

TO: John S. Blackton, Mission Director  
USAID/Pakistan

FROM:   
Alfred M. Clavelli, Acting RIG/A/Singapore

SUBJECT: Pre-Award Survey of the First International Investment Bank Limited,  
Pakistan. Report No. 5-391-93-04-N

The accounting firm of Ford, Rhodes, Robson & Morrow (Ford Rhodes), the Price Waterhouse affiliate in Pakistan, performed a pre-award survey of the First International Investment Bank Limited, Pakistan (FIIB). Five copies of the pre-award survey report are enclosed for your action.

FIIB is an investment bank that was registered as a public limited company in Lahore, Pakistan. FIIB commenced commercial operations in 1990 with the establishment of the Karachi branch office. The issued share capital currently amounts to \$5.1 million.

Pakistan is shifting from a state controlled to a free market economy. A clear constraint faced by small and medium sized investors is the absence of resources in the private sector to finance pre-investment feasibility studies. These studies would allow entrepreneurs to obtain loans from banks to finance their projects. To address this problem, FIIB submitted a proposed cooperative agreement to USAID/Pakistan to establish a pre-investment feasibility fund under the project entitled Private Investment Expansion Program. Under the proposed agreement, USAID/Pakistan will provide \$750,000 towards the pre-investment feasibility study fund which FIIB will implement through a "Special Account". FIIB will provide loans to various sponsors to conduct feasibility studies on projects which they intend to implement in Pakistan. FIIB will accumulate the proceeds from the repayment of these loans in a separate feasibility study fund for the same purpose, and with the passage of time, this fund will be self-sustaining.

Prior to entering into the proposed agreement, USAID/Pakistan contracted with Ford Rhodes to conduct a pre-award survey of FIIB. The pre-award survey objectives were to: (1) express an opinion on FIIB's management capabilities; (2) express an opinion on FIIB's financial capabilities; and (3) report on FIIB's system of internal controls. The period covered by the survey was from the commencement of operations in February 1990 through August 1992.

Ford Rhodes concluded that FIIB has sufficient management and financial capabilities to manage the activities under the proposed agreement and they reported that there were no material internal control weaknesses, although several reportable internal control conditions were noted.

The management of FIIB generally agreed with the survey findings and recommendations. Their comments are summarized under each individual finding in the report and are set out in full as Appendix I.

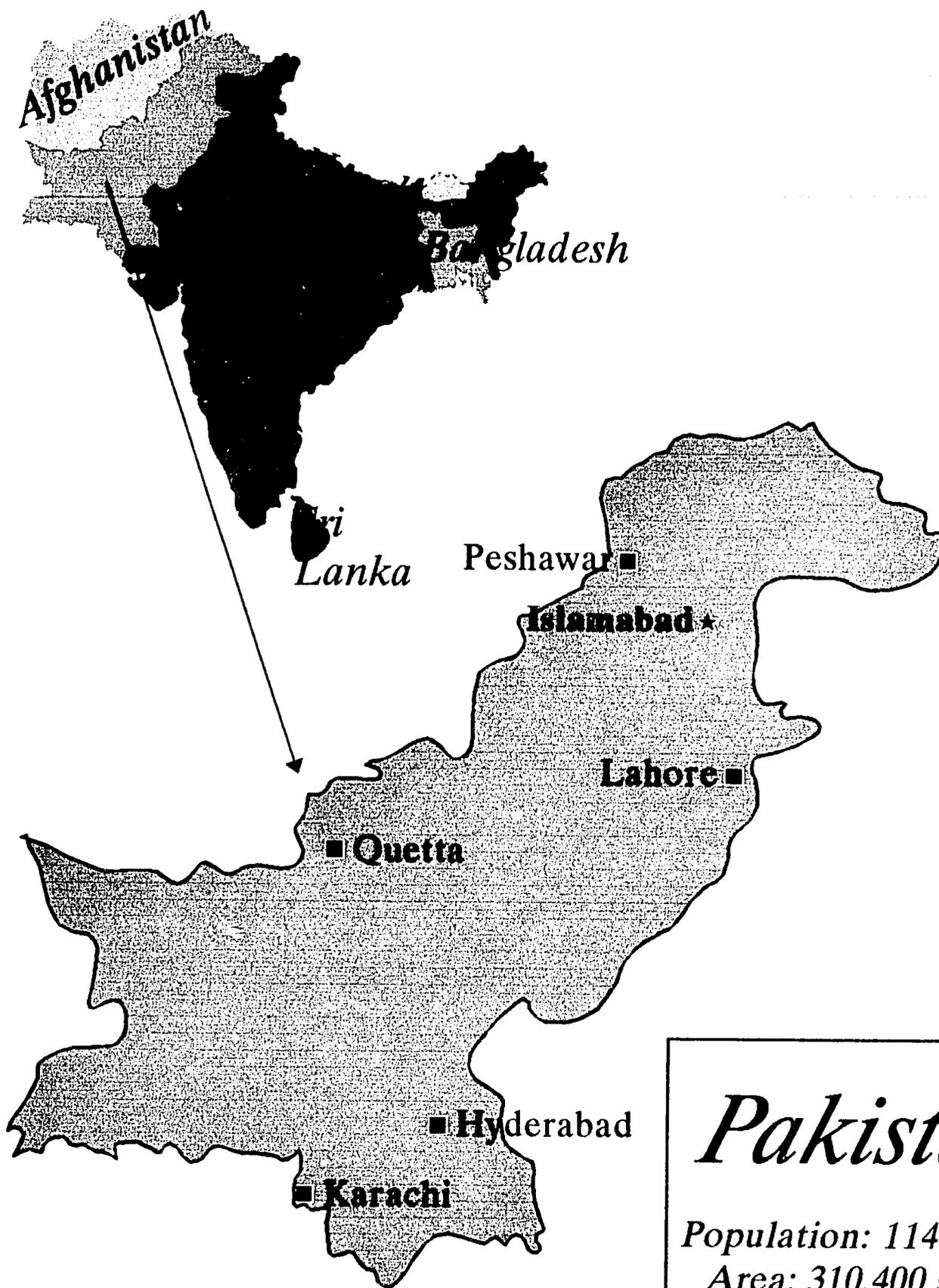
The Ford Rhodes report contains 11 findings and recommendations which USAID/Pakistan should consider in its negotiations with FIIB. We are making the following recommendation to be included in the Inspector General's recommendation follow-up system.

**Recommendation No. 1: Prior to entering into any agreement, we recommend that USAID/Pakistan verify that First International Investment Bank Limited, Pakistan has initiated procedures to: (a) develop an adequate accounting manual; (b) develop an effective budgeting and reporting system; and (c) document the resolution of reconciling items found in bank reconciliations.**

We appreciate the courtesies and cooperation USAID/Pakistan and FIIB extended to Ford Rhodes and our staff during the course of this pre-award survey.

Please advise me within 30 days of any actions planned or taken to close the above recommendation.

Attachment: a/s



# *Pakistan*

*Population: 114 million*

*Area: 310,400 sq. mi.*

*Capital: Islamabad*



REPORT ON THE  
PRE-AWARD SURVEY OF  
THE FIRST INTERNATIONAL INVESTMENT BANK LIMITED  
KARACHI, PAKISTAN

IN RELATION TO THE PROPOSED  
CO-OPERATIVE AGREEMENT WITH  
THE UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT  
PAKISTAN  
UNDER THE PRIVATE INVESTMENT EXPANSION PROGRAM

PERFORMED & PREPARED BY

**FORD, RHODES, ROBSON, MORROW**

**CHARTERED ACCOUNTANTS,**

**P: O. BOX 4719 KARACHI.**

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**BRANCHES AT LAHORE AND ISLAMABAD**

OCTOBER, 1992.

REPORT OF THE PRE-AWARD SURVEY OF THE  
FIRST INTERNATIONAL INVESTMENT BANK LIMITED,  
KARACHI, PAKISTAN.

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**FORD, RHODES, ROBSON, MORROW**

**CHARTERED ACCOUNTANTS**

BRANCHES IN PAKISTAN AT  
LAHORE & ISLAMABAD

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October 17, 1992.

Ms. Maryln B. Buchan,  
Chief Office of Contracts and Commodities,  
United States Agency for International  
Development Pakistan,  
Islamabad.

Dear Madam,

REPORT ON THE PRE-AWARD SURVEY OF THE FIRST INTERNATIONAL INVESTMENT BANK LIMITED, KARACHI, PAKISTAN IN RELATION TO THE PROPOSED CO-OPERATIVE AGREEMENT WITH THE UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT UNDER THE PRIVATE INVESTMENT EXPANSION PROGRAM

We are pleased to enclose our report on the pre-award survey of First International Investment Bank Limited, Karachi, Pakistan (FIIB). As far as it was practicable, the report has been prepared in conformity with the guidelines set out in "Statement of Work" referred to us by United States Agency for International Development/Pakistan (USAID/PAKISTAN).

**BACKGROUND**

Pakistan is shifting from a state controlled to a free market economy. Major policy changes supporting this shift have been announced and are in various stages of implementation. The country needs to have mechanisms for capital formation to support the private sector expansion. The stocks and shares markets are insufficient to meet all the capital needs. One clear constraint faced by small and medium investors is the absence of resources to finance pre-investment feasibility studies which would allow these entrepreneurs to obtain loans for their projects from banks.

To address this problem USAID/Pakistan is planning to establish a pre-investment feasibility fund in affiliation with FIIB in Pakistan under a co-operative agreement for the USAID/Pakistan project entitled Private Expansion Investment Program (391-0514). FIIB has submitted a proposal to USAID/Pakistan dated April 25, 1992 which outlines in detail the procedures which FIIB is going to adopt when implementing the project.

FIIB is an investment bank which was established as a public limited company under the Companies Ordinance, 1984 in February, 1990. FIIB's shares were floated to the public in July 1990 and commercial operations commenced in August 1990. Although its registered office is in Lahore the principal operations of the bank are conducted through its branch in Karachi which is the commercial centre of Pakistan.

FIIB being an investment bank is also governed by a notification issued by the Finance Division of the Government of Pakistan dated July 13, 1987. This notification prescribes inter-alia, the guidelines, objects and functions of investment finance companies.

FIIB's issued share capital after the public floatation in July 1990 and rights issue in March 1992 is as follows-

	Value in Rs Million	Value in US \$ Million	Percen- tage
American Express Bank Limited	30.0	1.2	23.6
Packages Group	45.1	1.8	35.5
International Finance Corporation	22.4	0.9	17.6
National Investment Trust	5.0	0.2	3.9
General Public	<u>24.5</u>	<u>1.0</u>	<u>19.4</u>
Total Issued Share Capital	<u>127.0</u>	<u>5.1</u>	<u>100.0</u>

## PROPOSED ACTIVITIES

Under the proposed co-operative agreement, USAID/Pakistan will contribute US Dollars 750,000 towards the pre-investment feasibility fund which will be held by FIIB in a "Special Account".

FIIB will work as an implementing agency and will use this fund to loan Pakistani sponsors, US sponsors and US- Pakistan joint ventures to conduct feasibility studies on projects which the sponsors intend to implement in Pakistan.

The sponsors will be loaned a maximum of 50% of the cost of a feasibility study on projects to be operated as a commercial venture by companies with major beneficial private sector ownership.

The repayment proceeds against feasibility studies loans will be placed into another account to be termed " Pakistani Rupee Feasibility Study Fund". With the passage of time, the " Special Account " will diminish while the " Pakistani Rupee Feasibility Study Fund " will gradually increase. Once the funds from the " Special Account " have been fully liquidated the " Pakistani Rupee Feasibility Study Fund " will be self sustaining.

As compensation for the administration of the fund FIIB will receive a fee based upon its projected one-year costs to operate the fund.

## PERIOD OF ACTIVITIES

The activities will commence upon receipt of funds by FIIB after signing of the co-operative agreement with USAID/Pakistan.

The "Special Account" and subsequently "Pakistani Rupee Feasibility Study Fund" will cease to operate in the event of

- a) the account reaches a monetary level too low to be economically viable in support of feasibility studies
- b) FIIB no longer wishes to be involved in operating the fund
- c) FIIB ceases to operate in Pakistan or
- d) Other similar circumstances

If the operation of the fund ceases, FIIB will donate the remaining balance of the fund to the American Business Council (ABC) in support of their operations in Pakistan. If for some reasons the ABC cannot be the beneficiary of this contribution, then FIIB shall make an appropriate contribution of the fund to charity.

#### OBJECTIVES OF THE PROGRAMME

The purpose of the fund is to enable small and medium scale entrepreneurs to finance pre-investment feasibility studies. These feasibility studies would enable them to obtain finance from banks and financial institutions.

#### ENTITIES COVERED

The entity covered by us for the purpose of the pre-award survey is First International Investment Bank Limited (FIIB). Our review is based on operations at the Karachi branch as this is the main area of activity of FIIB.

## OBJECTIVES AND SCOPE OF PRE-AWARD SURVEY

The objectives of the pre-award survey are to examine and express an opinion on FIIB's management and financial capabilities and report on its internal control structure. Specifically the objectives under each aspect covered by our examination are as follows:

- i) FIIB has the management capability to provide sufficient administration and span of control in relation to its activities under the proposed co-operative agreement with USAID/Pakistan. In order to express an opinion on management capability the following areas are pertinent -
  - . the review of the proposed program description and financial plan for sufficiency.
  - . the ability of FIIB to comply with the agreement conditions taking into consideration all existing prospective recipient commitments, non-governmental and governmental.
  - . the fact that FIIB has a satisfactory record of integrity and business ethics.
  - . FIIB is otherwise qualified to receive a grant under applicable local laws and regulations.
- ii) FIIB has the financial capability to manage its activities under the proposed co-operative agreement with USAID/Pakistan. In order to express an opinion on financial capability it is pertinent to evaluate that FIIB has adequate financial resources or has the ability to obtain such resources as required during the performance of the aforesaid agreement.

iii) FIIB has an adequate internal control structure to manage its activities under the proposed co-operative agreement with USAID/Pakistan. In order to report on the internal control structure the adequacy of the following is pertinent -

- . FIIB's accounting, record keeping, and overall financial management systems to meet standards spelled out in Paragraphs 1I, 1J, 1L and 1M of Handbook 13.
- . FIIB's procurement system to meet the standards set forth in Ch. 1 U, Handbook 13.
- . FIIB's other major internal control systems which are likely to affect the execution of the proposed activities under the proposed co-operative agreement.

In conducting the pre-award survey reference has been made to Guide for Financial Audits issued by USAID, US Government Auditing Standards issued by the Controller General and Statement of Auditing Standards issued by the American Institute of Certified Public Accountants. In addition a review of FIIB's published audited accounts, monthly unaudited financial statements, budgets, corporate audit report and other management information has been conducted. Moreover, reference to relevant laws in Pakistan like the Companies Ordinance, 1984, The Capital Issues Act, 1947, legal pronouncement governing investment finance companies, State Bank of Pakistan regulations and Stock Exchange requirements has been made for the purposes of the pre-award survey.

The period covered by our pre-award survey of the Karachi branch of FIIB was from its inception in February, 1990 to August, 1992.

#### BRIEF SUMMARY OF PRE-AWARD SURVEY RESULTS

a) MANAGEMENT CAPABILITY

We have carried out a review of the management capability of FIIB and assessed whether it is being managed by competent and experienced professionals. Based on our review we have concluded that FIIB has the management capability and sufficient administration and span of control in relation to its activities under the proposed co-operative agreement with USAID/Pakistan.

b) FINANCIAL CAPABILITY

We have carried out a review of the financial capability of FIIB and assessed whether FIIB is a financially viable and profitable entity. Based on our review we have concluded that FIIB has the financial capability to manage its activities under the proposed co-operative agreement and is operating profitably and is financially sound.

c) INTERNAL CONTROL STRUCTURE

We have carried out a review of the internal control structure of FIIB and assessed whether FIIB has an adequate internal control structure to manage the activities under the proposed co-operative agreement. Based on our review we have concluded that FIIB has a sound control environment, a proper accounting system and adequate control procedures.

Our review of the management capability, financial capability and internal control structure did not reveal any material weaknesses. However, we have noted certain matters in respect of the above which we have included as reportable conditions in survey findings 1 to 11 on pages 17 to 32 of this report.

FIIB management responses to our survey findings have been included individually under each finding and collectively in Appendix I. FIIB generally agreed with our findings and recommendations.

An audit of FIIB was conducted by the internal auditors of American Express Bank Limited and a report dated February 21, 1992 was issued. We reviewed the status of action taken by the management of FIIB on the findings reported by the internal auditors and concluded that corrective actions have been taken on all matters raised in the report except on follow-up of reconciling items in balances with other banks. This has been included as a reportable condition in survey finding 11 on page 31 of this report.

For the purpose of this report the exchange rate used for conversion of Pakistani Rupees to US Dollars is Pakistani Rupees 25 to US Dollar 1.

Please let us know if you require any additional information or explanations in connection with our report.

Yours faithfully,

*Ford Rhodes Robson Morrow*

Ford, Rhodes, Robson, Morrow,

Chartered Accountants.

**FORD, RHODES, ROBSON, MORROW**  
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 KARACHI, PAKISTAN IN RELATION TO THE PROPOSED CO-OPERATIVE AGREEMENT  
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REPORT ON MANAGEMENT CAPABILITY

We have carried out a review of First International Investment Bank Limited's (FIIB) management capability with a view to ascertaining whether FIIB is capable of providing sufficient administration and span of control in relation to its activities under the proposed co-operative agreement between FIIB and United States Agency for International Development/Pakistan (USAID/Pakistan). Our review was carried out in accordance with the applicable generally accepted US Government Auditing Standards and included an evaluation of the organizational set-up of FIIB, involvement of the Board of Directors in the management and decision making process, assessment of staff qualification, experience, morale and integrity, relationships with customers and third parties and adherence to laws and regulations prevalent in Pakistan. Based on such a review we report that:

- a) FIIB has a satisfactory record of integrity and business ethics;
- b) FIIB has the ability to comply with the proposed co-operative agreement conditions; and

c) we are not aware of any local laws or regulations which would disqualify FIIB from receiving a grant under the proposed co-operative agreement.

In our opinion, First International Investment Bank Limited has sufficient capability to manage the activities under the proposed co-operative agreement with USAID/Pakistan.

This report is intended for the information of management and the Agency for International Development. This restriction is not intended to limit the distribution of this report which is a matter of public record.

Yours faithfully,

*[Handwritten signature]*

Ford Rhodes, Robson, Morrow,

Chartered Accountants.

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 UNDER THE PRIVATE INVESTMENT PROGRAM

REPORT ON THE FINANCIAL CAPABILITY

We have carried out a review of First International Investment Bank Limited's (FIIB) financial capabilities with a view to ascertaining whether FIIB has the financial capability to manage the activities under the proposed co-operative agreement between FIIB and United States Agency for International Development / Pakistan (USAID/Pakistan). Our review was based on examination of audited financial statements, monthly management accounts, budgets and other information. The review was conducted in accordance with applicable generally accepted US Government Auditing Standards. Based on such a review we report that:

- a) FIIB is operating profitably and is financially sound; and
- b) FIIB has adequate financial resources or has the ability to obtain such resources that may be required during the performance of the proposed co-operative agreement.

In our opinion, First International Investment Bank Limited has the financial capability to enable it to manage the activities under the proposed co-operative agreement with USAID/Pakistan.

This report is intended for the information of management and the Agency for International Development. This restriction is not intended to limit the distribution of this report which is a matter of public record.

Yours faithfully,

*Ford Rhodes Robson Morrow*

Ford Rhodes, Robson, Morrow,

Chartered Accountants.

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REPORT ON THE INTERNAL CONTROL STRUCTURE

We have carried out a review of the Internal Control Structure of First International Investment Bank Limited (FIIB) with a view to ascertaining whether FIIB has an adequate internal control structure to manage the activities under the proposed co-operative agreement between FIIB and United States Agency for International Development / Pakistan (USAID/Pakistan). Our review was carried out in accordance with the applicable generally accepted US Governemnt Auditing Standards.

The management of FIIB is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of the financial statements in accordance with generally

accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories:

- (i) Investments
- (ii) Loans and advances
- (iii) Deposits
- (iv) Revenue receipts
- (v) Revenue expenditure
- (vi) Budgeting
- (vii) Transaction recording
- (viii) Safeguard of assets and documents
- (ix) E.D.P. environment

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public

Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable conditions covering matters involving the internal control structure and its operation are included in Survey Findings and Recommendations Section on pages 17 to 32 of this report.

A material weakness is a condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level, the risk that errors or irregularities in amounts that would be material in relation to the pre-award survey may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

This report is intended for the information of management and the Agency for International Development. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Yours faithfully,

*Ford Rhodes, Robson, Morrow*

Ford Rhodes, Robson, Morrow,

Chartered Accountants.

**FORD, RHODES, ROBSON, MORROW****CHARTERED ACCOUNTANTS**

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UNDER THE PRIVATE INVESTMENT EXPANSION PROGRAM

## SURVEY FINDINGS AND RECOMMENDATIONS

## FINDINGS ON MANAGEMENT CAPABILITY

## Finding 1

Operation of a branch in Karachi

## Condition :

The First International Investment Bank Limited (FIIB) is registered at Lahore in the province of Punjab. However it is operating a branch in Karachi in the province of Sindh since it commenced commercial operations in August, 1990.

## Criteria :

FIIB needed permission from regulatory authorities prior to opening a branch outside the province of Punjab. Although an application was made but a written permission was not granted until August, 1992.

## Effect :

As a result the branch was operating in Karachi, Sindh without formal written permission for nearly two years.

Cause :

There was an inordinate delay on part of the regulatory authorities to grant written permission for branch operations.

Recommendation :

We recommend that permission should be obtained prior to opening a branch so as to remain within the ambit of law and obviate potential exposure to loss or penalties.

Management Response :

The sponsoring shareholders, American Express Bank Ltd. (AEB), International Finance Corporation, and packages Group, decided even ahead of floatation to open an office in Karachi, for which we have obtained the government's written permission. The delay in receiving formal consent resulted from rule changes after submission of our request.

Finding 2

Rates of return on deposits placed with FIIB

Condition :

FIIB offered varied rates of return on deposits placed with them having the same maturity period. This condition existed in respect of deposits received upto June 30, 1992.

Criteria :

The State Bank of Pakistan (SBP) vide a circular dated December 5, 1991 made it mandatory for all non-banking financial institutions to offer a uniform rate of return on deposits having the same maturity period. The effective date for the above was initially January 1, 1992 and was subsequently extended to July 1, 1992 through an amendment in May 1992.

Effect :

As a result of the extension of the effective date, there was no violation of the SBP regulations although between January and May, 1992 there would have been a breach of SBP regulations had the effective date not been extended.

Cause :

The SBP regulation was disregarded in anticipation of the extension of the effective date. We were informed that during the period January to May 1992, FIIB had various discussions with SBP on extension of the effective date so that deposits which had been received prior to January 1992 and remained unmatured could be regularised upon maturity. However with effect from July 1, 1992 uniform rates are being offered in line with SBP regulations.

Recommendation :

We recommend that SBP regulations should be adhered to and wherever possible, discussions with regulatory authorities be documented so as to remain within the ambit of law and obviate any potential exposure to penalties, etc.

Management Response :

Our policy is to comply fully with all applicable laws and regulations. As regards the new prudential regulations issued by SBP, these allowed "reasonable time", without prescribing any firm deadline, for bringing existing transactions and commitments into conformity with new regulations. As noted by the auditors, we are operating in compliance with the regulations. Wherever necessary, we do document our discussions with regulatory authorities. The change of implementation date of the new regulations to 1st July, 1992 was verbally advised in a meeting of investment banks and duly recorded later in the May, 1992 circular.

Finding 3

Margin loans

Condition :

Margin loans are extended by FIIB against collateral of shares of listed companies.

Criteria :

Margins loans as referred to in law and as stipulated in the standard FIIB agreement is understood to promote investment in the capital market. Therefore margins loans should be extended for acquisition of shares of listed companies.

**Effect :**

As a result of the above, margin loans do not necessarily serve the purpose for which they are intended i.e. promotion of the capital market. Under the present arrangement loans are being extended against collateral of shares already held and therefore do not generate activity in the capital market as a result of granting of the loan. Further, the finance provided could be used by the customer for any purpose.

**Cause :**

FIIB interprets both loans i.e. for purchase of shares and loans secured by collateral of shares, as margin loan within the meaning of the law governing investment banks.

**Recommendation :**

We recommend that FIIB confirm the specific interpretation with their legal advisors and if necessary amend the wording of their standard margin loan agreement which presently implies that shares will be purchased by the customers from the proceeds of the loan.

**Management Response:**

There is no basis in any of the laws and regulations governing our activities to suggest, either in spirit or letter, that there is any distinction between financing a new acquisition of shares or an existing holding.

Finding 4

Accounting manual

Condition :

FIIB has not developed a specific accounting manual and has presently adopted the American Express Bank Limited's system of accounting. A manual however has been developed only for treasury functions.

Criteria :

FIIB should have its own accounting manual as it is an investment bank with separate objects, functions and operations from those of American Express Bank Limited.

Effect:

FIIB does not have a tailor-made accounting manual to fit in with all of its requirements.

Cause :

FIIB being a relatively new entity has not yet been able to develop its own accounting manual and has therefore adopted American Express Bank Limited's manual.

Recommendation :

We recommend that FIIB should develop its own accounting manual to fit in with all of its requirements.

Management Response:

We are presently using SBS, the banking software used by AEB in all its banking locations worldwide. This is a tried and tested computer system, which has served our standard requirements (deposit accounting, loan accounting, general ledger) well. As users of SBS, we are inevitably required to use AEB's accounting manual as well, and we cannot deviate from AEB's accounting procedures so long as we are using SBS. We recognize, however, the need for developing operation manuals to suit the local needs in Pakistan. Towards this end, two manuals (for treasury and for regulatory compliance) have already been developed, and additional manuals will be developed in due course.

Finding 5

Internal audit department

Condition :

The internal audit department has been recently created and is being headed by a senior executive.

Criteria :

FIIB should have an effective internal audit department with clearly defined objectives, scope, duties and responsibilities.

Effect :

Monitoring of the controls, procedures, functions and activities of FIIB are not yet subject to the scrutiny of the internal audit department.

Cause :

FIIB being a relatively new entity has not yet effectively introduced the internal audit function.

Recommendation :

We recommend that the internal audit department with clearly defined objectives, scope, duties and responsibilities should be made operational as soon as possible.

Management Response :

During the first 17 months of its existence, FIIB had the benefit of no less than four comprehensive audits (thrice by our external auditors, and once by AEB auditors as part of our technical services arrangement with AEB). The internal audit department is operational; it has completed compliance audits of deposit and loan accounts in September, 1992, and audits of other functions will be carried out in the next few months.

Finding 6

Budgets

Condition :

The management of FIIB has prepared broad budgets for the year 1992. The budgetary controls, monitoring of actual with budgeted performance and budget amendments for changes in strategies and conditions have not been introduced by FIIB.

Criteria :

Budgets are an essential management tool for controlling and guiding the banks activities and measuring performance.

Effect :

As a result of the above the advantages of budgets, budgetary controls and evaluation of performance and results are not yet availed by FIIB.

Cause :

FIIB being a relatively new entity has not yet been able to introduce effective budgeting. However a detailed budget is being prepared for implementation in 1993.

Recommendation :

We recommend that management implement an effective budgeting system.

Management Response :

We prepared a budget for 1992; this was done for FIIB as a whole, but was not broken down into departmental budgets as our operations were in the start-up stage and the departments were under development. Our progress against budget was reviewed on a monthly basis and in August a full revision was prepared to reflect progress to date and a forecast for the remaining four months of the year. In early November, a further revision and forecast takes place for the remaining two months. Full scale budgetary variance analysis, etc., was not deemed useful during the early phase of operations when monitoring performance was simple and straightforward. With our broader base of operations projected for 1993, we have followed AEB's detailed and comprehensive guidelines to prepare a budget, which will be broken down by departments for objective evaluation of performance vis-a-vis the budget. As regards the effectiveness of our budgets, it is of note that in 1991, our only completed year, actual figures conformed very closely to the budget.

## Finding 7

## Management reporting system

## Condition :

Except for a monthly balance sheet and income statement no formal procedure exists for conveying information to the chief executive by the departments on a periodic basis.

## Criteria :

A formal procedure to submit appropriate management information should exist so as enable the chief executive and the board of directors to be informed on key matters and issues on a regular basis.

## Effect :

As a result of the above it is possible that information on a systematic and timely basis may not be conveyed to top management.

## Cause :

Apart from the head office at Lahore, FIIB essentially operates from one location at Karachi. We were informed that regular exchange of information does exist but is on an informal basis and is not always documented.

## Recommendation :

We recommend that a formal system of management information system be introduced whereby key and relevant information may be submitted on a timely basis.

Management Response :

The existing reporting system will be strengthened and made more comprehensive in view of the more detailed budgeting and reporting system being introduced by us from 1993 and the increased scale of our operations.

FINDING ON FINANCIAL CAPABILITY

Finding 8

Raising of additional share capital

Condition :

FIIB in March 1992 decided to raise its existing capital base of Rs.100 million (US \$ 4 million) to Rs.250 million ( US \$ 10 million) by issuing five million right shares of par value of Rs.10 (US \$ 0.40) at a premium price of Rs.30 (US \$ 1.20) per share. The rights issue was partially successful as it resulted in raising finance to the extent of Rs.81.09 million (US \$ 3.24 million).

Criteria :

The rights issue if fully taken up would have resulted in raising finance of Rs.150 million (US \$ 6 million).

Effect :

FIIB's efforts to raise capital resulted in generation of additional finance to the extent of Rs.81.09 million (US \$ 3.24 million) against the proposed Rs.150 million (US \$ 6 million) i.e. 54%. Moreover, one of the sponsors American Express Bank Limited which held 30% of the shares did not take up their entitlement of the rights issue. This has resulted in reducing the American Express Bank Limited's holding from the original 30% to 23.6% after the rights issue.

Cause :

The rights issue was not successful on account of the high premium of Rs.20 (US \$ 0.80) per share set by FIIB, the bearish trend in the stock market at the time of issue and American Express Bank Limited declining from taking up their rights entitlement.

Recommendation :

We recommend that timing, issue price, market conditions and sponsors' plans should be carefully considered by FIIB prior to making efforts to raise funds through public issue.

Management Response :

Timing, issue price, market conditions, and sponsors' plans had, in fact, been carefully considered prior to launching the rights issue, and even in a subsequent weak bear market we were able to raise our capital base by 80 per cent, with a 200 per cent premium over the par value of our shares, when we had been in operation less than two years. As regards the AEB dilution to 23.6 per cent, it is noted in our original prospectus of July, 1990 that, by order of the Corporate Law Authority, the sponsors must dilute their holdings by May, 1993. In the case of AEB, this means that further dilution of 3.6 per cent to 20 per cent is still required to fulfill this condition.

## FINDINGS ON INTERNAL CONTROL STRUCTURE

## Finding 9

## Vouchers

## Condition :

We observed that in some instances vouchers were not authorized by responsible officials and were undated.

## Criteria :

All vouchers need to be authorized and dated prior to their entry in the accounting system.

## Effect :

As a result of the above unauthorized transactions are entered into the accounting system. Moreover, an undated voucher is incomplete.

## Cause :

The prescribed procedures of authorization and dating on occasions are not adhered to.

## Recommendation :

We recommend that the control procedure of authorization be strictly implemented to ensure that all authorized transactions are entered into the system. Moreover, the vouchers should be dated as this is an important element of any transaction.

Management Response :

All vouchers are in numerical sequence and are reconciled to the daily list of date-wise transactions. Manual entry of date on each voucher represents a further useful check, which we are now ensuring. Authorization of certain, very few, vouchers was not documented because of oversight. Strict conformity to procedures is now being ensured.

Finding 10

Control over safe movement register

Condition :

We observed that access to the safe movement register maintained for the purposes of recording movement of the safe's contents in and out of safe is not restricted.

Criteria :

The safe movement register should not be accessible to persons other than those who have been authorized for this purpose.

Effect :

The above could result in difficulty of assigning responsibility in the event of loss or misplacement of the register.

Cause :

A procedure for safe custody of the safe movement register has not been introduced.

Recommendation :

We recommend that the safe movement register be kept in the custody of a responsible official or in a secure place.

Management Response:

Safe movement register is now kept in safe custody "within" the safe itself.

Finding 11

Bank reconciliations

Condition :

We observed that old open items are appearing in the bank reconciliation and there is no documentary evidence of follow-up on such items.

Criteria :

Ideally there should be no old outstanding open items on the bank reconciliations.

Effect :

The open items could result in an incorrect reflection of the financial statements.

Cause :

We understand that all open items on bank reconciliations are followed up on a verbal basis.

## Recommendation :

The open items should be followed up in writing and expeditiously resolved.

## Management Response :

Open items are regularly and expeditiously followed up. However, a few sundry items have not yet been resolved. These are being pursued and are expected to be settled by end of November.

Yours faithfully,

*[Handwritten signature]*

Ford Rhodes, Robson, Morrow,

Chartered Accountants.



November 5, 1992

Mr. Salim Chinoy/  
Mr. Majid Khandwala  
Ford, Rhodes, Robson, Morrow  
Karachi Fax No. 241-9592

Dear Sirs

Report on Pre-Award Survey

We are writing with reference to your letter dated 1st November, 1992 on the above-mentioned subject.

Our response to findings 1-11, on pages 17-29 of "Survey Findings and Recommendations" section of your report is enclosed. If you have any comments or questions, please contact us.

Yours sincerely,

A. SAEED SIDDIQUI  
Director - System, Audit, and Compliance

Finding 1: Operation of a branch in Karachi

The sponsoring shareholders, American Express Bank Ltd. (AEB), International Finance Corporation, and Packages Group, decided even ahead of floatation to open an office in Karachi, for which we have obtained the government's written permission. The delay in receiving formal consent resulted from rule changes after submission of our request.

Finding 2: Rates of return on deposits placed with FIIB

Our policy is to comply fully with all applicable laws and regulations. As regards the new prudential regulations issued by SBP, these allowed "reasonable time", without prescribing any firm deadline, for bringing existing transactions and commitments into conformity with new regulations. As noted by the auditors, we are operating in compliance with the regulations. Wherever necessary, we do document our discussions with regulatory authorities. The change of implementation date of the new regulations to 1st July, 1992 was verbally advised in a meeting of investment banks and duly recorded later in the May, 1992 circular.

Finding 3: Margin Loans

There is no basis in any of the laws and regulations governing our activities to suggest, either in spirit or letter, that there is any distinction between financing a new acquisition of shares or an existing holding.

Finding 4: Accounting manual

We are presently using SBS, the banking software used by AEB in all its banking locations worldwide. This is a tried and tested computer system, which has served our standard requirements (deposit accounting, loan accounting, general ledger) well. As users of SBS, we are inevitably required to use AEB's accounting manual as well, and we cannot deviate from AEB's accounting

procedures so long as we are using SBS. We recognize, however, the need for developing operations manuals to suit the local needs in Pakistan. Towards this end, two manuals (for treasury and for regulatory compliance) have already been developed, and additional manuals will be developed in due course.

Finding 5: Internal audit department

During the first 17 months of its existence, FIIB had the benefit of no less than four comprehensive audits (thrice by our external auditors, and once by AEB auditors as part of our technical services arrangement with AEB). The internal audit department is operational; it has completed compliance audits of deposit and loan accounts in September, 1992, and audits of other functions will be carried out in the next few months.

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The existing reporting system will be strengthened and made more comprehensive in view of the more detailed budgeting and reporting system being introduced by us from 1993 and the increased scale of our operations.

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