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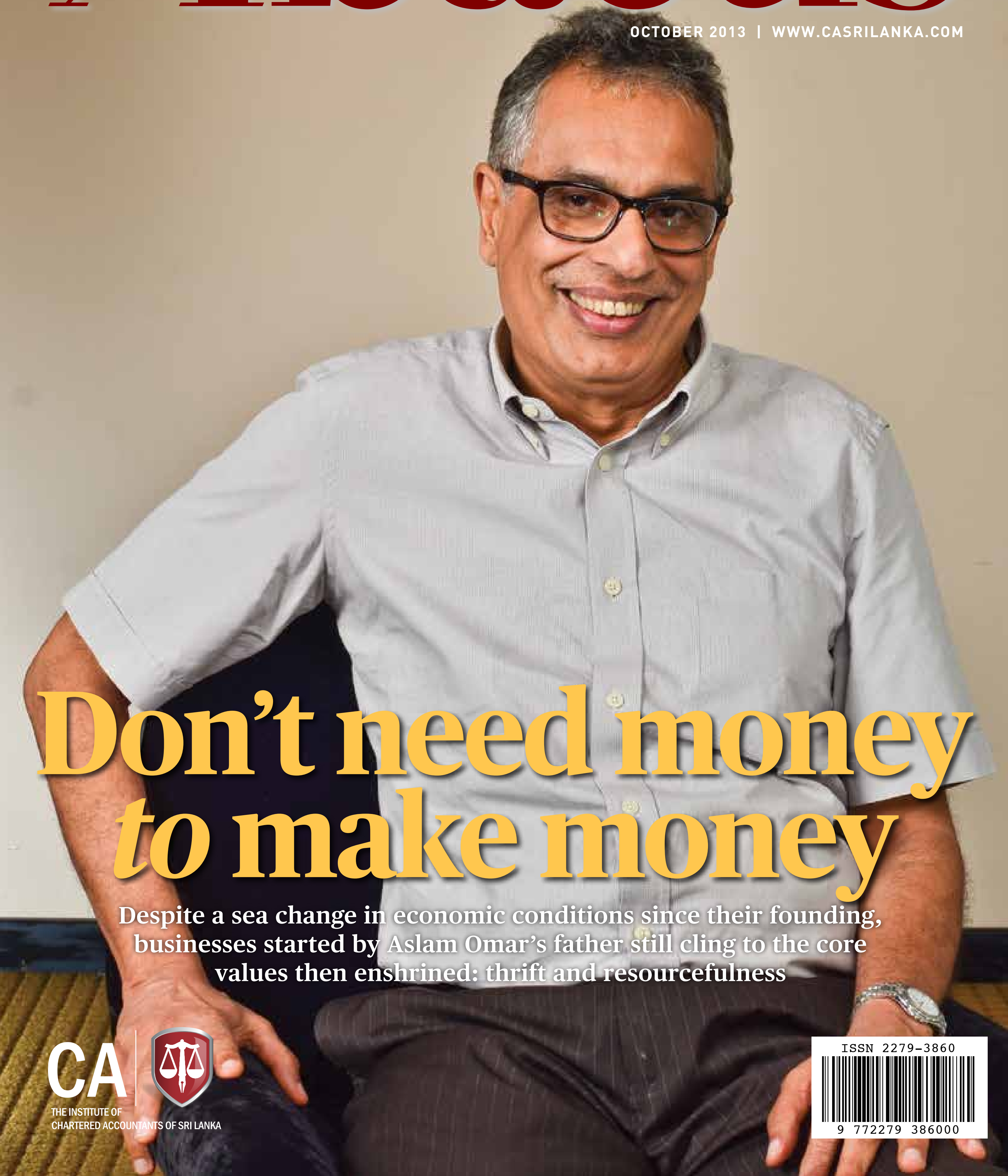

Don't need money *to* make money

Despite a sea change in economic conditions since their founding, businesses started by Aslam Omar's father still cling to the core values then enshrined: thrift and resourcefulness

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FOR INQUIRIES:
0777 546 546
0771 689 175
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SERVICES AT YOUR DESKTOP
RECRUIT
REGISTER FOR EVENTS
VIEW MY TRANSACTIONS
UPDATE MY PROFILE
PAY MY SUBS
MEMBER JOB BANK
MANAGE MY CPD
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Intelligence & Insight from CA Sri Lanka

Thrift and Wits in Business

Businesses are essentially repositories of savings, not the source of it. The established model is that businesses would hand back any cash to shareholders either as dividends or as share buybacks. Rarely is a business so competitive that it keeps generating cash year after year, even during challenging periods.

Firms have to be exceptionally profitable to generate enough free cashflow to reduce their reliance on banks and the capital markets. Such unusually high profit margins are rare as they are tough to maintain; requiring constant innovation and productivity leaps. It's only an exceptional firm with a clear competitive position and a business philosophy emphasizing liquidity that can break away from the norm.

Phoenix Ventures, the owning company of the apparel giant Brandix and the plastics manufacturer Phoenix Industries, has a formidable track record of generating cash and reinvesting smartly. The group is one of the biggest in the island almost rivaling listed giants like JKH and Dialog.

In our cover story Phoenix Ventures Managing Director Aslam Omar reveals how the group's unique cash-focused approach and its unwavering faith in investing in Sri Lanka has helped it establish a dominant position in the market.

The business disciplines of thrift and wits were more a survival strategy during the difficult era when the business first started than a philosophy. However, sticking to these values when Phoenix Ventures is wildly successful, make them a core philosophy.

CA
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) is one of the largest professional organizations in Sri Lanka that supports over 4,300 chartered accountants. The Institute provides insight and leadership to the accountancy and finance profession in Sri Lanka as well as globally.

Our well qualified members are trained to provide financial knowledge and guidance based on the highest professional, technical and ethical standards, thereby assisting communities and organizations gain long-term sustainable economic growth.

CONTRIBUTORS
Mark Hager
Padraig Colman
Rohan Gunasekera
Shamindra Kulamannage
Sravasti Ghosh Dastidar

DESIGN & LAYOUT
Thilini Perera

PHOTOGRAPHY
Chamil Thanthrimudalige
Dinidu De Alwis
Shafraz Farook

CA JOURNAL'S publications consultant is Capital Media (Pvt) Ltd.,
22, Flower Terrace, Colombo 7.
Phone 0112577387

CA SRI LANKA
30A, Malalasekera Mawatha,
Colombo 7, Sri Lanka
T : 0094-11-2352000
F : 0094-11-2352060
E : secretariat@casrilanka.com

Editorial Committee

Sujeewa Rajapakse
FCA, MBA
President, CA Sri lanka

Managing Partner of BDO Partners, Board Member of Sri Lanka Accounting and Auditing Standards Monitoring Board, Securities and Exchange Commission, Postgraduate Institute of Management and the National Institute of Business Management. Member of the Central Bank's Monetary Policy Consultative Committee, Technical Advisor for Confederation of Asian Pacific Accountants and South Asian Federation of Accountants. Serves on the Board of Directors of National Development Bank, Asian Alliance Insurance and Haycarb.

Arjuna Herath
FCA, BSc, MA in Financial Economics, MBA
Vice President , CA Sri lanka

Partner and Head of Information Technology, Risk Advisory Services and Business Advisory Services at Ernst & Young. Board Member of the Sri Lanka Accounting and Auditing Standards Monitoring Board and South Asian Federation of Accountants. Member of the Professional Accountancy Organisation Development Committee of the International Federation of Accountants.

Coralie Pietersz
Bsc (Hons), MBA, FCA, ACA (ICAEW)

Associate member of the Institute of Chartered Accountants in England and Wales and fellow member of the Institute of Chartered Accountants of Sri Lanka. Holds a B.Sc (Honours) degree in Physics from the University of Sussex and an MBA from Heriot-Watt University, Edinburgh. Finance Director of Finlays Colombo. Worked in both the private and public sectors and has many years of experience at a senior level in the banking industry.

Gerard J David
ACA

Partner of SJMS Associates, an Independent Correspondent Firm to Deloitte Touche Tohmatsu. Specializes in corporate insolvency and has significant experience in closure management of companies. Has experience in a number of areas in Transaction Advisory Services, which includes business valuation, company amalgamation, vendor due diligence, divestiture of business and business turnaround of medium-sized family owned companies in Sri Lanka. Also experienced in the Corporate Secretarial Practice and advises on Foreign Direct Investments in Sri Lanka.

Channa Manoharan
FCA, FCMA

Head of Advisory/ Chief Operating Officer of Pricewaterhouse Coopers, Sri Lanka & Maldives and the Partner leading the Consulting Practice. Member of the council of the Institute of Chartered Accountants of Sri Lanka since 2008 and Chairman of the Member and Student Services Committee & IT Faculty. Member of the Brand Development and Corporate Communications, Examinations, and Operations Review committees at CA Sri Lanka.

Aruna Alwis
Diploma in Business Administration, AIMIS; MBA
Secretary/ Chief Executive Officer

Received his Executive education from INSEAD, IIM– Bangalore and Open University of UK. An Associate Member of the Institute for the Management of Information Systems – UK. Holds a Diploma in Business Administration from University of Colombo and an MBA from University of Warnborough.

A word from the President

Codifying Corporate Conduct

The revised Code of Best Practice on Corporate Governance issued jointly by The Securities and Exchange Commission of Sri Lanka & The Institute of Chartered Accountants of Sri Lanka could go a long way in preventing corporate misdeeds that not only tarnish individual and organisational reputations but the image of the profession involved as well.

Those who do business according to the code will ensure they have sound corporate policies and procedures and effective monitoring and uphold sturdy business ethics.

CA Sri Lanka was the proud pioneer in introducing good corporate governance principles to the nation with the issue of the 'Code of Best Practice on matters related to financial aspects of Corporate Governance' in 1997, a voluntary best practice code which was later revised and updated, in 2003 and then in 2008.

The committee that drafted the revised code reviewed corporate governance codes of the UK, USA, India, Singapore and Australia. Those involved with the process were members of the legal profession and representatives from listed companies, the SEC, Colombo Stock Exchange, Sri Lanka Accounting & Auditing Standards Monitoring Board, Central Bank, Insurance Board of Sri Lanka, and the Council and Technical Directorate of the Institute of Chartered Accountants of Sri Lanka.

We encourage companies to adopt this code, especially those numerous unlisted ones who have still not adopted such governance procedures. This is all the more important at a time the country is trying to attract foreign investors, who, naturally, will judge us by the codes of corporate conduct in their own countries. They will find us wanting if we do not comply with international best practices.

Among the key amendments in the revised code are reporting requirements of the remuneration committees, disclosure and approval of major and material transactions, including those with related parties and communication with shareholders. There are changes in other areas as well. CA members and anyone interested would do well to study the new code which ensures transparency, fairness and accountability.

Adopting the code will show investors as well as all other stakeholders including particularly, employees and society at large, that our companies and organisations are well managed and governed and therefore, worthy of their trust, labour and money. Well-functioning and governed businesses are important for economic growth.

Our institute is no stranger to these values, for almost since inception we have been promoting these very same objectives through our annual report awards. As one of the largest professional organizations in the country with an internationally recognised qualification, our members, who play decisive roles at Boardroom and senior management levels of corporate Sri Lanka, are in a good position to uphold and promote the importance of transparency, good governance and accountability.

Sujeewa Rajapakse

Adopting the code will show investors as well as all other stakeholders including particularly, employees and society at large, that our companies and organisations are well managed and governed

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Periscope

TAX BREAKS FOR TRANSHIPMENT, ENTREPOT TRADE

The government in late July enacted legislation declaring its main ports, Colombo and Hambantota, as 'Free Ports' where business can be done tax free.

The move was meant to attract investors to use the island's location for transhipment, entrepot trade and regional logistics services.

The legislation provides exemptions from customs duty, exchange control and import-export regulations.

According to the Finance Ministry, the gazette also envisages Katunayake Export Processing Zone, Koggala Export Processing Zone and Mattala Rajapaksa International Air Port as bonded areas.

The enterprises which will benefit are entrepot trade involving import, minor processing and re-export and off – shore business where goods can be procured from one country or manufactured in one country and shipped to another country without bringing them to Sri Lanka.

Provision of front-end services to clients abroad, operations of the headquarters of the leading buyers, logistic services are also covered by the regulations gazetted as Commercial Hub Regulations No 1 of 2013.

To qualify for the tax benefits, companies must make a minimum investment of US$5 million and achieve an annual re-export turnover of not less than US$ 20 million over a period of five years.

For businesses engaged in logistic services such as a bonded warehouse or multi-country consolidation in Sri Lanka, the minimum investment will be US$ 3 million.

The Ceylon Chamber of Commerce welcomed the government initiative to declare free ports, saying it will help increase Sri Lanka's exports.

"We believe that this initiative lays the foundation for a paradigm shift in our economy to boost investments and exports, at a time when the Asian giants China, India and Japan are actively exploring opportunities to invest in Sri Lanka." ■

BANGLA INTEREST BRINGS NANDA UPBEAT OUTLOOK

Nanda Investments and Finance is a finance company described as minuscule, but a recent ownership change has brightened its prospects, according to RAM Ratings Lanka.

The rating agency placed Nanda Investments' long- and short-term financial institutions ratings of BB- and NP on Rating Watch, with a positive outlook, which indicates the rating may be raised.

The rating watch was triggered by the recent acquisition of Nanda by BRAC Lanka

Investments, a subsidiary of BRAC Bangladesh, a leading player in microfinance with a global presence in 11 countries, and LOLC Micro Investments, a unit of Lanka ORIX Leasing Company.

BRAC together with LOLC acquired Nanda with respective stakes of 56.6% and 33.4%.

"Nanda's ratings had been pressured by its miniscule size, lack of clear strategic direction and weak franchise," RAM Ratings says.

"However, given the change in its ownership, it is envisaged that the company's future growth strategies would be guided by the new shareholders' expertise in the financial services sector." ■

200% ESTIMATED TOTAL TAX ON IMPORTED WALL AND FLOOR TILES.

THE GOVERNMENT MORE THAN DOUBLED EXCISE CESS ON IMPORTED CERAMIC GLAZED WALL AND FLOOR TILES TO 35% FROM 15% IN SEPTEMBER 2012 TO PROTECT THE LOCAL CERAMIC INDUSTRY FROM CHEAPER IMPORTS AS DEMAND FELL AND MANUFACTURING COSTS ROSE.

Rs6.90mn

Value of a perch at the Slave Island property held by Ceylon Cold Stores, a subsidiary of John Keells Holdings. CCS has a freehold land extent of 4.49 acres and leasehold extent of 3.16 acres in Slave Island where the group plans a property development complex.

GROWTH PROSPECTS GOOD; LOW RESERVES, HIGH DEBT RAISE RISKS

Sri Lanka retains its robust growth prospects but remains vulnerable to external economic shocks because of low foreign exchange reserves and high debt, Standard & Poor's Ratings Services says.

The rating agency confirmed Sri Lanka's 'B+/B' sovereign credit ratings with a Stable Outlook.

"The stable outlook reflects our view that the country has strong prospects for per capita real GDP growth over the next few years and the government's fiscal profile is improving," it says.

We project that the attendant interest burden will comprise more than a third of government revenue through 2015

"At the same time, Sri Lanka's external liquidity is vulnerable and it has high fiscal and external debt."

"Sri Lanka's external liquidity remains exposed to international liquidity conditions," Standard & Poor's said.

Through 2015, it projects that Sri Lanka's gross external financing needs will exceed 120% of current account receipts (CAR) plus usable reserves. It also forecast that the country's external debt - net of official reserves and financial sector external assets - will be more than 100% of CAR.

Standard & Poor's expects Sri Lanka's gross international reserves to remain at a similar level to that in 2012, at three months' coverage of current account receipts.

"That's despite decisive action from the government and the central bank in early 2012 to improve the country's external position, through allowing the Sri Lankan rupee to depreciate and reining in credit expansion."

Although government finances have improved, "fundamental fiscal weaknesses remain," the rating agency says.

Inflation should fall but government debt will remain high. It projects annual growth in

general government debt will be 7.4% of GDP on average for 2013-2016.

"We project that the attendant interest burden will comprise more than a third of government revenue through 2015.

"In addition, some of the country's political institutions lack extensive checks and balances," said Standard & Poor's credit analyst Takahira Ogawa.

INVESTMENT TAX CREDITS MOOTED

The International Monetary Fund has advised the government to convert existing corporate tax holidays and exemptions to accelerated depreciation or investment tax credits linked to investment amounts.

This was among the recommendations made by an IMF team which visited the island for talks earlier this year.

Recent government tax reforms have aimed at creating a more attractive environment for investment.

A Tax Appeals Commission and a Tax Interpretation Committee have been set up. Paying taxes on a self-assessment basis and making tax payments online have been introduced to promote tax compliance and timely filing of tax returns.

The IMF expressed concern that tax revenues have been declining as a percent of Gross Domestic Product for years and are now low by international standards.

The IMF expressed concern that tax revenues have been declining as a percent of Gross Domestic Product for years and are now low by international standards.

The IMF proposed comprehensive reforms to broaden the tax base, simplify the system, and strengthen administration, including valuing all existing tax holidays and exemptions, and subsequently rationalizing costly or ineffective ones.

Rs 995,990

LEGAL EXPENSES INCURRED BY THE SECURITIES & EXCHANGE COMMISSION IN 2012. IT WAS RS 138,528 THE PREVIOUS YEAR

AUDIT FIRMS TO REGULATE MFIs

Micro-Finance Institutions (MFIs) will come under the supervision of audit firms approved by the Central Bank, according to draft legislation to regulate the industry.

The audit firms will support the Central Bank to enforce regulatory action with regard to MFIs under the new Microfinance Institutions Act.

These small finance institutions are required to obtain a license and to maintain a minimum capital level depending on their scale of operations, under the MFI act.

The absence of a solid regulatory and supervisory system is one of the main barriers to the industry's growth, says Bartleet Religare Stockbrokers.

While the Central Bank regulates the bigger microfinance providers like Regional Development Banks, a large number of NGO - MFIs are entirely unsupervised and not governed by specific regulations.

Periscope

62% increase in income tax expenses at Dialog

IN 2Q13 FROM A YEAR AGO. AFTER ITS 15-YEAR TAX HOLIDAY EXPIRED IN THE END OF 2012, DIALOG OPTED FOR A CORPORATE TAX POLICY OF 2% OF REVENUE. IT PROVISIONED A TAX EXPENSE OF RS275.8 MILLION IN 2Q2013.

DATA DOMINATES DIALOG GROWTH

Dialiog Axiata is investing heavily in expanding infrastructure for data business which is the next key driver of growth given increasing use of smart phones.

"We believe the non-voice segment would achieve about 35-40% compound annual growth rate in revenue in the next five years," TKS Securities said in a report.

In a market with smart phone penetration of 6%, the recently introduced smart phone range under the in house brand at affordable prices would also contribute towards Dialog's 'non voice' growth, they said.

Dialog is Sri Lanka's leader in mobile telephony with about 38% market share and 8.0 million subscribers.

Dialog is positioned as a direct beneficiary of the island's economic growth, TKS Securities said.

"Data revenue would be the key driver of the mobile operation's growth whereas voice revenue would continue to grow gradually around 10% per annum." ■

TAX GAINS FOR NESTLÉ LANKA

84%

NESTLÉ LANKA'S RETURN ON EQUITY IN 2012

Exports and value-added beverage products that attract lower taxes are yielding tax gains for Nestlé Lanka.

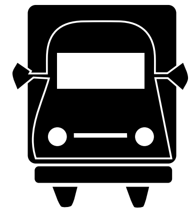
The company's effective tax rate for the second quarter of 2013 was 20.8% compared with 22.8% a year ago and 18.2% in 1Q2013.

"Exports and ready-to-drink segments are taxed at concessionary rates of 12% and 10% respectively," CT Smith Stock Brokers said in a report.

Nestlé Lanka's exports accounted for 12% of revenue in 2012. The brokers said Nestlé Lanka enjoys high cash flow generation, with net cash generated after interest and tax amounting to Rs 1,712 million in 1H2013, up 48% from the year before. Nestlé Lanka's 2013 first half net profit was up 37% to Rs.1,701 million from the year before. Gross profit margins were broadly maintained at 34.2%. ■

BOTTLENECK BRIDGE

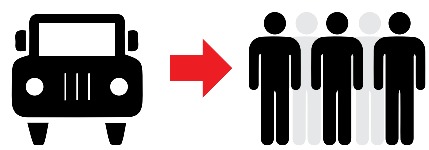
70%

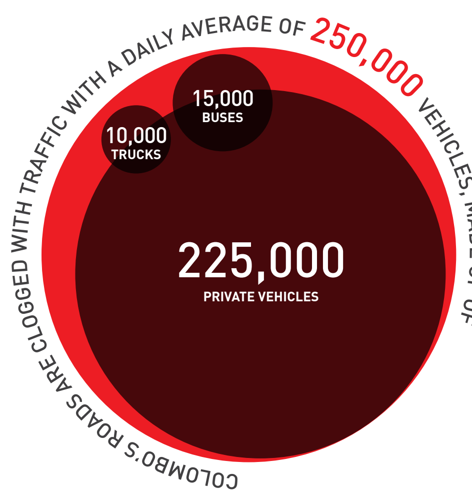


OF IMPORT-EXPORT CARGO PASSES THROUGH THE KELANI BRIDGE

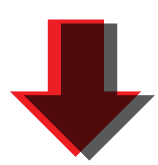
CURRENTLY SRI LANKA HAS A VEHICLE POPULATION OF AROUND **4 MILLION**

THERE ARE 130 VEHICLES PER 1,000 PEOPLE





ANNUAL ECONOMIC LOSS OF



Rs40 BILLION DUE TO ROAD TRAFFIC CONGESTION

Sources: SLPA corporate plan/Sunday Times Business Club Forum

INTERNATIONAL

FATCA SEEN RAISING COSTS, CHANGING RULES

The United States has delayed the introduction of the Foreign Account Tax Compliance Act (FATCA), a law meant to catch American tax evaders that has significant cost and regulatory implications for non-US banks and financial institutions, including fund managers and custodians.

Implementation of the law, originally planned to come into effect from 1 January 2014, has been postponed until June 2014, according to a US Internal Revenue Service (IRS) notice. It also eliminated reporting on US accounts for 2013.

Tax experts see FATCA as a serious data management challenge and have raised concerns about whether global fund managers and banks carrying the ultimate legal responsibility for compliance will be able to properly assemble customer information dispersed in multiple applications and locations.

FATCA, introduced to combat tax evasion by US tax residents using foreign accounts or through investments in overseas assets, requires financial institutions outside the US to pass information about their US customers to the IRS.

These include US citizens, US residents, US green card holders and foreign companies with more than 10% US ownership.

The legislation is controversial and viewed by many non-US financial institutions as intrusive and potentially violating local data privacy laws, while costing a lot of money to implement.

The US has proposed intergovernmental agreements (IGAs) that allow foreign financial institutions (FFIs) to forward sensitive US customer information to their own tax authorities instead of the IRS.

However, by mid-2013 only eight such agreements among the dozens under negotiation have actually been signed.

Non-US financial institutions are concerned about whether their governments would approve an IGA before the 30 percent penalty becomes effective.

There are two ways to report the information to the IRS. FFIs can report information directly to their own governments, and that information will be automatically sent to the IRS.

Or FFIs can register with the IRS and report information regarding their US accounts directly to the IRS, provided foreign governments enact local laws allowing the exchange of information with the United States. ■

FATCA requires non-US financial institutions to disclose data on US persons with accounts of at least US$50,000 or be faced with a penalty

withholding tax will be charged from foreign financial institutions on dividend, income, and other payments they get from US sources if they don't comply with FATCA

IRS REGISTRATION BY APRIL 2014

The IRS's registration website, the FATCA portal, was scheduled to open on August 19, 2013 to enable financial institutions to register.

Foreign financial institutions are allowed until December 31, 2013 to enter and modify information, without the information being regarded as final, thus allowing them to become familiar with the registration process.

They must complete registration by April 25, 2014 in order to avoid FATCA withholding beginning on July 1, 2014.

The participating FFIs do not need to file reports regarding US accounts maintained during 2013 but must do so during 2014. Such reports must be filed by March 31, 2015. ■

TRAINING FOR BANKERS

Local banks have begun preparing for FATCA compliance and training staff on the requirements of the US law.

The Association of Compliance Officers of Banks, Sri Lanka organised a training event for senior managers and compliance officers of banks and financial institutions in May that was conducted by Standard Chartered's Head – Compliance Training, India and South Asia P. Ananthakrishnan.

FATCA requires banks and financial institutions in Sri Lanka to identify and report on financial accounts like current accounts, savings accounts and fixed deposits of their US customers to the Internal Revenue Service of the US, Ananthakrishnan said.

The US law will have a widespread impact on banks and financial institutions and will require banks to adopt significant changes to their KYC (know your customer) systems and processes to identify US persons and report the details required to IRS, Ananthakrishnan said. Implementing these changes will be costly.

Despite being a US law, he said also said FATCA has extra territorial impact as it requires sharing of customer information and data with an overseas regulator. This could require amendments to the banking laws and regulations to permit such disclosures. ■

By
Shamindra Kulamannage

The Risks of Growing Up

Sri Lanka's graduation to lower middle-income status poses a number of new challenges in economic management

With graduation comes responsibility. Over the last several years Sri Lanka's economy has firmly graduated in to the ranks of lower middle-income status. This means it can rely less on the largesse of aid from the World Bank and ADB and its exports to rich countries no longer qualify for preferential tariffs that are available to Least Developed Countries (LDCs).

The capital flows that have replaced concessional flows are more expensive and also short term. Sri Lanka has sovereign bonds outstanding of US$3.5 billion and has attracted another US$3.7 billion in foreign holdings in treasury instruments. Foreign holdings of Sri Lankan rupee treasuries, unlike concessional aid, is fickle money; which will fly out at the first sign of trouble here or changes in global economic outlook.

The enduring challenge of the Sri Lankan economy is its twin deficits on the budget and the current account on external trade

Over the next year a major global trend is expected to be the withdrawal of the economic stimulus in the US by the Federal Reserve that has so far resulted in a major flow of short-term capital to the very riskiest end of the emerging markets scale: frontier markets like Sri Lanka. The mere announcement that the Fed will soon commence tapering its $85 billion a month bond buying programme put the Sri Lankan rupee under tremendous selling pressure. On sovereign debt raised overseas Sri Lanka has paid in excess of 6% interest and Treasury bill yields top 10% a year.

However, any sovereign debt it plans to raise in the future will likely cost more. Weeks ago Mozambique, which has a Standard & Poor's B+ credit rating which is the same as Sri Lanka's, sold its first sovereign bonds raising $500 million costing 8.5% a year.

The enduring challenge of the Sri Lankan economy is its twin deficits on the budget and the current account on external trade. These two have been in continuous deficit now for a quarter century. The twin deficit record would have been spectacularly longer had it not been for a budget surplus in 1987. The current account on trade has been in deficit annually since the nineteen seventies or for around 40 years.

The bruises of theses twin deficits are apparent. The Sri Lankan Rupee has fallen dramatically in value from Rs4 to the US dollar in the nineteen seventies to levels exceeding Rs130 to the dollar. In 2012 the current account deficit topped $9 billion.

Consequences of budget deficits are more severe and devastating, because it comes in the form of inflation. Inflation is like a tax imposed on the entire population irrespective of their ability to pay. Inflation hurts the poorest and the most vulnerable because they don't have a hedge against it, unlike the rich who own assets. Sustaining these twin deficits has been bruising and come at a price paid by citizens of this country.

With Sri Lanka's graduation in to lower middle-income status it now must take more responsibility for its actions like its consistently running current account and budget deficits.

When US tapering starts, hedge funds and other foreign investors will pull money out first from the countries with the weakest fundamentals. Firstly from those that have large current account deficits and secondly excessive budget deficits. A large and sudden exodus will weaken the currency and send the economy in to a shock rebalancing.

Clearly the realization about the imminent challenge is worrying policy makers. Banks are being pushed to borrow overseas to finance lending here and the government is also seeking more foreign loans from friendly countries and bank syndicates, paying market interest rates. Central Bank is also reaching out to China, clearly aware of the challenge facing the economy if holders of Sri Lankan Rupee bonds worth $3.7 billion all decide to sell.

To avoid dangerously depleting its reserves and facing another Balance of Payments crisis the Central Bank realizes it needs to attract as much money in a short span as might leave the island when the US bond buying programme is wound down.

Warnings that budget and current account deficits are unsustainable have been sounded for years, and Sri Lankan businesses and investors should brace themselves for the impact of the gradual end to the US tapering programme on the Sri Lankan economy. The impact may be somewhat softened by, so far, unanticipated inflows like emergency loans or bailouts.

The first impact is the continuing of somewhat high interest rates and the possibility they may have to rise further next year. Higher interest rates will tempt hedge funds to linger longer, encourage exporters to bring back their foreign income sooner and curb demand for goods, including imported ones. Continuing the high rates regime will continue to dampen consumer demand and economic growth.

Secondly, the 2014 government budget will likely recommend more import curbing tariffs mainly on consumer goods. For importers and retailers of consumer goods, who are already struggling with flat or falling sales, this isn't going to be good news.

Thirdly, credit expansion could turn sour. Already firms lending to the riskier segments of the market are seeing rising defaults. Small businesses that have expanded capacity but are not seeing increasing demand for goods and services are servicing loans with difficulty.

Fourthly, corporate profit growth will remain marginal. In the last four quarters ending in March 2013 reported listed firm profits had risen by around 9%, which is roughly in line with the inflation rate; so no real profit growth. If interest rates remain at current high levels it will likely continue to dampen corporate profit growth in 2014 too.

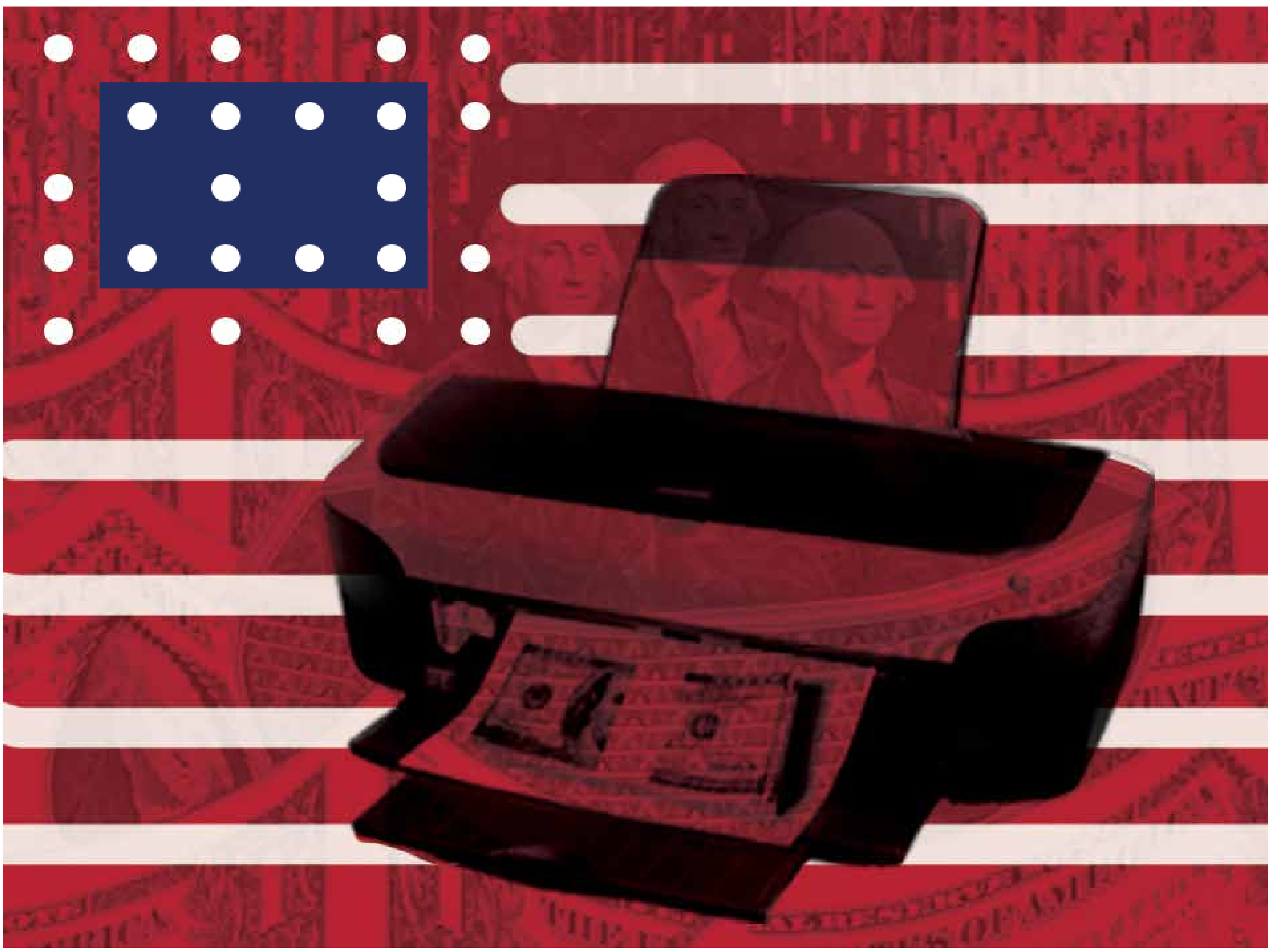
Tinkering with policy often isn't effective over the long term. Sri Lankan policy makers will have to move faster on reforms keeping in their sights the twin deficits. Should these deficits deteriorate because the reforms aren't able to keep up, Sri Lanka may face a debt crisis. Short-term capital will move out at the first sign of stress putting the exchange rate under severe pressure and exposing Sri Lanka for the first time to the tyranny of international capital markets. No government in this world has survived a middle-income debt crisis and if not anything else, political expediency should spur action. ■

By
Mark Hager

Perspective

Dead Fed Bread Ahead?

Generous dollops of printed money are sloshing through America's banks, sparking fears of ruinous inflation and asset-price bubbles



Some contend that the most powerful person in the world today is Federal Reserve chairman Ben Bernanke, not President Obama. The future livelihoods of hundreds of millions may turn on the decisions of one academic bureaucrat in Washington, D.C.

Since last December, the Federal Reserve (or 'Fed'), the U.S. central bank, has implemented 'quantitative easing IV,' (QE 4), the latest phase in a novel policy initiative launched back in 2008 and maintained intermittently since then. Under QE 4, the Fed buys billions of dollars in long-term government debt (Treasury bonds or T-bonds) and mortgage-backed securities (MBSs). It finances these purchases by simply crediting

Incentives all push toward the risky end of the spectrum

its own account with magically-conjured new money, which it then uses to buy the bonds (mainly newly-issued T-bonds) and MBSs.

The main objective, as I explain below, is to keep interest rates at rock-bottom levels so as to stimulate borrowing for new business investment and home purchases, thereby promoting recovery. There may be secondary objectives and side-benefits as well. The danger is that it will do no good and instead spark inflation and other problems through a massive increase in money supply. Don't look now, but chairman Ben presides over the biggest, most unprecedented experiment in monetary history.

Printing money to fight recession is hardly a new idea of course. Right-of-centre Milton Friedman facetiously suggested throwing money from helicopters while left-leaning Keynes favoured burying bags of money and paying unemployed folks to dig them up and keep the money. Get money into people's hands fast so they will spend, spend, spend.

There's a danger of course. If we could defeat recession by simply issuing more and more money, we could prevent recession forever by printing infinite money. The obvious problem is that the money would thereby become worthless. If there is logic to fighting recession with monetary expansion, it must be balanced against controlling inflation by limiting expansion.

It's hard to escape suspecting that the world has fallen into chronic stagnation. The 2008 bank crisis may have been less cause than symptom. Singly and together, economies worldwide may face 'structural obstacles', sharply constraining growth for the foreseeable future. If nothing more, can chairman Ben buy us time?

Fed purchase of T-debt lowers interest rates in two ways. First, it puts cash into the hands of sellers (usually banks), thereby increasing the active money supply, at least if the banks lend this cash out rather than holding it or making non-loan investments. With money more abundant, less interest can be charged to lend it: interest rates fall correspondingly.

Second, Fed T-debt purchases bid up T-debt re-sale prices, thereby reducing their 'yield' when paid off at maturity. (Regardless of its cost when purchased originally from the government (let's say $85), a T-debt instrument that will pay $100 when redeemed at maturity carries an effective yield of 25% (20/80) if bought for $80 in the re-sale market but only 11% (10/90) if bought for $90.)

If we could defeat recession by simply issuing more and more money, we could prevent recession forever by printing infinite money

Falling yields on T-debt push general interest rates downward because investment money migrates away from safe but low-yield T-debt and starts competing elsewhere for borrowers who will pay interest on new loans. As more potential loan capital chases the limited supply of sound lending opportunities, borrowers bid down what lenders can charge them in interest. The hope, of course, is that by making it cheaper to borrow, the resulting low interest rates will boost production and growth.

In theory, MBS purchases foster job creation as well, in somewhat roundabout fashion. MBSs are created as collection rights on multiple mortgages (typically many thousands) get sold in packages. Lenders selling these mortgages get cash promptly in hand instead of waiting through the durations of the loans for repayment and running the risk of defaults. For their part, buyers of packaged mortgages (MBSs) exchange their cash for chances to win big through collecting repayments on multiple mortgages. Because the original lenders can reduce their risks through sales of mortgages in MBS markets and quickly replenish their cash supplies for further lending, interest rates on home loans supposedly fall. This can stimulate home-buying. By pushing MBS prices upward, Fed purchases stimulate the MBS market and thereby encourage low mortgage rates and increased home-buying. This fosters job creation through revival of the critical and long-moribund construction sector. So goes the theory.

Rallying on the promise of prolonged low interest rates, stocks have performed impressively since announcement of QE 4. This may be a secondary benefit of QE: creating a 'wealth effect' whereby shareholders see their portfolios fatten and start spending.

Concern over QE 4 comes on four main fronts. First is that the flood of dollars could cause depreciation, especially against currencies of export-dependent developing economies. In fact, however, the dollar has gone up against developing country currencies since 2008, when QE began. Weak as the U.S.

Perspective

2013 DEBT STATISTICS

SOURCE: ADVANTAGE CREDIT COUNSELLING SERVICES- DEBT MANAGEMENT

Low bank equity encourages risky investment by shifting loss exposure to creditors

recovery has been, America remains an attractive investment venue compared with even worse economies elsewhere. Investors therefore keep buying dollars, keeping its value high against other currencies.

A second concern, more parochial than the first, is that the U.S. stock rally will go into reverse when Chairman Ben begins tapering off QE4. The stock markets fluttered in late June over some ambiguous hints that tapering might begin by year's end, but then bounced back when Bernanke dropped more hints indicating he had no such intention. His hope, of course, is that by the time he closes QE4 down, the markets will be chugging along on their own steam.

A third concern is that QE's flood of dollars will touch off ruinous inflation. Chairman Ben projects low inflation based on 'core' numbers that exclude food and energy prices because they both tend to fluctuate a lot. But if food and energy are included, inflation already registers closer to 3% than 2%. Some evidence that food prices are on a long-term upward trend and should therefore be indexed somehow into 'core' inflation. And QE itself may push energy prices up, as inflation expectations drive investors toward commodities in general and oil in particular. Former Fed chairman Paul Volcker (an inflation hawk if ever there was one) recently warned that Bernanke needs to look out for inflation before it starts accelerating.

Concern number four is that QE4 is failing in its main goal of promoting lending by stuffing banks full of cash through purchase of their T-bond and MBS holdings. Corporate America is already flush with cash that it's not spending, so it has no need to borrow. Meanwhile, household America can't afford to borrow as it struggles to pay down massive debt loads. Furthermore, while rock bottom interest rates are nice for borrowers, they're not so nice for lenders.

Instead of lending for low returns, the banks are busy making money other ways. What ways? That's the scary part. Using their QE4 cash, banks are drifting right back into the reckless speculation in complex derivatives that brought us the 2008 credit crisis and subsequent recession.

In response to reproaches, Chairman Ben would probably remind us that worldwide recovery depends heavily on restoring prosperity and high spending to the American consumer, exactly what he's trying so hard to do. But is he pulling the economy upward or around some ironic loop?

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TRANSFER PRICING

At arm's length

BY ROHAN GUNASEKERA

Transfer pricing provisions or regulations to determine 'arm's length' pricing of transactions between related parties have just become effective in Sri Lanka.

The move comes at a time when corporate use of legal loopholes to reduce tax costs has drawn the attention of tax authorities worldwide. This has partly been in response to a sharp fall in the tax rates paid by multinationals, especially those with intangible assets like firms with big brands or information and communications technology companies.

Governments, including the Sri Lankan government, are looking for ways to increase revenues. One obvious method is to focus on and track intercompany transactions, given the known corporate practice of using accounting tricks and gaps in the law to reduce their tax burden.

Multinational companies have long been known to avoid paying tax through transfer pricing and other tactics like profit-shifting that show or inflate costs in high-tax countries and transfer profits to low-tax jurisdictions or tax havens. One tactic is the proliferation of subsidiaries that enjoy tax breaks, either for new ventures or expansion. This can be seen among local companies, who like their peers elsewhere, create subsidiaries not only because of the need to expand but also to benefit from government tax breaks such as those offered by the Board of Investment. Some firms shift profits to newly established subsidiaries or associates with tax concessions to lower the overall tax burden.

These lawful tax reduction or avoidance tactics inevitably result in the erosion of the tax base and also raise issues of fairness. Such practices can be unfair by other players in an industry, such as say, a garment factory with tax breaks having an advantage over one which does not have access to tax concessions. Some garment factories are known to run at a loss for years with transfer pricing tactics used to shift profits elsewhere - to related party companies abroad where taxes are low or to tax havens.

Another difficulty is that some products are difficult to compare to arrive at arm's length pricing agreements. This can be say, a Sri Lankan factory supplying parts such as car door locks to a foreign firm. The problem here is that there's no comparable article to compare with

Advantage

as each item is unique to that particular final product.

Tax avoidance in the services sector is a huge issue. The practice, known to be widespread, results in large loss of foreign exchange earnings. The main difficulty here is the nature of the products or services - software - as these intangibles are difficult to keep track of or compare with others.

Cross-border transfer taxation is a hugely complicated issue with at least four parties involved - the two companies and two tax authorities in the different countries - and can even create diplomatic problems.

Transfer pricing rules became effective in April 2013 following proposals in this year's government budget to make separate provisions to determine the 'arm's length' price of goods and services in local transactions of associated undertakings and to introduce Advance Pricing Agreements (APAs) by amending Section 104 of the Inland Revenue Act. Companies resident in Sri Lanka will now have the opportunity to do APAs to ensure their inter-company pricing practices comply with the law.

These APAs usually tend to be specific given the confidential nature of inter-company transactions and pricing arrangements. But since of late a demand for more transparency has arisen both by the public as well as governments in developed countries. Public interest groups in developed countries have investigated and exposed corporate tax avoidance schemes.

60%

of world trade takes place within transnational companies, such as the extractive industries (oil, gas and mining)

In reaching APAs, Sri Lanka's bargaining position can be weak, like that of other developing countries, as it lacks the resources and skills when dealing with developed country tax authorities or their corporations, which have more clout and expertise. Powerful MNCs can simply threaten to pull out if not happy with the tax treatment here.

The Inland Revenue Department also aims to introduce penalty provisions perhaps in the next year or two to ensure compliance with the new arm's length pricing regulations. This is being held back to give tax payers time to become familiar with the new law and be compliant. But without proper penalty provisions tax authorities say it would be very difficult to address transfer pricing issues.

The government might also need to review double tax agreements with other countries to avoid double non-taxation - the possibility of companies using loopholes in existing double-taxation agreements to avoid paying tax in either jurisdiction.

Closing tax gaps

The Organisation for Economic Co-operation and Development (OECD), an organisation of rich countries, has launched an Action Plan on Base Erosion and Profit Shifting, known as BEPS, to prevent tax evasion.

National tax laws have not kept pace with the globalisation of corporations and the digital economy, leaving gaps that can be exploited by multi-national corporations to artificially reduce their taxes.

OECD's Action Plan on BEPS offers a global roadmap that will allow governments to collect the tax revenue they need to serve their citizens. It also gives businesses the certainty they need to invest and grow.

"This Action Plan, which we will roll out over the coming two years, marks a turning point in the history of international tax co-operation. It will allow countries to draw up the co-ordinated, comprehensive and transparent standards they need to prevent BEPS," said OECD Secretary-General Angel Gurría.

"International tax rules, many of them dating from the 1920s, ensure that businesses don't pay taxes in two countries – double taxation. This is laudable, but unfortunately these rules are now being abused to permit double non-taxation.

The Action Plan recognises the importance of addressing the digital economy, which offers a borderless world of products and services that too often do not fall within the tax regime of any specific country, leaving loopholes that allow profits to go untaxed.

The Action Plan will develop a new set of standards to prevent double non-taxation. Closer international co-operation will close gaps that, on paper, allow income to 'disappear' for tax purposes by using multiple deductions for the same expense and "treaty-shopping". Stronger rules on controlled foreign companies would allow countries to tax profits stashed in offshore subsidiaries.

Domestic and international tax rules should relate to both income and the economic activity that generates it. Existing tax treaty and transfer pricing rules can, in some cases, facilitate the separation of taxable profits from the value-creating activities that generate them.

The Action Plan will restore the intended effects of these standards by aligning tax with substance – ensuring that taxable profits cannot be artificially shifted, through the transfer of intangibles (eg patents or copyrights), risks or capital, away from countries where the value is created.

Greater transparency and improved data are needed to evaluate, and stop, the growing disconnect between the location where financial assets are created and investments take place and where multinationals report profits for tax purposes.

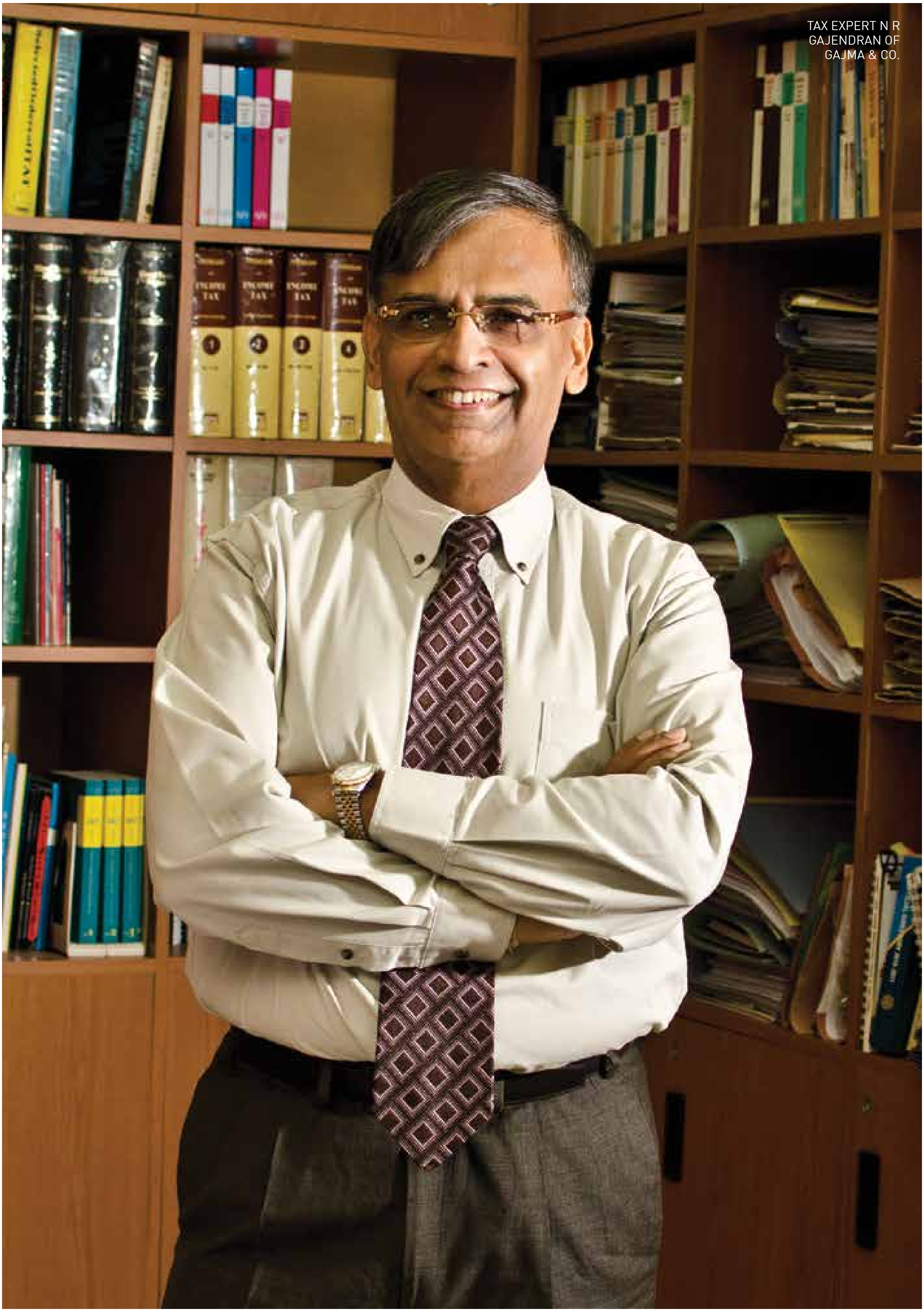
Requiring taxpayers to report their aggressive tax planning arrangements and rules about transfer pricing documentation, breaking-down the information on a country-by-country basis, will help governments identify risk areas and focus their audit strategies.

Big revenue gains seen

Tax expert N R Gajendran of Gajma & Co. gives his views on transfer pricing, regulations for which have just been enacted.

Pricing

An arm's length price refers to an uncontrolled price in an uncontrolled situation between two unrelated parties reflecting market conditions, market rates, and demand and supply. With the phenomenal growth of multinational supply chains and cross-border transactions, the taxing rights of a state were eroded because of non-arm's length transactions. For example, if you are in a tax jurisdiction where tax rates are low or zero, like in a tax haven, or are entitled to exemptions as given in certain countries, the business logic is to book greater profits in a non-tax or low-tax jurisdiction. One tactic, in inter-company cross-border transactions, is to use prices that do not reflect the arm's length prices that would usually prevail in transactions between two totally unrelated parties. In such circumstances, if the transactions are between two related parties who are clearly defined, the law can say the price will have to be determined at arm's length



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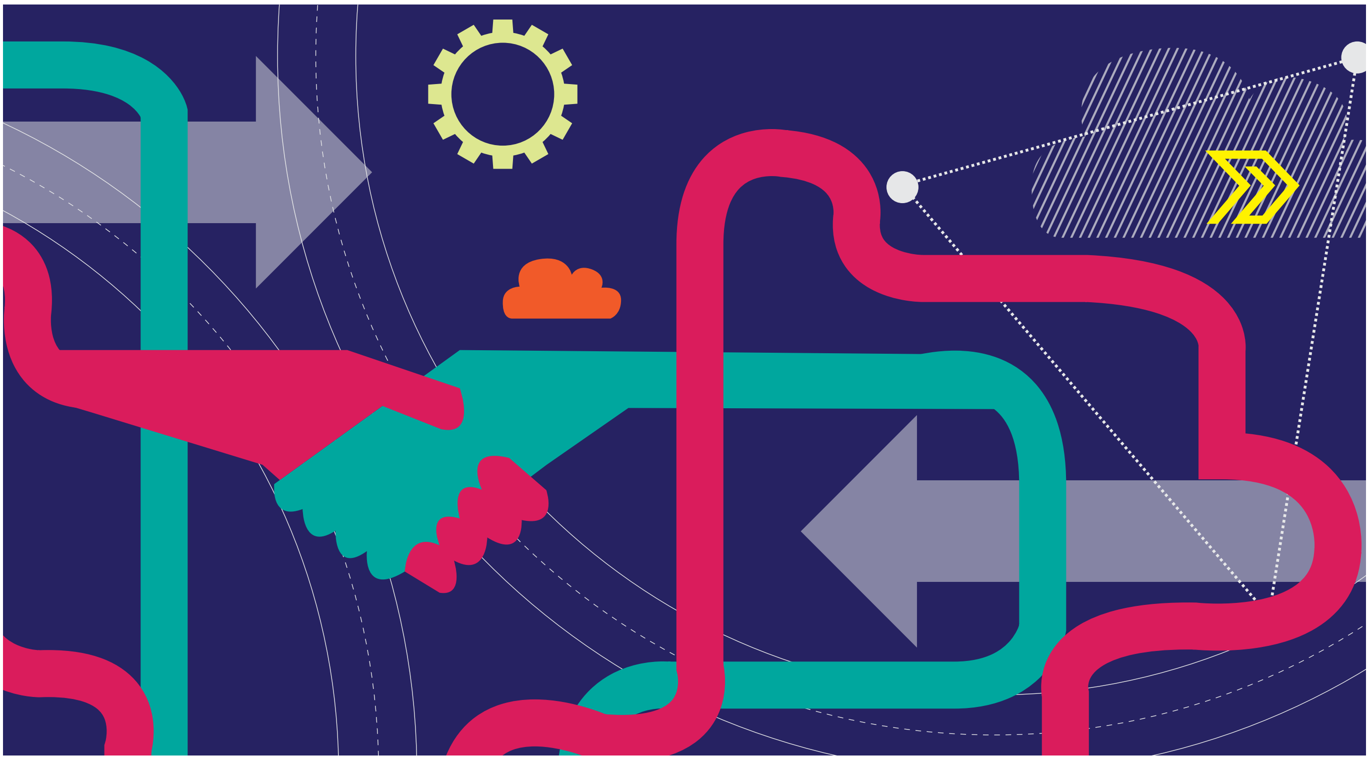


and it can re-fix the prices and profits.

Corporate endeavour is to increase the bottom line. They enter into transactions and have their own justifications for the prices at which they transact. Whether it'll meet the arm's length test is the question.

In arm's length pricing, you don't come to an exact price - it has to be a sort of range.

To establish transfer pricing, you must have information for comparable transactions in an uncontrolled environment. If you don't have comparables, the profits of an entity depend on three factors - the assets employed, the functions performed and the risks assumed. So if there is greater risk or if there is a greater intellectual element going into a certain operation, there can be greater profits, depending on the situation.

Furthermore, even an unrelated party, depending on the facts and circumstances, might sell goods to a particular type of person at one price and to another person at another price. You will have your reasons for doing that. It can be bulk orders. It can be a regular customer. There can be so many factors. So you have to see the market price for that particular scenario. It can be a branded product or a non-branded product.

1%

of GDP is the estimated extra tax revenue the government can earn if international transfer pricing is regulated

Double non-taxation

A concern particularly in European countries is about double tax treaties and the issue of double non-taxation. In double taxation there are two elements; an economic double taxation and a juridical double taxation.

In the case of an economic double taxation, the same profit is taxed in the hands of two people. For example, when a company makes profits it pays tax, and when it declares dividends to a shareholder, the shareholder again pays tax.

Juridical double taxation takes place in cross-border transactions when the same person pays tax on the same profits in two jurisdictions. Double tax treaties are meant to minimize or avoid juridical taxation. Say, if a legal entity earns profits in Sri Lanka and pays tax and if the same profit is going to be captured in the entity's home country taxation, then there has to be a mechanism to avoid the double taxation. If not, cross-border transactions become unaffordable and meaningless.

But in this process, corporate entities and groups use their ingenuity and structure operations using domestic law and international laws in the form of double tax treaties to have double non-taxation. That means the same profit is not taxed in both the countries.

In other countries, transfer pricing and international taxation is a huge business, even for the department of inland revenue. A lot of focus and emphasis and specialists are employed. Because when it comes to transfer pricing, you can't decide on your own. There are two states involved. If Sri Lanka wants to tax more and if they want to avoid double taxation, the other country has to make adjustments. So there has to be mutual agreement procedures (found in double tax treaties). Just because Sri Lanka thinks our taxing right is eroded it cannot simply impose taxes because the taxpayer will come and say if he's going to pay more tax here he'll have to get released from the other country, otherwise he goes into double taxation. The objective is to avoid international double taxation.

Tax base erosion

So far there has been no systematic and organized method to find out whether Sri Lanka has lost on transfer pricing, from a tax point of view, because we didn't have regulations to look in to this. So, for example, a subsidiary of a foreign company can have losses for many years, and you could have done other verifications and evaluations but you could not have tried to see if the price was arm's length or not.

The revenue loss is very difficult to estimate. My guess is, if we focus properly on international transfer pricing, we'll have additional revenue equivalent to at least 1% of GDP, maybe at least Rs 40-50 billion, coming to the country's coffers over a period of time.

Transfer pricing gazette notifications were issued in 2008. For international transactions, the laws were introduced only in the 2013 amendment to the Inland Revenue Act. The professionals have been calling for this and now there's the realization that it's necessary, particularly with the tax: GDP ratio going down.

Tax haven

It may be easy for the authorities to look at domestic transactions more than international transactions. But the revenue lost on international transactions is significantly more. Of course, Sri Lanka being a developing country gives certain tax exemptions for certain entities. Some of these tax exemptions being given, say for strategic development projects, make Sri Lanka almost like a tax haven. That is a conscious policy decision to make the country competitive and attract investors.

6,038
number of subsidiaries of ten of the world's most powerful extractive companies, of which 2,083 (34.5%) are incorporated in secrecy jurisdictions or tax havens

Although we give foreign businesses huge tax exemptions, when they take the dividends or profits to their home country they might pay normal tax rates which sometimes can be higher than our rates. There's no logic in it. There should be a mechanism to make sure that if we are giving exemptions, the beneficiary should be the company, and not the revenue of another state. There seems to be inadequate study of the implications of giving generous tax breaks to attract foreign investors since some of them are known to end up being taxed in their own jurisdictions.

And particularly with certain exemptions available for income taxes in certain industries and some for very long periods of time, if the transaction is large the transfer pricing issues will not be from the Sri Lankan perspective but from the other country's perspective. Because we having an exemption means, even if you have an inflated profit here, we give them the exemption. So there can be inflation of profits in Sri Lanka's entity. But if you go into details you might find that the full profit is not exempt, only a part of it is and the other part may be from a non-exempt source. So that type of analysis and research has to be done. You have to go into the transaction in more depth.

Learning process

Finding the arm's length price is not an easy endeavour. The department of Inland Revenue has to set the pace and there will be documentation issues on what is required. There'll be teething problems. It'll be a learning process. A lot of time and effort has to go into it as well as resources. And it has to be productive and objective from all points of view.

The new regulations certainly will lead to a change in company behaviour. Naturally, they will be more conscious of it. They will have to be more alert.

GAMINI WIJESINGHE, COMMISSIONER, INTERNATIONAL TAX POLICY OF THE INLAND REVENUE DEPARTMENT

Inland Revenue gets ready

In this interview, Gamini Wijesinghe, Commissioner, International Tax Policy of the Inland Revenue Department discusses the latest developments and how the tax authorities are preparing to implement the new regulations:

What are the amendments made to the prevailing law regarding cross-border transactions?

Transfer Pricing arrangements have been found to be controversial in the field of taxation, particularly in the taxation of international transactions. Sri Lanka enacted the required provisions in 2006 and subsequently gazetted relevant regulations but due to various deficiencies the provisions were not properly implemented. Now, Section 104 of the Inland Revenue Act has been further amended to strengthen the legal base with a view to capture the cross-border and domestic tax evasion through transfer pricing arrangements.

The changes made are mainly as follows:

(a) International and domestic transactions are treated separately for the determination of the arm's length price. Certain complications that existed were removed, such as definition of international transactions and separate treatment for corresponding adjustment for international and domestic transactions.

(b) What is meant by "international transactions" is defined in the law.

(c) Commissioner General of Inland Revenue has now been empowered to enter in to Advance Pricing Agreements (APAs) for the purpose of transfer pricing with prospective entities who wish to enter in to such agreements.

(d) Application of a uniform approach is vital in the determination of arm's length price in relation to cross-border transactions. Therefore, to comply with international practice, a special portfolio called 'Transfer Pricing Officer' (TPO) was introduced to quantify the arm's length price relating to a given transaction.

How does the Inland Revenue Department view the prevalence of transfer pricing in Sri Lanka?

Tax evasion is very common in the international as well as the domestic business arena. This is common in relation to the foreign exchange transactions as well. Today, international trade covers a major volume of the trade in Sri Lanka. Due to different tax and customs duty rates and different FDI attraction approaches by various countries, profit shifting into different tax jurisdictions is a very common practice by multinational companies to save on their tax expenses.

Multinational companies play a major role in international trade and it has been strengthening in the last two decades. So, Sri Lanka is lagging behind in the application of the 'arm's length' principle in mitigating the loss of tax revenue. However, even in the absence of transfer pricing provisions the Department could deal with the effect to some extent through certain other Sections of the Inland Revenue Act, such as the thin capitalization rule, ceiling on head office expenses and management fees.

What sort of resources and skills does the Inland Revenue Department deploy in this area?

Transfer pricing methods are complex and time consuming, often requiring attention from some of the most skilled and experienced human resources in both multinational enterprises and tax administrations. Transfer pricing reports often run into hundreds of pages with many legal and accounting experts employed to create them. This kind of complexity and knowledge requirement puts tremendous strain on both the tax authorities and the taxpayers, especially in developing countries where resources tend to be scarce and the appropriate training in such a specialized area is not readily available.

The Department has established a new unit to monitor the determination of 'arm's length prices' and other relevant issues, under a Commissioner. It expects to further expand the unit after completion of training of relevant staff.

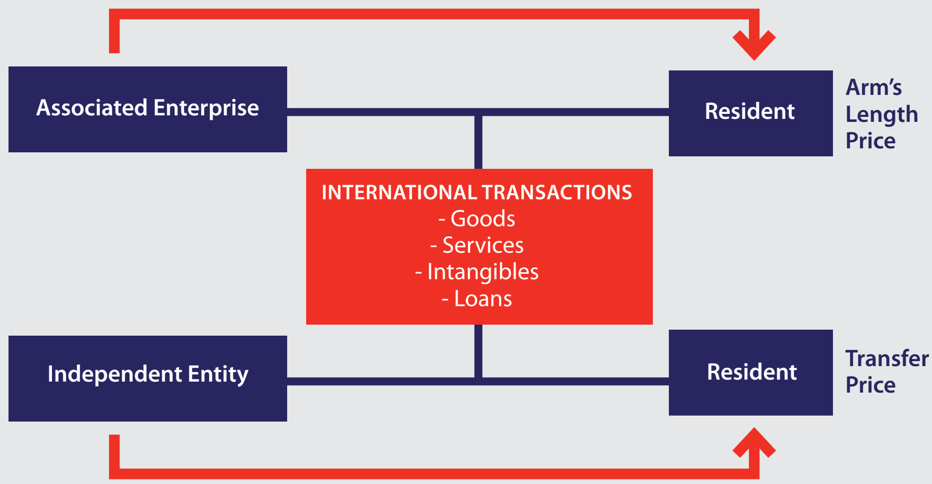
The training of staff is mainly categorized as follows:

- Short-term local training on identified Transfer Pricing issues.
- Long-term local training course for around 40 officers to handle the Transfer Pricing issues.
- International training for certain selected officers.

What are the methods prescribed to define the arm's length price of a controlled transaction?

The Department has followed the common OECD guidelines in defining methods for determination of arm's length price. Accordingly, the following methods have now been chosen and published in the Gazette under Transfer Pricing Regulations:

WHY TRANSFER PRICING?



1. Comparable Uncontrolled Price Method (CUP)

The CUP method compares the price charged for a property or service transferred in a controlled transaction to the price charged for a comparable property or service transferred in a comparable uncontrolled transaction in comparable circumstances.

2. Resale Price Method

The resale price method is used to determine the price to be paid by a reseller for a product purchased from an associated enterprise and resold to an independent enterprise. The purchase price is set so that the margin earned by the reseller is sufficient to allow it to cover its selling and operating expenses and make an appropriate profit.

3. Cost-Plus Method

The cost plus method is used to determine the appropriate price to be charged by a supplier of property or services to a related purchaser. The price is determined by adding to costs the supplier incurred an appropriate gross margin so that the supplier will make an appropriate profit in the light of market conditions and functions he or she performed.

4. Profit-Split Method

The profit split method takes the combined profits earned by two related parties from one or a series of transactions and then divides the profits using a defined basis that is aimed at replicating the division of profits that would have been anticipated in an agreement made at arm's length. Arm's length pricing is therefore derived from both parties by working back from profit to price.

40

number of Inland Revenue Department officers to get long-term local training to handle Transfer Pricing issues

5. Transactional Net Margin Method (TNMM)

This method seeks to compare the level of profits that would have resulted from controlled transactions with the return realised by the comparable independent enterprise. The TNMM compares the net profit margin realised from the controlled transactions with the net profit margin realised from uncontrolled transactions.

The most appropriate methods for different transactions or class of transactions may be selected by the respective related parties and informed to the Department.

How will the new provision affect taxation of companies?

Basically, the law addresses the compliance issue. All the companies identified as related parties should comply with the transfer pricing provisions. The documentation process of the related party transactions needs to be streamlined. The law is relative and burden of proof is largely passed to the relevant companies.

Related party transaction disclosure is compatible with Sri Lanka Financial Reporting Standards. Informal approaches for transactions among the related parties will be made available in a more formal manner to comply with the Transfer Pricing Law.

If a non-arm's length price approach is identified as intentionally, or unintentionally, additional tax may arise.

How do the effects of transfer pricing lead to the erosion of the tax base?
Taxation must always be fair and equitable. If the law itself provides for paying less tax and tax avoidance, there is a moral effect on other genuine taxpayers to keep away from the tax system. The transfer pricing law covers important aspects of tax avoidance and evasion which are planned by related parties locally and internationally. So, the department hopes a strong compliance culture will develop owing to this legislation.

Is there any estimate of revenue lost due to non-arm's length transfer pricing?
There are only unofficial estimates of the size of tax losses due to Sri Lanka not having proper transfer pricing provisions, especially concerning multinational corporations in relation to their cross-border transactions. This affects not only tax revenue but also inflows of foreign exchange. ■

Tax revenue as a % of GDP

14.0 *2002* **12.0** *2012*

While Sri Lanka's tax revenues have been increasing, its share of Gross Domestic Product has shrunk

How transfer pricing works

Suppose a company, Smartphone Sri Lanka, resident in Sri Lanka which has a tax rate of say, 40%, manufactures a mobile for Rs 10,000 and sells it to its associated company Smartphone USA, resident in the US which has a tax rate of 20% for Rs 20,000 which in turn sells in the open market for Rs 40,000. Had Smartphone Sri Lanka sold it direct, it would have made a profit of Rs 30,000 that would have been taxed at 40%. But by routing it through the US firm, it restricted it to Rs 10,000, allowing Smartphone USA to appropriate the balance to be taxed at 20% only.

The transaction between Smartphone Sri Lanka and Smartphone USA is arranged and not governed by market forces. The profit of Rs 20,000 is thereby shifted to Smartphone USA.

The product is transferred at a price (transfer price) which is arbitrary or dictated (Rs 20,000) but not on the market price (Rs 40,000). So, in effect, the company in Sri Lanka will have lower profit and therefore a lower tax incidence whereas the company in the USA makes a higher profit which is taxed at a lower rate. The overall effect is that the company, Smartphone, manages to reduce tax payments by shifting profits.

Subsidiary syndrome

Tax administrations globally lose billions of dollars because of transfer pricing arrangements by oil, gas and mining companies known collectively as the extractive industries.

These revenue losses are particularly relevant for countries like Sri Lanka, which is now on the verge of having its own oil and gas industry while multinational mining companies are also showing interest in the island's mineral resources.

Ten of the world's most powerful oil, gas and mining companies own 6,038 subsidiaries and over a third of them are based in secrecy jurisdictions, according to a study by Publish What You Pay (PWYP) Norway, part of a global coalition of anti-corruption groups that aims to reduce corruption by increasing transparency.

Secrecy jurisdictions facilitate illicit financial flows, to which the developing world loses US$1 trillion a year. The financial opacity created by the use of secrecy jurisdictions also undermines trust in markets and damages market efficiency, they say.

PWYP Norway has tried to unravel labyrinthine corporate structures created by some of the world's biggest energy and mining companies by examining annual reports and stock exchange filings.

They found that 2,083 (34.5%) of the 6,038 subsidiaries belonging to the 10 of the world's most powerful extractive industry companies are incorporated in secrecy jurisdictions, the most favourite of which is by far the US state of Delaware with 15.2% of the subsidiaries located there.

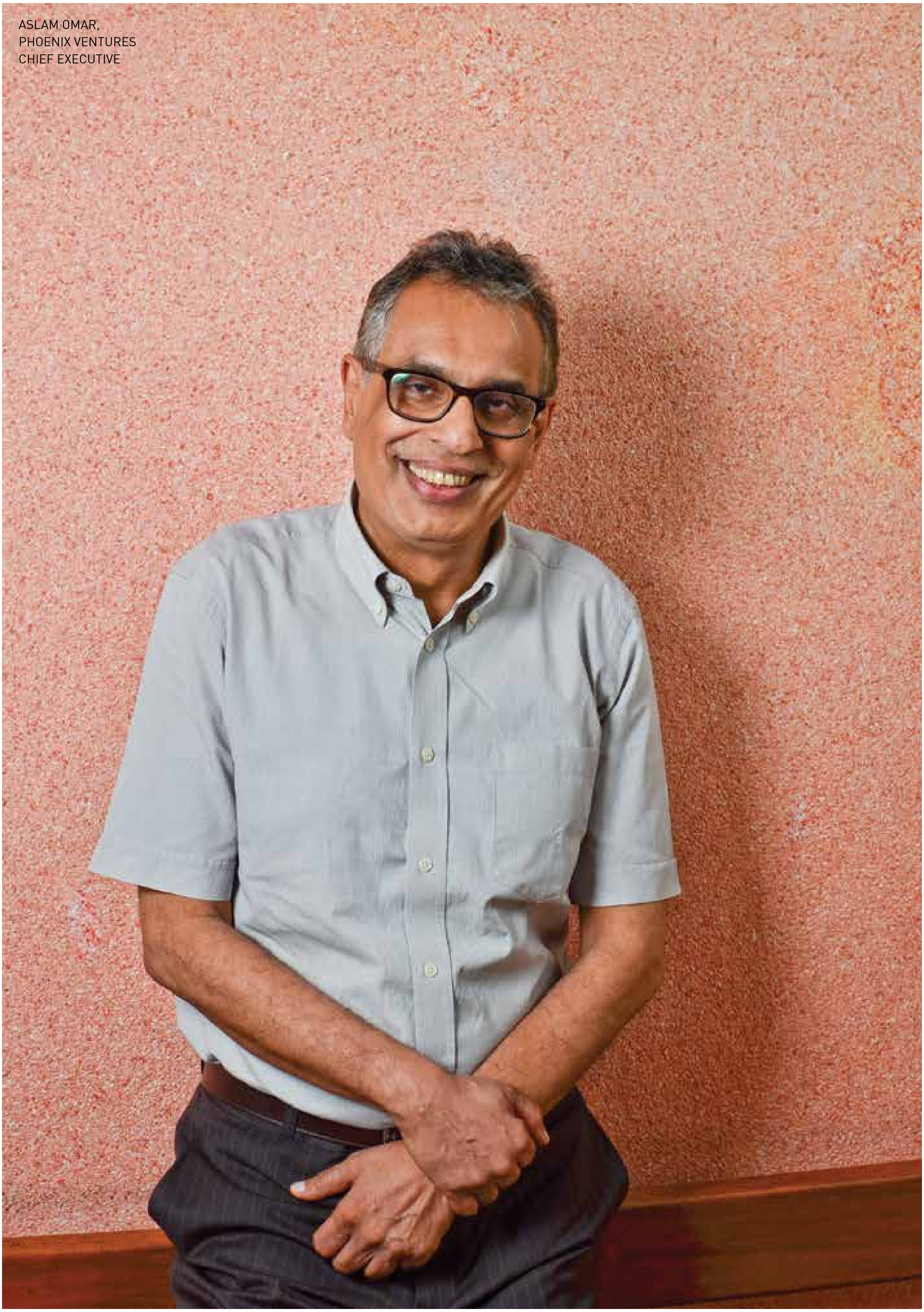
The second favourite Extractive Industry Company (EIC) Secrecy Jurisdiction is the Netherlands, where 358 subsidiaries belonging to EI giants are based.

The Netherlands is the largest host of conduit companies worldwide and is an important jurisdiction for corporate internal debt shifting.

"These findings are of critical concern as natural resources offer the largest financial potential to improve economic and social opportunities for hundreds of millions of people living in least developed and emerging countries," the report says.

This is why, in order to combat this veil of secrecy, PWYP Norway believes every company should publish their full revenues, costs, profits, tax and the amount of natural resources it has used, written off and acquired in any given year in every country it operates. This is known as country-by-country reporting (CBCR).

The 10 Extractive Industry Companies featured in Piping Profits are BP, Chevron, ConoccoPhillips, Exxon, Royal Dutch Shell plus Anglo-American, Barrick Gold Corporation, BHP Billiton, Glencore International AG and Rio Tinto.



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PHOENIX VENTURES
CHIEF EXECUTIVE

Advantage

Don't need money *to* make money

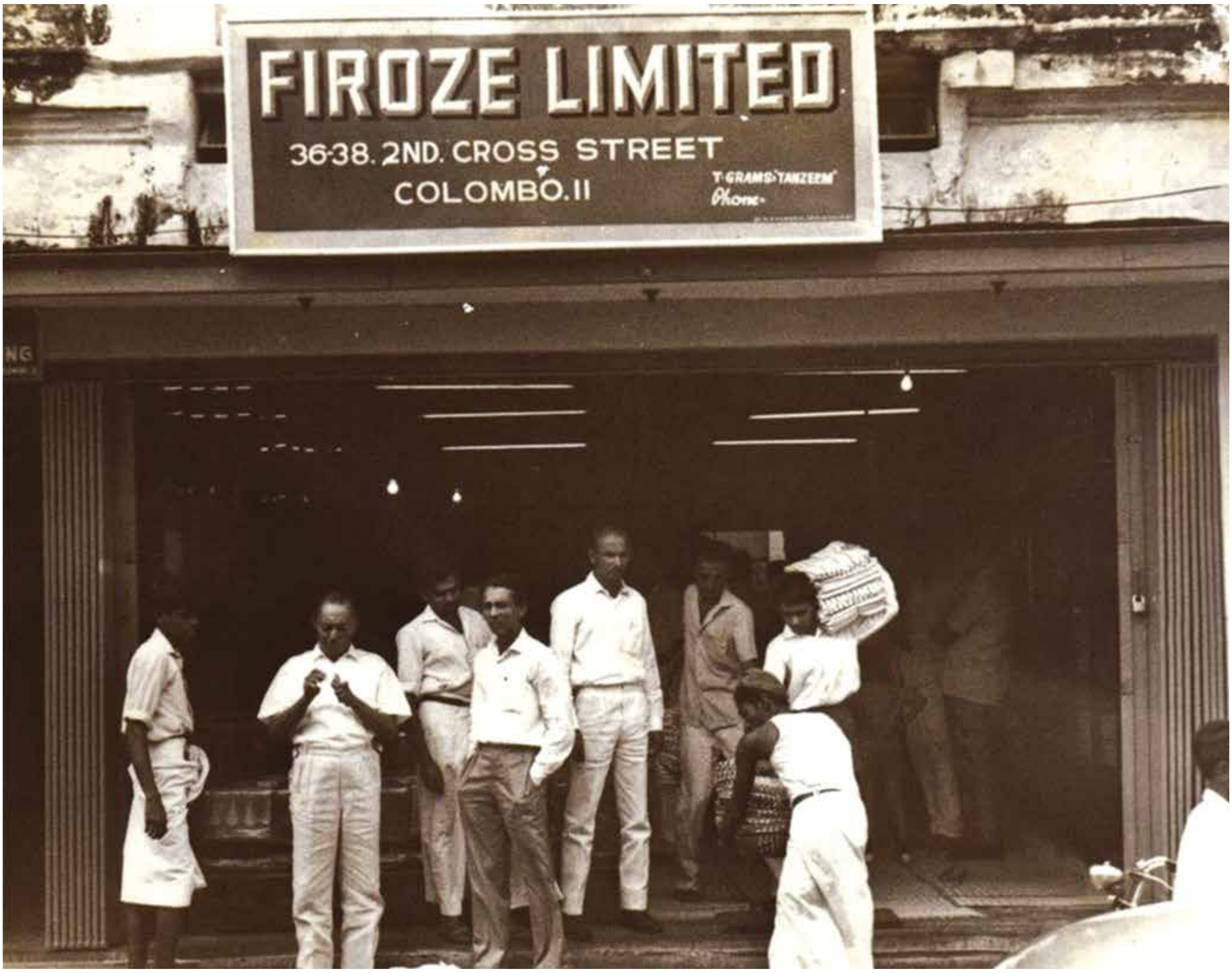
BY SHAMINDRA KULAMANNAGE

Despite a sea change in economic conditions since their founding, businesses started by Aslam Omar's father still cling to the core values then enshrined: thrift and resourcefulness

The enduring model is that businesses attract surplus resources usually channeled through the banking system or the securities market, and put it to use in enterprise. Businesses are essentially repositories of savings, not the source of it.

Firms taking on debt and issuing securities gain more stakeholders whose competing interests they need to deftly handle to ensure funding lines remain open. Banks have a mean habit of tightening credit just when a firm is experiencing cash flow challenges and the securities market pushes up risk premiums at the first whiff of difficulty. Although past crises may make firms skittish about having to rely on banks and securities markets for funds to grab growth opportunities, few generate enough cash internally to not have to.

Firms have to be exceptionally profitable to generate enough free cashflow to reduce their reliance on banks and the capital markets. Such unusually high profit margins are rare as they are tough to maintain; requiring constant innovation and productivity leaps. It's only an exceptional firm with a clear competitive position and a business philosophy emphasizing liquidity that can break away from the norm.



FIROZE LTD., A TRADING HOUSE IN COLOMBO STARTED BY MOHAMMED HAJI OMAR WAS THE PREDECESSOR TO PHOENIX VENTURES. THE BUSINESS COMMENCED TRADING IN 1969, GREW AND DIVERSIFIED DESPITE THE CHALLENGING ECONOMIC CLIMATE THEN

"Analyse any business and you realize the biggest cost items are not the interest charge or the taxes you pay the government, but the other costs that are within the businesses control," points out Phoenix Ventures Chief Executive Aslam Omar. Thrift and resourcefulness, values at the heart of Phoenix Ventures come from its founder, its Chief Executive Aslam Omar's father Mohammed Haji Omar who started a trading business in 1969. The business disciplines of thrift and wits were more a survival strategy during the difficult era when the business first started; than a philosophy. However sticking to these values, when businesses are now wildly successful, make them a core philosophy.

Phoenix Ventures is the holding company of Brandix - a giant apparel & related accessories manufacturer which also manages industrial estates - and plastics maker Phoenix Industries. Aslam Omar and his two younger brothers Ashroff and Feroz joined their father's business during the nineteen seventies and eighties.

Aslam Omar's father's business, trading house Firoze Limited at Second Cross Street in Colombo Fort, had to quickly adapt to the economic blight of the nineteen seventies when government policy suppressed markets causing widespread shortages and business failures. "For us the definition of success is very simple. It's identifying how much money was credited to our bank account. Profit means money in the bank," explains Omar who is now at the helm of

Phoenix Ventures that reported a Rs70 billion consolidated top line in the financial year that ended in March 2013.

Its cash focused variation of the income statement is simple. Closing stock and work in progress is considered at the raw material cost and 100% provision for debtors over 90 days. "Your profit is your cash not your stocks and debtors, there is no value in those," points out Omar.

Underlying the groups frugality and determination is the philosophy that, "you make money with your brains, not with money. That's also how my father started the business," Omar emphasizes. The group's recent entry to the Rs12 billion a year PVC pipes business is an example of this strategy at work. It's partnered US chemicals and construction materials firm Lubrizol, to set up a PVC pipes manufacturing business here investing Rs300 million. Established brands dominate the PVC pipes business, but Aslam Omar thinks he can dent the market with a relatively small investment.

It isn't however that Phoenix is infallible. It initially planned to enter the PVC pipes business by manufacturing hot water pipes, a Rs800 million a year market, but later thought that focusing on a narrow segment restricted opportunities. Competing with two established brands with a tiny capital outlay doesn't seem to daunt Omar. "My father never believed in having big capital, he believed you have to be able to leave home in the morning without any money and make enough to feed your family," paraphrases Omar.

Not only are management accounts based on this principle but it's also used in the budgeting and individual and unit performance measurements at the firm. Performance is measured in terms of KPI's and pay for staff is based on achieving these KPI and business results. "If you are a CEO in the group, you have to push your sales guys to bring the cash, and accountant to make the provisions."

A central treasury manages the cash and arranges term loans when necessary allowing the independent units to focus on their core operations.

The group owned by the Omar family, isn't focused on how much money competitors make, a widely used metric by public firms keen to deliver superior shareholder returns, but stick to the business philosophy set by its founder.

"For us the definition of success is very simple. It's identifying how much money was credited to our bank account. Profit means money in the bank"–

Aslam Omar

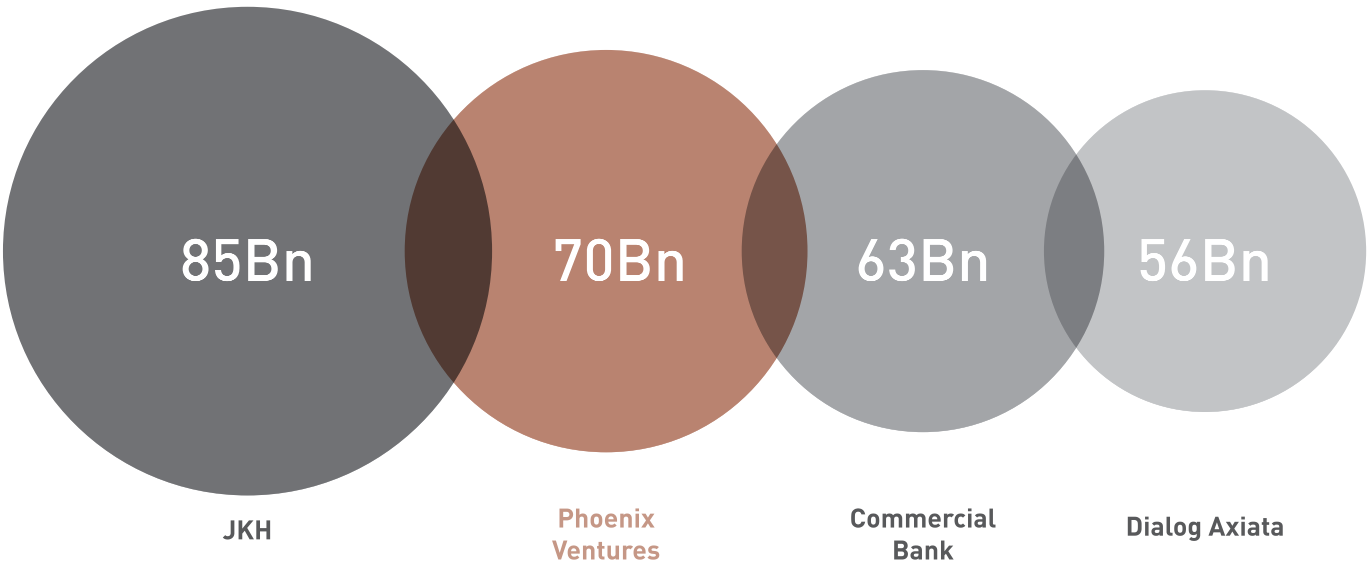
That doesn't mean Phoenix Ventures controlled firms' perform sub optimally or have complacent leadership. The group is one of the largest in the country and in the 44 years since founding its growth has outpaced most other much older listed firms. Although the group isn't measuring itself against other successful firms, its cash focus automatically makes it remarkably profitable. Aslam Omar isn't willing to discuss group's bottom line but points out firms have generated sufficient cash to reinvest, aggressively grow and diversify the business.

Readymade clothes manufacturing had its first association with the Omar family when it acquired Lux Shirts which had 15 sewing machines. Unlike now, in the nineteen seventies machinery was expensive due to high taxation. The family expanded the Lux Shirts business because the government allowed 100% depreciation of sewing machines in tax calculations. The depreciation allowance made the Lux Shirts readymade clothes business a profitable one which today has transformed in to the Brandix apparel business.

Soon the family also acquired a plastics manufacturing business, which today is Phoenix Industries, Sri Lanka's largest plastics manufacturer where Aslam Omar is Managing

Big League

Phoenix Ventures revenue compared against some of the island's largest listed firms (Rs Bn)



SOURCE: ANNUAL REPORTS, PHOENIX VENTURES

> "If you are a CEO in the group, you have to push your sales guys to bring the cash, and accountant to make the provisions,"
>
> *Aslam Omar*

Director. Success hasn't always been immediate nor has profitability meant that the family has stuck to every single business that worked. The first movie the family funded and produced, Thushara, was a financial success. However they didn't pursue movie producer stardom because the business wasn't a strategic fit.

The firm has also been reluctant to develop new brands counting instead on its expertise as a manufacturer. In businesses where it doesn't have much knowledge, Phoenix seeks someone who does have the expertise as the lead partner, according to Aslam Omar. It recently invested in Cinnamon Air, a domestic airline, partnering JKH and others, but stays on the sidelines on management of it because they have no experience there.

The group isn't frugal when it comes to attracting and retaining talent. Omar identifies some of its biggest early failures to not having the right talent. A botched order to supply shirts to Marks & Spencer, a UK retailer, is still fresh on his mind. To save a trivial amount of money managers had used polythene in the interlining of shirt collars. Marks & Spencer was unhappy and it took some time to win their confidence again. "We had tones of failures like that because we didn't have the right people," he admits.

Phoenix has grown organically, acquiring the scale funded largely by earnings. Since Phoenix controlled ventures aren't listed there isn't a wide shareholder demand for dividends, allowing the compounded retained earnings to fuel growth in ways that aren't possible in large businesses with many shareholders.

It's not uncommon that firms dealing in natural resources account for large cash buildups. That boom reflects the rise in commodity prices something that does not impact firms like Phoenix; a manufacturing outfit. The only other firms that have large cash buildups are ones that have remarkably desirable products; like Apple Inc. In some ways manufacturing firms like Phoenix Ventures, which are globally competitive have a similar opportunity to build cash stockpiles.

"My father never believed in having big capital, he believed you have to be able to leave home in the morning without any money and make enough to feed your family,"

Aslam Omar

Meddlesome regulations, high tax rates and policy uncertainty have for decades been a disincentive for investing in Sri Lanka. Export earnings are invested overseas or are channeled to the country disguised and through tax havens, leaving open the option for a quick retreat. High debt at some firms is a legacy of stashing the cash overseas, more than liquidity challenges at home.

Even in the worst of times when Tamil Tiger attacks were undermining the suitability of Sri Lanka as an investment destination Phoenix related firms kept faith. "We were signing expansions agreements when everyone was saying we were stupid and we should send the money overseas," Omar explains the dilemma confounding the firm then.

Faced with difficult markets firms' here experienced challenges growing sales as debt soared and cash flows deteriorated. Corporate investments were dogged by other uncertainties and challenges too. High taxes, high & volatile interest rates and an ambivalent bureaucracy made doing business here more challenging and could have been incentive enough for firms, that can, to shift investment overseas. However the Omars' were more circumspect facing these challenges again influenced by the patriarchs guiding principles. "The world can be cruel," agrees Aslam Omar, but offers no excuse for complacency pointing out that the laws, tax and interest rates apply to everyone doing business here. Macroeconomic challenges are only relevant at certain forums he says, "nobody's forcing anyone to do business here."

If after the end of the conflict with the Tamil Tigers there are worries about investing, they can only be residual. Firms that invested during the conflict however have a unique position of strength, having already established brands, the right people and proven operations. Phoenix Ventures, in addition to expanding operations, also invested in land in Colombo and industrial areas outside the city, which areas may soon transform to residential and mixed use as factories move further out to the provinces where labour is plentiful.

"Right now what's exciting me is the land bank which we are trying to develop," confides Aslam Omar. The group is exploring partnerships with real estate specialists, including hotel operators overseas, to start tapping the development potential of its land portfolio. Real estate is a relatively laid back business according to Omar, "it doesn't keep you excited in the night or get your blood flowing."

Outside the island its subsidiary Brandix operates a 1000 acre industrial park in India where some of its own and many unrelated manufacturing facilities are located. The firm has also invested in Bangladesh, a major readymade clothes manufacturing location which attracts lower import tariffs than do exports from Sri Lanka to the European Union.

Phoenix is also willing to sell businesses that aren't central to the firm's strategy. Recently it sold a bakery business which it had promoted, Finagle Lanka to the bakery's management team. Its cash, even during the worst of times, has been invested in existing & new businesses and real-estate. Multiple crises and civil unrest in 1971, 83 & 89 didn't shake its investment resolve, leaving it in a formidable position to capitalize on the turnaround. Now that there is only residual uncertainty firms like Phoenix Ventures are best placed to take advantage of opportunities because of their boldness in the past and strong values.

Interview

Integrated Reporting - combined corporate account

BY ROHAN GUNASEKERA

A new form of corporate reporting is coming that will transform the way companies describe themselves and how others see them. The integrated reporting concept is being tried out by some of the world's top companies in a pilot project under the International Integrated Reporting Council (IIRC), an outfit set up to manage the development of this new approach to corporate reporting. In this interview, Superna Khosla, Relationships Director of IIRC, discusses the International Integrated Reporting Framework, currently at draft stage, along with Suresh Gooneratne, Director of Diesel & Motor Engineering who shares his company's practical experience in the IIRC Pilot Programme. Khosla, a chartered accountant on secondment from PwC where she was a financial auditor, visited Sri Lanka for several forums organised by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).

SUPERNA KHOSLA, RELATIONSHIPS DIRECTOR OF IIRC SAYS THE KEY DIFFERENTIAL UNIQUE TO INTEGRATED REPORTING IS THAT OF CONNECTIVITY.

Could you explain the importance of Integrated Reporting?
Khosla: There are two main drivers at the moment to our Integrated Reporting framework. Firstly, if you look at our current corporate reporting, it's just weight - an increasing weight of paper work is coming out, increasing volume and density, that isn't necessarily helping the target audience, the investor, to really understand the resilience of the business and what it can do. The recent financial crisis has shown where that dialogue and communication has broken down between businesses and investors. So we are looking for communications that enables dialogue between the investor and business to be enhanced, so that there will be greater transparency in the financial markets, thereby supporting financial stability globally.
Secondly, we know we are up against this limitation of natural resources and every year we deplete more than the world can actually renew. And so that is the free cost of business, resources that businesses need for their business models to survive but at the moment is not necessarily being taken into account in the thinking and in the reporting. Or if it is, it's in a very ad hoc way and you can't see that kind of clear story coming through.

What are the key points of the recent IIRC draft that are being discussed now?
Khosla: We are in the midst of our public consultation on the draft frame work, with the aim of issuing the frame work in December this year. Effectively, there are three fundamental concepts which the frame work introduces. The first is the concept of capitals. We are asking people to look at reporting and to consider capitals that are broader than the more traditional financial and manufactured capital that you find in financial reporting. It also looks at other capitals such as natural, social, human, intellectual and tries to pick up on the real resources that businesses are using and needing within their organizations. The second important fundamental concept is that of value creation. Today a lot of reports are about how much money you make. We want to understand how do you make money, but beyond money, what is the value you actually create. Because there is a sort of virtuous circle where financial returns support growth in the other capitals. So what we see as value creation and where we see that being stored is in the capitals and the outcome you have on the capitals. It could be training of a few people, it could be the development of intellectual capital and that's all value that hasn't necessarily been captured in the way financial reporting is being done at the moment. So it looks at some of those intangible concepts. Third is the business model - what's at the heart of your business, what are the unique activities that say, makes Pepsi Cola different to a Coca Cola. What is it that you do to create value?
We have six guiding principles and the key one, the key differential unique to integrated reporting is that of connectivity. So bringing together the various information pieces you have between the capitals and making that unique story happen, making the connection between past and future outlook, but importantly also connecting everything back to strategy, that is the key principle. The other one that will differ particularly from current reporting is the future orientation and strategic focus. The framework then looks at what content elements are actually important, what people should be considering, what they should write about.
It's a series of questions looking at the environment you operate in, what impact it has on your organization or impacts you have on it back again, the business model's response to that. There are a number of content elements but it looks at governance, the future outlook, performance against strategy, what is your strategy, where do you want to go and what resources do you have to actually allocate against it.

Pilot Programme participants

- Microsoft
- Unilever
- Deutsche Bank
- Coca Cola
- Tata Steel
- HSBC
- Generali Group
- PricewaterhouseCoopers
- Diesel & Motor Engineering

What is the current status of integrated reporting, both globally and here in Sri Lanka?
Khosla: In less than three years we are very close to having a framework whose development is led by the market with business input through the pilot programme that we have at the IIRC. We have regional networks established in about 10 countries that vary in their objectives but bring peers together to discuss their innovations, they test in a live situation with investors what some of their developments are

and in some cases they're getting policy makers and stock exchanges involved in the debate. And we have the history that South Africa has made this a listing requirement. We don't have any mandatory requirements globally but we are seeing this increasing trend of people taking aspects of integrated reporting. There are many self-declared integrated reporters out there. And in Japan there is a huge momentum towards taking on some of these aspects in their current reporting. Nearly a hundred businesses are in the pilot programme, corporate reporting leaders who are testing and innovating in this space. But the number of people looking at integrated reporting is clearly far greater.
Gooneratne: Sri Lanka was introduced to Integrated Reporting about three years ago. DIMO did the first annual report in 2011 and since then there have been a few companies who have made an attempt to do an integrated report. It's an evolving process because we all start in a small way. In our case, with the knowledge we gained being part of the IIRC pilot programme we have been able to improve our report to a large extent. I think there is a lot of eagerness among Sri Lankan companies to understand the concept and perhaps embrace it. We can see it from the responses we have for seminars and things like that. So what I see currently is, a lot of companies are interested, a few have already done integrated reports and there is a lot of scope in the future for integrated reporting.

To what extent is Integrated Reporting driven by or going to be driven by regulation and legislation?
Khosla: The IIRC is very clear that we want this to be market-led. We want businesses to look at the framework, to comment on it and think about its suitability. We are keeping regulators across the globe informed of the movement. There's lots of movement within regulators that's self-initiated around narrative reporting, setting up of corporate reporting labs (you see that experience in Japan and the UK). And we are making sure that the Integrated Reporting thread is very much central to those conversations and debates. But for us at the moment, we think it's too early for regulations to step in.
I think the markets have to determine what Integrated Reporting means for them and what it will look like. We need to see implementation by businesses, so businesses will lead the way and we don't want it to be a straight jacket regulation without it having been tested in the market.

South Africa has made it a listing requirement. What is their experience? How successful has it been?
I am not an expert in the South African market but from what I hear through the pilot programme and the others within the IIRC/GRI (Global Reporting Initiative), they are now into year three and the quality of reports has certainly progressed across that period. But the one thing people keep coming back to is the integrated thinking theme. The external report you might put out is completely dependent on the quality of thinking that you actually have going on within your organization and we've got some great examples of leaders within South Africa who have shared their experience with others globally. I think that everything that we have been seeing really backs up the view that this increases transparency with investors and hopefully the stock exchange. They are beginning to think that this means growth in their market because of the increased transparencies that they get with investors.

What's the actual impact on stakeholders and investors? What's the real difference between integrated reporting and traditional financial reporting from the South African experience?
Khosla: The real difference between integrated reports and what's gone before is giving the contextual information to an investor that supports their investment decisions. So we have a huge amount of volume out there in terms of reports and compliance reports required. We had a comment from one of our banking CFOs who's part of the pilot programme from HSBC. He says there's an opaqueness among some of these reports that lead investors to price in risks. Now the manager might be managing those risks well enough, but the market puts the risk factor into the share prices and it's actually the provision of a proper dialogue among investors that is a fundamental difference.

What about managing and measuring - what are the actual qualitative and quantitative indicators relevant to integrated reporting in terms of natural capital exploitation like energy, water and land?
Khosla: We don't put a particular emphasis on any one capital. We have six capitals set out in the framework and the definitions aren't that important because for some people they won't all be material and people need to consider the breadth of the capitals they actually use. For us, this is about the unique value creation story within a business. It's not about a set KPI list. And so we understand that if you're beginning to look at natural capital, you're beginning to look at social and intellectual capital, that may not all be drilled down to a number. Maybe there is narrative information that you need to provide. It's not necessary for you to measure all the capitals in an integrated report but provide the information so the investors can make a decision on that. Because I think it will be unrealistic for us to say that you only put something in there that you can tangibly measure, because you will be missing out the whole swathe of the resources you are actually using. Because right now, you don't have the mechanism to put the numbers to it.

SURESH GOONERATNE, DIRECTOR OF DIESEL & MOTOR ENGINEERING SAYS INTEGRATED REPORTING IS SOMETHING THAT IS DONE WITH THE PARTICIPATION OF EVERYONE.

Globally there are some measurements like emissions. Sri Lanka is not as well prepared as advanced countries in measuring these different capitals such as natural capital. How would Sri Lankan companies fare when they adopt integrated reporting?
Gooneratne: First of all, the assertion Sri Lankan companies may not be that well equipped may not be quite true. For example, carbon footprint, I think is not a very complicated calculation. It's a very simple calculation. The problem, if at all, will be in collecting data. But I think an average Sri Lankan company will have all the resources to get those things done. Similarly, as Superna said, it's not absolutely necessary that we measure everything. As long as we can describe it well for the reader to understand that this is the strength of the company, that would do. Practically, I don't see any measurement that we are not able to do and any company in a foreign country is able to do. I don't think we are disadvantaged or we have lack of knowledge in that sphere. It's a common problem to everyone but I think as time goes on things will evolve and people will start measuring or describing or building models to describe them. It will come eventually, because the need has been created only now.

What has been DIMO's experience especially in coping with the costs and complexities of Integrated Reporting?
Gooneratne: Integrated reporting is not really an additional cost for the company. Basically, what you are trying to do is, the thinking of the top management, the thinking of the CEO, you are trying to put on paper. While doing so the only thing, if at all, that will cost you money is to find out what your stakeholders want. Perhaps you may have to pay somebody and do a survey. Apart from that I don't see any big costs. Because it's knowledge, basically. You are speaking your heart out, what is in your head you are putting on paper. I think in the long run it will be for the better because a lot of duplications will get eliminated. There is no need for training to be done separately for different business units. There is some commonality involved. So that can bring in savings as well.
Khosla: What is important there is it comes back to the integrated thinking piece - some organizations may be more advanced on that journey. So it is about just capturing what the Board is already on the page for. We see this as being 20 minutes with the Board and seeing what would the Board say about strategy and all the resources that they use in their business models. To get to that 20 minutes though, when people are confined to what it's actually about, there are challenges. People haven't been able to articulate some

of these things because there has been a siloed mentality around some of the different aspects. The more progressive businesses will be in the same position that Suresh just described. Others will have an investment in time but there's a relative cost-benefit to that, because that would lead to better decision-making and therefore there won't be a net cost to it.

What are the obstacles that you see that would prevent faster or greater adoption of Integrated Reporting?

Khosla: From the business preparers' perspective there are a lot of voluntary and mandatory guidelines around in this space that take pieces and aspects of this thing but don't look at things holistically. That causes confusion in the market. We want to work with the key parties in this to make sure that people are going in one direction. To that end we have signed MOUs with the International Federation of Accountants, with the International Accounting Standards Board, with GRI and with others. Internally, this is calling for a behavioural change. Often you do get that siloed mentality structured into an organization chart and people become heads of department and don't necessarily want to whittle that away. So there're some of those practical challenges. Plus there is a call for new data being looked at with the same level of rigour as financial data.

What obstacles do you see or have you encountered in Sri Lanka?

Gooneratne: One of the things that we have to improve upon will be measurement. Measurement of capitals and a lot of what we call non-financial data. For the time being a narrative description would suffice. Maybe times will come when we need to be a little more specific. Apart from that, as Superna said, getting the change happening in their organisation is very important.

And Integrated Reporting is something that is done with the participation of everyone. It's not done by the finance department. So, the inputs, the behaviour has to come from them. It's a team effort. That transformation will have to happen. Any company that is going for Integrated Reporting surely will have to have the sponsorship from the top management.

What are the time frames you are looking at? How soon will Integrated Reporting be adopted?

Gooneratne: It's an evolving process. This is the third financial year we have done it. And I see in the last financial year, a lot of companies have or at least they've called their report an Integrated Report. That means there is a lot of interest. Very soon it will pick up. Each company has to build up their story. You refine it, perhaps change it as you go on.

Who or what will ensure a common standard?

Superna: The IIRC has issued a framework and it's still very much at that framework stage and we are not at the regulation stage. But what we will be looking to do at the G20 meetings in Australia next year and after that in Turkey is looking to put this onto the agendas of the business ministers, the finance ministers and then it would be up to the jurisdictions to think about how they might implement it in their areas. But for that you're looking at a 5 to 10-year time frame in terms of that kind of regulation or standards setting.

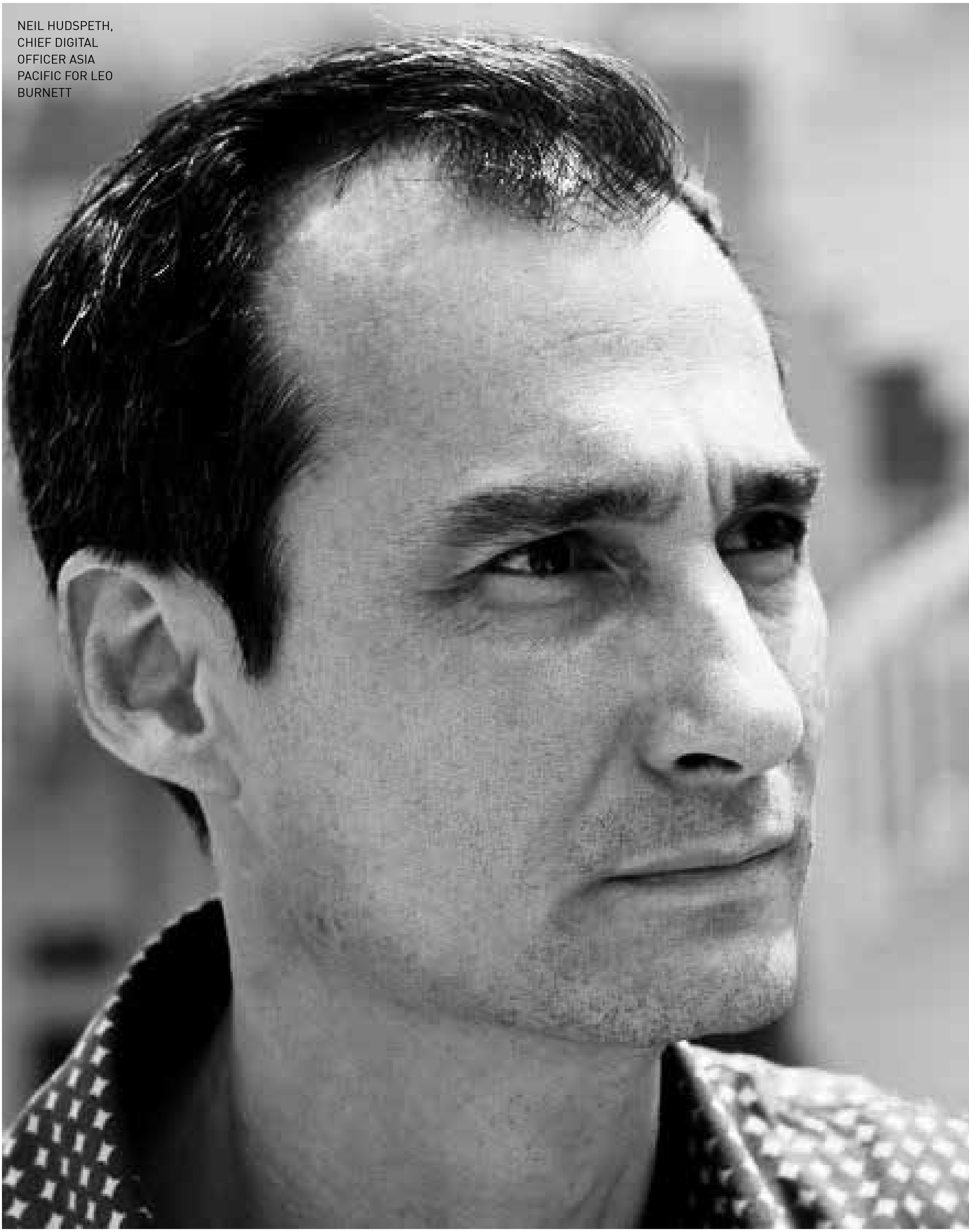
What are the safeguards to ensure companies will not abuse this process or use it to camouflage bad behavior such as environmental pollution or rapacious natural resource exploitation?

Khosla: That's obviously a priority for us, so it doesn't just become something like 'green wash'. One of the principles that we have is the consistency and comparability one. We don't imagine there will be a whole series of KPIs that you can just sit at a terminal and compare one company to another. There is an expectation that year-to-year and within your sector there is some comparability in the narrative of the issues that your sector or your region might actually face.

We need to think about what assurance might be provided on these reports that are being produced. The IIRC is producing a thought paper on some of those key issues and we are inviting some of the players in the assurance field to think about how they might actually take that forward. But reliable information is absolutely key. At the moment because we are at a stage of just developing the framework we are not at the stage of thinking about certification or anything like that but we think it would be for others in that space to make sure that they are taking the assurance thinking model alongside their reporting movement.

Will verification and audits become part of the process?

Khosla: For us at the moment it isn't. We are looking at some of the issues around assurance and they would be sharing that paper and looking to the audit firms to take that on to see what more needs to be done in this space. But I think we need the framework in December because that's still not out - there's still the consultation phase. We then need more reports and more experience that will come through the pilots next year and that I think will begin to help inform assurers in terms of what programmes and things they need to design. But I think inevitably there will be a call for some kind of assurance on this.



NEIL HUDSPETH, CHIEF DIGITAL OFFICER ASIA PACIFIC FOR LEO BURNETT

Interview

THE POTENCY *of and* PANIC SURROUNDING *Digital Marketing*

Marketers have been used to lobbing messages in to the media and measuring effectiveness by the number of people who see these. Digital media is changing that and many other industry practices

BY SHAMINDRA KULAMANNAGE

Digital media is offering opportunities and challenges that are reasons for both potency and panic in marketing. Digital technology, the internet and social networks have given marketers a host of new ways to take their message to the likeliest consumers; that's the opportunity. However digital mediums and social media in particular have made it possible for consumers to talk back. The panic emerges with the inability of brands and marketers to deal with customer conversations regarding their brands, especially when the message is negative.

Marketers have been used to lobbing messages in to the media and measuring effectiveness by the number of people who see these. The industry calls this paid media. Brands have also focused on owned media which are retail stores, company websites, mobile apps and even a company Facebook fan page. The third type, earned media, which has been taking off with widespread social media use, depends on word of mouth when customers become brand ambassadors. Earned media conversations around brands can be managed if marketers are proactive. Consumers are however in charge, they badmouth shoddy brands and questionable corporate ethics on Facebook.

Neil Hudspeth, the Chief Digital Officer Asia Pacific for advertising firm Leo Burnett says marketers need to adapt to the challenges surrounding earned media. Marketers are used to delivering big ideas and implementing long planned campaigns. However they now also need to be quick witted and have lightning reflexes. Excerpts from an interview

Digital ad spending was about banner advertising in the early stage. How is this changing?

There has been a gradual shift away from display advertising that's starting to ramp up within the last 12 months and looking at digital. We are also moving clients away from bought media, more into owned and earned media. That's the real opportunity.

Clients don't need to think of advertising in the digital space as a direct reflection of what they tend to do *Above the Line* (ATL), which is; let's buy as many media assets as we possibly can so we can get as many eyeballs as we can. That is no longer relevant and may not optimize their investments. What one needs to look at is how I engage with my consumers through relevant experiences or through relevant content which is going to be targeted, not through display advertising, but through conversations.

Display advertising is dropping. It's going to ramp up only in mobile because it's a new arena, allowing advertisers to serve out more targeted messages, to mobile.

Give me a sense of what's happening with display advertising over the last couple of years?

Display advertising is dropping. It's going to ramp up only in mobile because it's a new arena, allowing advertisers to serve out more targeted messages, to mobile. But generally the spend in display advertising is not allowing clients to maximize their ROIs. But what our clients are challenged with now is, how do they provide all their potential consumers with platforms where they can choose to engage, where they can provide experiences and where potential consumers can take the clients content back into their owned spaces and have more conversations. It's a completely different model.

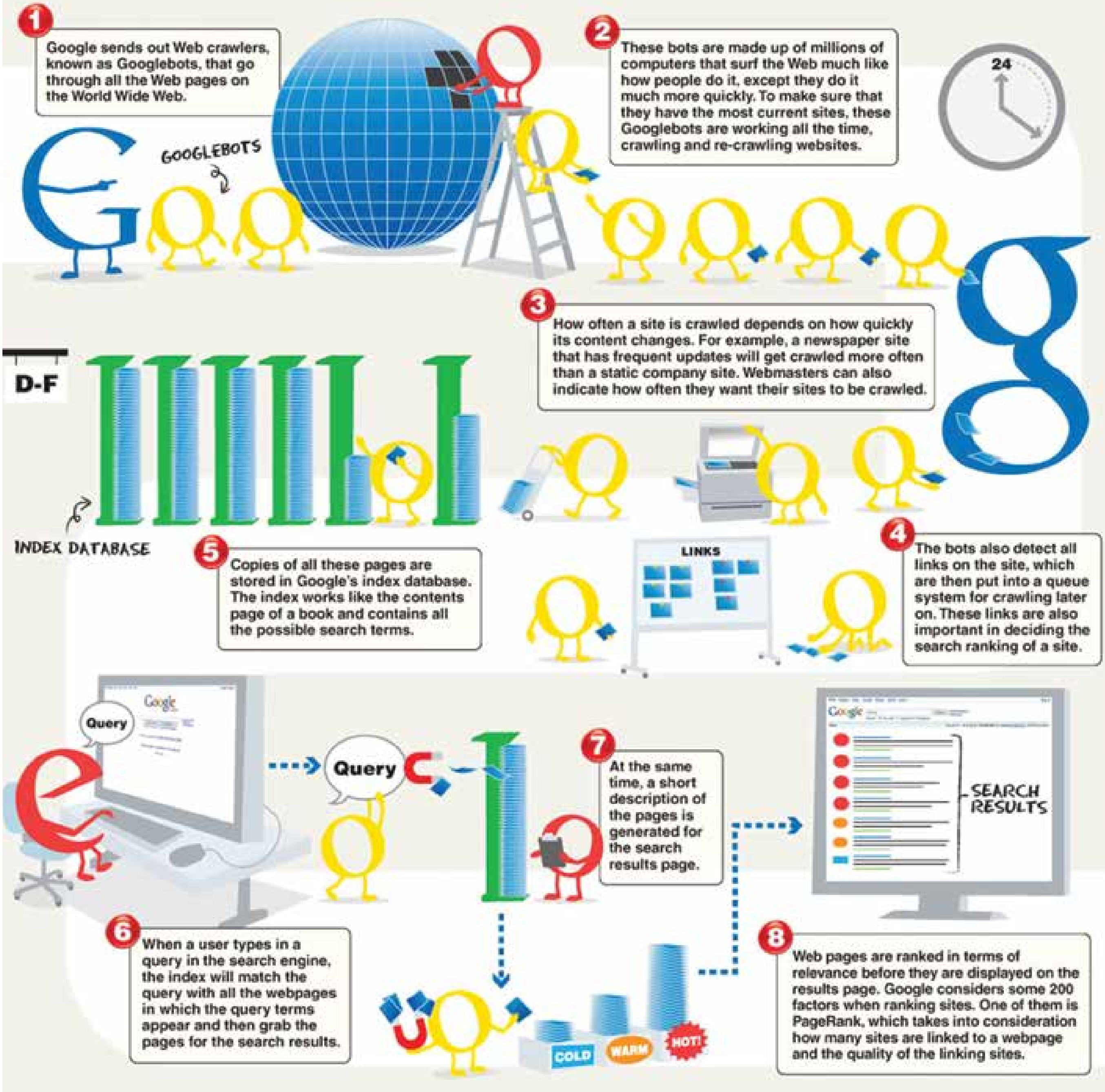
If you think about the traditional model of advertising which is display advertising - it's more about awareness and about consideration. It's the front end of the path to purchasing. Now the shift is towards; driving preference through much more intimate and relevant engagement as opposed to advertising based on a campaign of one or two months. Owned media investments are now starting to ramp up. Earned media investments are going through the roof. Search is also ramping up because it's still fundamentally necessary because we know most users are going to look for what they are going to engage with. Banner click throughs are averaging 0.18%; a complete waste of money. Brands have got to start to think about using data to understand how consumers are behaving, what they are talking about, what they want to consume and serve out relevant content in time, on all the relevant platforms on which consumers want to engage.

How has this affected advertiser spending over the last few years?

Two years ago the likes of P&G (Procter & Gamble) went public and said they want to put at least 25% of all their media spend into

HOW GOOGLE SEARCH WORKS

Have you ever wondered what happens when you type in a query in Google's search field? Tham Yuen-C and Quek Hong Shin go behind the scenes of the search engine



SOURCE: GOOGLE

digital. That came from the Digital CMO. The regional president for Samsung in Asia Pacific about a year an a half ago said, 'I want to spend 30% of all advertising dollars into digital'. The CMO for Nike said 'I want to spend up to 40% of all my regional spend into digital'. The reality is at the end of last year (2012) P&G was probably spending 8% or 9% on digital at most, although they have lofty ambitions. The main reason why they weren't able to deliver on that ambition is they historically deal with media agencies that persuade them to buy display advertising.

Consumers online are spending most of their time not on web sites, but primarily on social media. When you consider this, then you understand the shift in investment that's necessary towards owned and earned media. The teams perhaps didn't have the relevant knowledge in terms what they should be doing in digital, they had KPI's which were cut from a traditional cloth, so they hadn't really evolved to a new set of success criteria. That's now starting to be the watershed change for us. We're finding now that from North Asia through to South East Asia, that client teams are transforming their knowledge because advertising agencies are helping them to transform, and they are trying to transition through some of the people related challenges.

Look at the digital pie; you're talking about it moving away from display advertising, how does it break down in to the various segments there?

It really depends on the brands. I can't really give you that accurately because we don't work across all the brands. For example if you were to talk about skin care, we know a large majority of their priority markets are in the Asia Pacific, that the key target groups are spending a lot of time on social networks or on community sites which talk predominantly about health & beauty, fashion and style.

If you do have the insights into how target groups are consuming their time and therefore consuming content, then it's much easier to target the level of investment to that channel. So what type of content does the beauty brand have to produce to make it available through owned and earned media to reach out to the target demographic, to engage with it, share it, talk about it and then amplify it and obviously encourage them to purchase it?

In an age of the web, consumers will find the brand they choose to engage with as opposed to the old model of advertising where the product finds the consumer. So that is a huge shift.

In a completely different category, say in food and beverage you might find that a completely different channel is the best route. For example, McDonald's. You'll find in most markets in Asia Pacific people investing into mobile because they know that is the device of choice when it comes to shopping, when it comes to location based services and when it comes to driving people into a direct purchase, through a store, online or through online ordering.

How effective do you think key word searching and real time bidding is, what Google does?

Hugely efficient. Every brand should have an all zone search strategy. Why? Because people search on their phones, to find a service, a product or location. In the age of the web, consumers will find the brand they choose to engage with as opposed to the old model of advertising where the product finds the consumer. So that is a huge shift. So the role of search is increasingly important, compared to even five years ago.

Is this an opportunity at all for the traditional advertising industry?

Yes of course, because we need to help our clients optimize the content. We need to look at the words that we're using, look at the tagging behind the content. We need to look at what we actually write and basically optimize the content so that it can easily be found by the search engines. Now Google will allow you to buy the premium spaces which are the top three at the top of the advertising list or you can have your brand appear at the top right hand side of the search page. But if you want to do organic search, you have to make sure your SEO's (search engine optimization) is in place. Those that appear at the top are what we call SEM (search engine marketing). So you essentially buy words and make sure you appear at the top. All brands need to have an always-on search strategy that does not mean you always have to buy search, it just means you have to have your SEO's in place.

Is this an area where you find brands are as challenged as they are with their overall digital spending?

I think brands in general understand the role that SEO plays. I think the question that you pose is, do they understand the priority of it? I think that's going to vary from brand to brand, client to client.

What do you find are the biggest misconceptions or challenges that brands have as far as digital spending in general is concerned?

I think, generally, the consensus is knowledge. So, brand marketing teams will have their own degrees of knowledge which means in terms of how they invest. They will have KPI's which haven't been evolved or updated, so what they are measured against in terms of success should look like it has been cut from very old cloth. Which means it is no longer relevant as it was three or four years ago. Three or four years ago any brand in the world, would have had on their list of key criteria the number of eyeballs that have seen the message, whereas now that's no longer as relevant as it was. Now it's more about how many conversations, how many voices are perhaps more prevalent around our brand and is it basically positive or negative sentiments and what are they doing with that sentiment. Is it leading them into an act of participation?

This also relates to something we were discussing a little earlier with SEO etc. There is a backlash against peoples' behaviour online being tracked. In the EU, you have to get consent for your cookie policy.

How big a challenge is this, how do you look at this?

I have kids. As a parent you are perennially worried about security. The explosion of new technology is empowering us to do anything we want and allow other people to know what we're doing. But there are pros and cons to that. If a brand is smart enough to understand relevancy and serve you content which they deem to add value to you, then I think most consumers would want to embrace what we call the value exchange. I will give you something but you better give me something back in return. So if you want my facebook profile, if you want access to all of my friends, if you want my mobile phone number, then what are you going to give me? If you understand the consumer you will serve them stuff which adds value to them and makes them feel privileged or gives them access to exclusive experiences or saves them money, then perhaps they will be willing to exchange that information.

If you have a social networking account you're automatically saying I'm completely open to go and talk to and to share personal earned information with whoever I choose to share it with.

When people don't know they are being tracked and they find out in perhaps a very intrusive way, then they have the right to start to question. Two thirds of the planet has some sort of social networking account. If you have a social networking account you're automatically saying I'm completely open to go and talk to and to share personal earned information with whoever I choose to share it with. So I think, human behaviour has evolved and perhaps privacy is at times not so much misunderstood but privacy is perhaps misinterpreted by a lot of people and therefore redefined in their own minds.

I have two kids. One of a legal age to have a facebook account and she would like a facebook account, I'm quite happy to set it up for her. But I know how to control the privacy whereas most people don't, so they tend to open themselves up to perhaps a broader audience which perhaps they weren't planning to. However privacy is a very personal subject and hard to generalize.

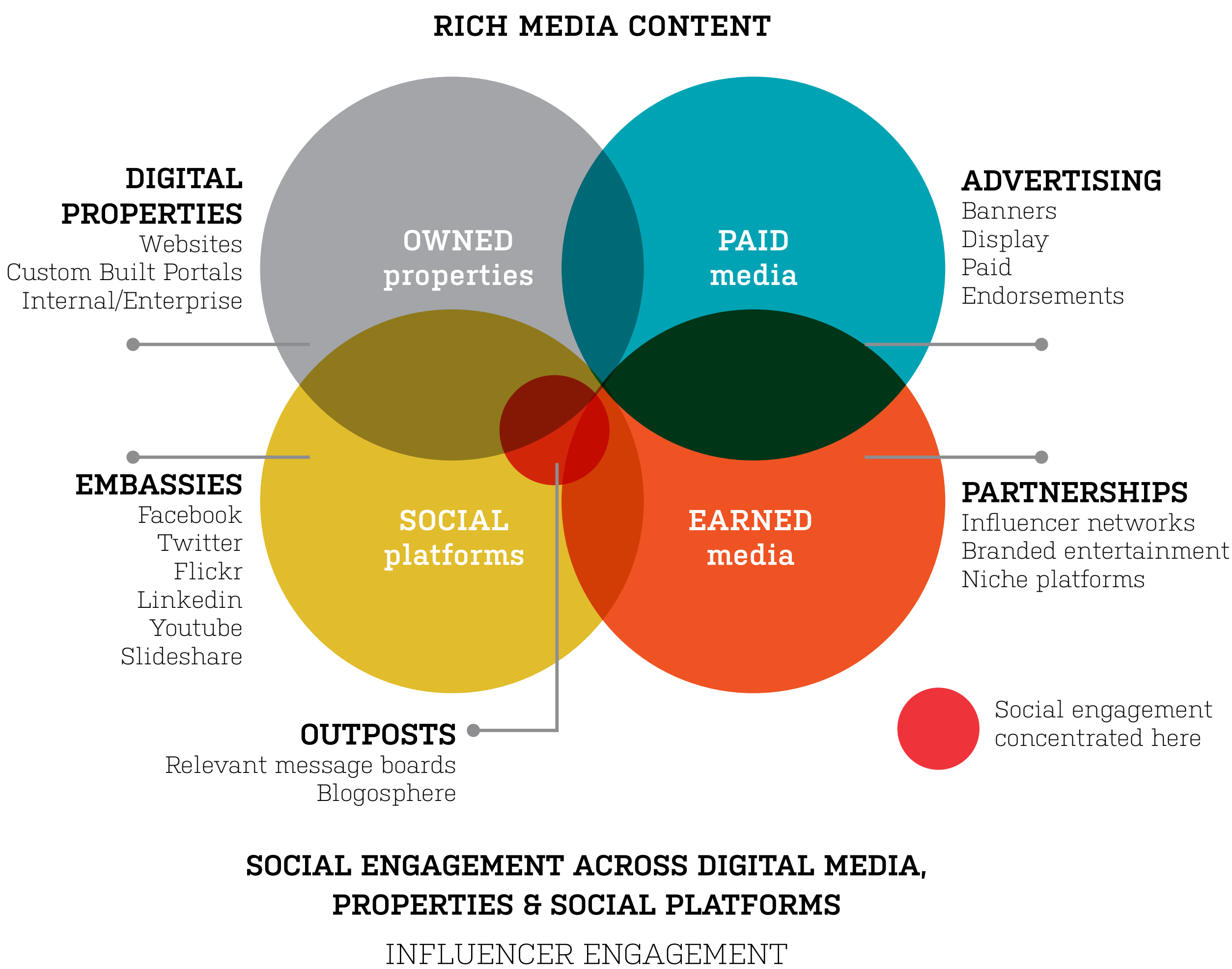
Is it true that in Asia about half the digital spend is expended on search?

In North Asia if you're in Japan, there's a huge amount of money that goes in to mobile search. Whereas you look at the spending going in to mobile search in South East Asia and it's still very small.

How do you suggest brands in a country in the development stage that Sri Lanka is in, with relatively low internet penetration, approach this? Where can companies start? Is that in search? Is that in building owned media, earned media?

As a fundamental, all brands here should have extremely good owned assets. If you're a bank you have as many retail branches as you possibly can. If you're a grocery shop you would want to invest in your grocery shop front. It's the same thing they all need to have - a world class website because it becomes a business asset.

They fundamentally need to be in social media because it will grow exponentially. Yes,



there are twice as many men here who have a Facebook account but that will change very rapidly.

Social media is an ideal environment where you can efficiently start to amplify a brand message or a brand experience which doesn't cost you a great deal of money. So social media is probably the biggest opportunity here for brands in terms of where they should invest. Where you go in social media you can actually have a conversation with them. You can understand the conversation, you can understand the sentiment, and you know what they are going to do with content. You know who their friends are; you know what conversations they are having with their friends. That's hugely valuable for any brand, so I would strongly recommend to any brand that hasn't thought about going into social; the first thing you need to do is have the right strategy for engagement in place.

Because there are only four models of engagement, they need to choose what's right for them. They need to start investing in social listening because they need to know what people are saying. They need to take that insight and put it back into the strategy so they can actually fine-tune their content. Third of course would be mobile. Again a huge opportunity but still more of a green field here. You have 90% mobile penetration in the country but only 10% are smart phones which might be web enabled. But that might be growing 1% a month now or 10% a year.

Almost every brand will of course have a website but what they need to think about is how those integrate with social media and how that plays with mobile. This is the fourth thing. It needs to be orchestrated.

In social media you can actually have a conversation with them. You can understand the conversation, you can understand the sentiment, and you know what they are going to do with content.

Is social media, earned or owned media?

Both. It can also be bought media. You can buy Facebook ads.

Portrait

Shared success

How two relatively-new but fast-growing companies are out-performing peers with employee-friendly management methods and generous compensation packages that deliver industrial harmony, higher productivity and profits

Access Engineering and Royal Ceramics are relatively new players in the construction and manufacturing sectors who have outshone their peers by their rapid rise up the echelons of Colombo's corporate community. Both listed firms are highly profitable and among the top players in their respective sectors - construction and construction-related manufacturing. Both are led by businessmen who already are, or could well become, billionaires. And both stand out in the way their human resources policies and compensation packages motivate employees and have a direct impact on the bottom line.

Access is a construction and engineering company with a diversified range of activities such as roads, ports, water and waste management. The company's core resource is engineers - professionals whose qualifications ensure well-paying jobs here or abroad and who therefore are sought-after. The company, whose Chairman is Sumal Perera, the single largest shareholder with an almost 30% stake, drew attention when it gave free shares to employees as it went public.

SMS contact with factory-floor employees, helps sort out grievances

Royal Ceramics has just shaken up the entire ceramics sector, swallowing up its older rivals in a corporate takeover that gives it a monopoly in domestic tile and sanitaryware manufacturing. The firm is noted for its more effective brand building and higher profitability compared with peers. Managing director Nimal Perera has an unusual, worker-friendly management style that, along with generous pay and perks, has ensured lower factory defect rates and industrial harmony in an industry where strikes have disrupted production among peers. Perera keeps in constant SMS contact with factory-floor employees, especially labour union leaders, looking into production problems and worker welfare.

His tact and texting helps sort out grievances that could otherwise prove vexing, although he's tough when required.

The experience of both firms show that salaries and incentives delivering above-average take-home pay packets or an ownership stake for employees clearly pay dividends.

Royal Ceramics

Lahiru Sampath Bandara,
Production Operation, Powder Preparation section, and Secretary of the Inter-Company Employees Trade Union:

Harmonious relations between the workers and the management helped our company become the top ceramic tile manufacturer in the country. Most companies don't have this kind of relationship between employees and the top management.

We have a productivity committee with employee and management representatives that meets monthly to sort out both worker problems as well as production shortcomings.

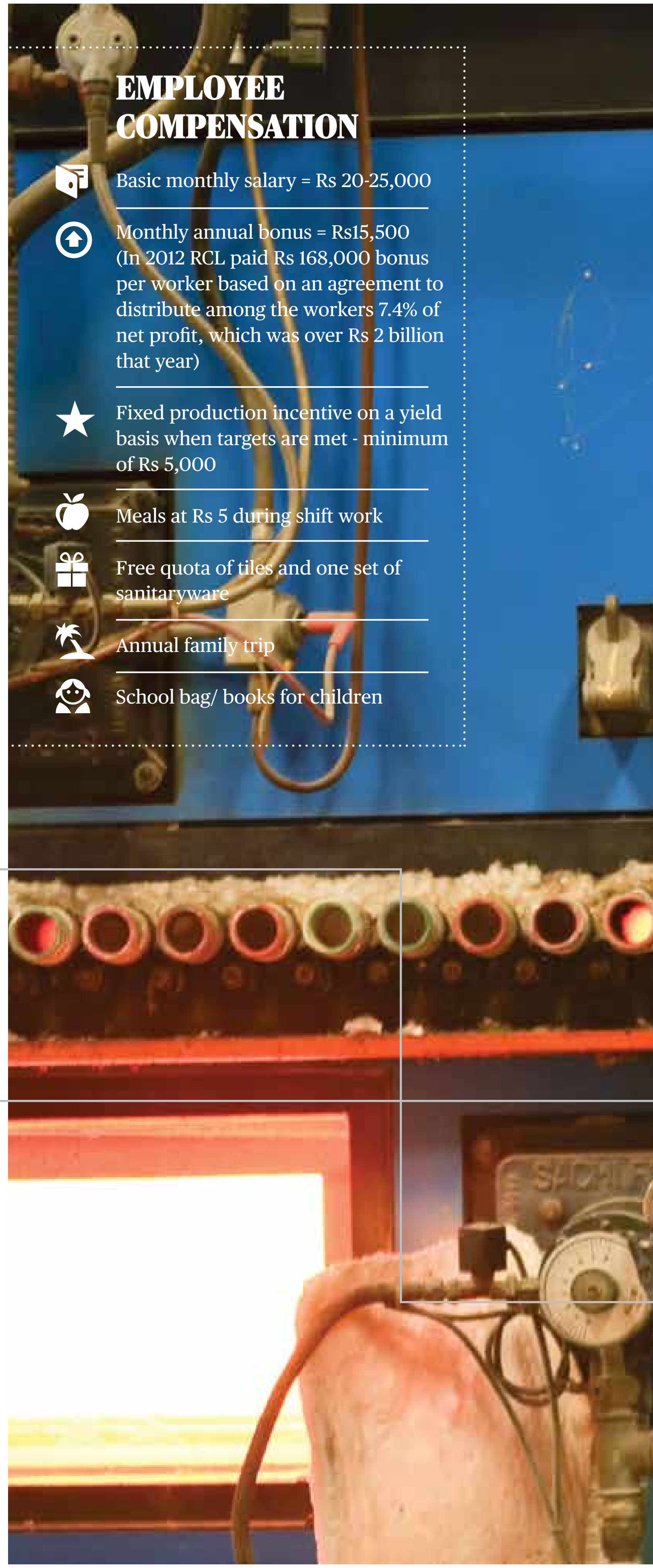
The employees have a Collective Agreement with the management that is usually negotiated in a short time, unlike in other countries where sometimes workers resort to strikes to win their demands.

The company's above average salaries, bonuses and incentives help motivate the workers to perform at their best and be more efficient.

The acquisition of our competitors in the Lanka Ceramics group makes us one of the biggest ceramic tile manufacturers in the region. Now that we've captured the local market we aim to push exports. Already we have got a big order from Australia.

R. A. Sanjiva Ratnayake,
Team Leader, Mechanical Section, Engineering Department and President of the Inter-Company Employees Trade Union, is the second employee to be hired by the factory:

The attractive salary and incentives given by the company makes the workers more motivated and productive. The company also helps employees pursue higher studies and become better qualified, even giving us paid leave. Another key incentive is that we have opportunities to get promoted, depending on our ability and experience. There are two employees who have been given management executive appointments having started on the factory floor. Our bonuses are the highest in the tile industry but we're aware that business can fluctuate and along with it, company profits and profit-share incentive.



EMPLOYEE COMPENSATION

- Basic monthly salary = Rs 20-25,000
- Monthly annual bonus = Rs15,500 (In 2012 RCL paid Rs 168,000 bonus per worker based on an agreement to distribute among the workers 7.4% of net profit, which was over Rs 2 billion that year)
- Fixed production incentive on a yield basis when targets are met - minimum of Rs 5,000
- Meals at Rs 5 during shift work
- Free quota of tiles and one set of sanitaryware
- Annual family trip
- School bag/ books for children

Top Contributors to Sector: Performance Comparison (12 month Cumulative)

COMPANY	Current	Previous	Change (%)	PER[1]	Sector PER[1]	PBV[1]	Sector PBV[1]
CHEVRON LUBRICANTS*	2288	2001	14%	14.52	8.74	7.67	1.57
ROYAL CERAMICS	1752	1461	20%	6.69		1.40	
DIPPED PRODUCTS	1418	1907	-26%	5.32		1.10	
TEXTURED JERSEY	1017	628	62%	7.73		1.37	

Earnings in Rs millions and include exceptional capital gains/losses

1. Trailing PER & PBV include exceptional gains/losses

*Year Ending 31st December

SOURCE: Acuity Stockbrokers

Building strong relationships

Royal Ceramics was the second best performer in total earnings of manufacturing sector companies on the Colombo bourse in the 2013 financial year, after Chevron Lubricants.

The company makes porcelain and ceramic tiles, along with sanitary ware and employed 1,535 people as at March 31, 2013 at its two tile plants and sanitaryware plant and two warehousing complexes and 50 showrooms islandwide. The group invests regularly to expand production capacity and also has diversified into complementary businesses, acquiring a paint and allied product manufacturing company.

The firm has been twice featured in Forbes Asia's 'Best under a Billion' list of 200 exceptional small and midsized publicly traded companies in the Asia Pacific region with annual revenue under US$1 billion.

Under an agreement with labour, the company distributes 7.4% of net profit among workers.

Excerpts of an interview with Managing Director Nimal Perera:

My way of managing human capital is totally different from other CEOs. I have a different approach. We don't have different categories or grades. We treat everybody equally. Anybody can approach me without going through barriers found in other companies. I'm the only CEO who communicates with floor level guys via SMS!

We have above-average pay since we strongly believe our employees are one of our most important stakeholders and we also believe in wealth distribution. We're one of the few companies who have distributed a major portion of group net profit among employees and we may be one of the few firms to have paid a big bonus in the last year to factory floor employees. Our sales staff are also given sales incentives on achieving targets. That's how in some months we exceed a billion rupees in turnover.

Under an agreement with labour, the company distributes 7.4% of net profit among workers. As sales and profits grew, so has the take-home pay of workers and that's why they have been getting this kind of higher bonus. When we make an annual profit of Rs2 billion, 7.4% is huge.

These incentives eventually benefit the institution as employees have a better sense of belonging to the organisation, have a better life and perform better. That's why we did two billion rupees in net profit last year. In the last 8-9 years our employees' lifestyles have visibly changed - almost everyone has a motorcycle, some have three-wheelers, some are building new homes and some have even 1-2 acres of tea or rubber.

After I took over, I used to visit every week a factory or warehouse. I built very strong relationships with floor workers, middle management supervisors and senior managers. I have a group management committee meeting every month not in Colombo but in factories on a rotation basis. I ask the top management also to move with the people, share ideas, listen to grievances. This is a long process.

In the last six years we've been giving employees Rs 2,000 per month annual increments but we realise we cannot continue to do so as costs would get out of control. We explained this to the workers and they understand.

MANAGING DIRECTOR NIMAL PERERA BELIEVES IN WEALTH DISTRIBUTION

Access Engineering

Srimal Fernando, General Manager - Projects Office 2, Access Engineering, a civil engineering graduate from the Peradeniya University joined the firm's geo-technical division in August 1999 and took his current position in 2008. He specialises in piling work, a deep foundation method required in building high-rises which has good growth prospects given the ongoing and anticipated construction boom. Fernando received four million free Access shares:

It took me by surprise. I believe it was based mainly on my performance whereas with some others the criteria may have included their length of service. I intend keeping all my shares and have no intention of selling because this was really a gift to me. Also, I get a good salary from the company.

Although my workload is heavy and I have a lot of responsibilities I feel comfortable and happy at Access. The company's management style is different from that of others. You are given a lot of freedom and with that freedom we have definitely to take the responsibility but that responsibility is not a problem for me.

IPO timeline

200 million

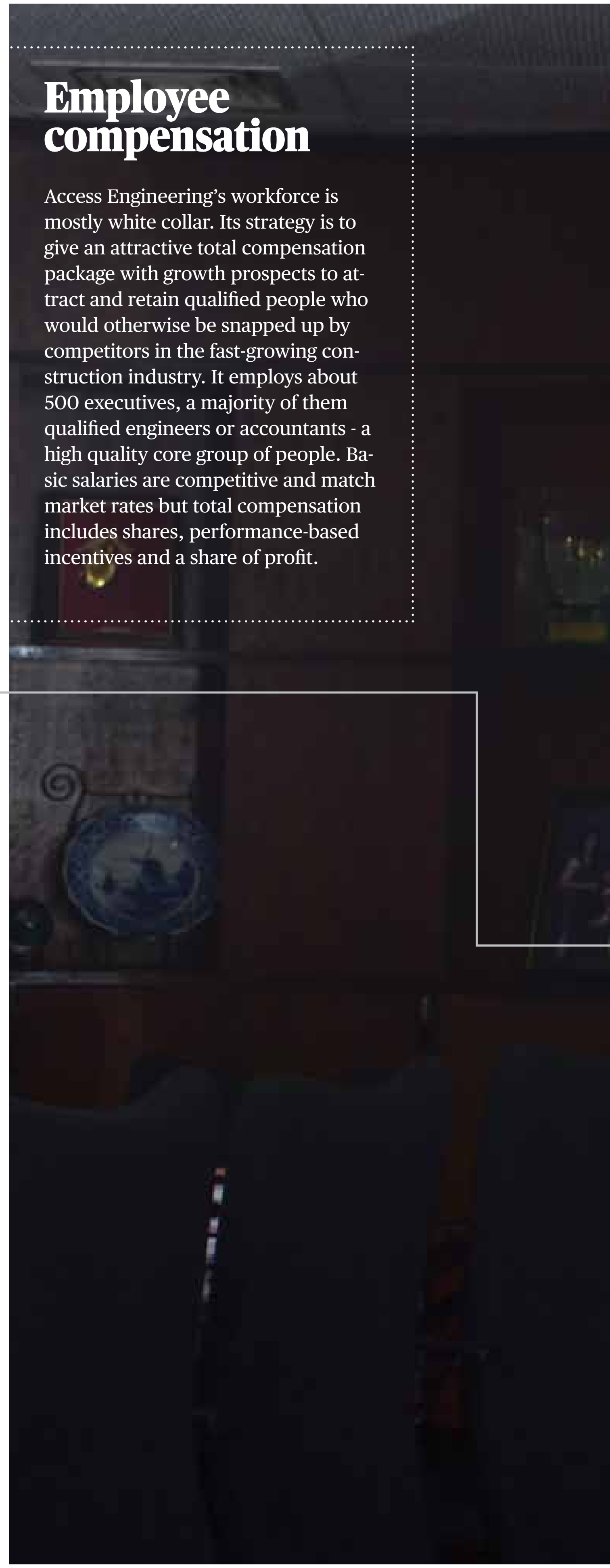
new shares were issued to the promoters in March 2011 after the first tranche of the capitalisation of reserves. The promoters then transferred for free a big portion of shares to their related parties and company employees.

400 million

Number of Access Engineering shares after a 1:2 sub-division of shares that followed the first tranche of the capitalization of reserves

200 million

new shares were issued to the promoters for free in the second tranche of the capitalization of reserves in May 2011, a large portion of which was transferred to related parties and employees



Employee compensation

Access Engineering's workforce is mostly white collar. Its strategy is to give an attractive total compensation package with growth prospects to attract and retain qualified people who would otherwise be snapped up by competitors in the fast-growing construction industry. It employs about 500 executives, a majority of them qualified engineers or accountants - a high quality core group of people. Basic salaries are competitive and match market rates but total compensation includes shares, performance-based incentives and a share of profit.

Top Contributors to Sector: Performance Comparison (12 month Cumulative)

<table>
<tr><th>COMPANY</th><th>Current</th><th>Previous</th><th>Change (%)</th><th>PER[1]</th><th>Sector PER[1]</th><th>PBV[1]</th><th>Sector PBV[1]</th></tr>
<tr><td>ACCESS ENGINEERING LTD</td><td>2379</td><td>1266</td><td>88%</td><td>8.45</td><td rowspan="4">9.94</td><td>1.61</td><td rowspan="4">1.48</td></tr>
<tr><td>COLOMBO DOCKYARD</td><td>1979</td><td>1542</td><td>28%</td><td>10.30</td><td>1.59</td></tr>
<tr><td>MTD WALKERS</td><td>279</td><td>140</td><td>97%</td><td>12.82</td><td>0.91</td></tr>
<tr><td>LANKEM DEVELOPMENTS</td><td>-179</td><td>-479</td><td>63%</td><td>n.a</td><td>0.57</td></tr>
</table>

Earnings in Rs millions and include exceptional capital gains/losses
1. Trailing PER & PBV include exceptional gains/losses

SOURCE: Acuity Stockbrokers

Compensating performance

Access Engineering was the top performer in total earnings of construction sector companies on the Colombo bourse in the 2013 financial year. The company issued free shares to employees in 2011 when it went public with an initial public offer of 20 million ordinary shares at Rs.25 each.

Excerpts of an interview with Access Group Chairman Sumal Perera:

When we decided to take Access Engineering public we felt one of the best incentives to the staff is to make them feel that they are also one of us. That we believe would motivate them, because we believe that while financial reward is very important, other factors are also important like team spirit, the sense of belonging, the sense of ownership. Because we are dealing mostly with white collar workers. Of a total workforce of about 3,000, our core is about 500 executives, most of them qualified engineers or accountants.

Also, we realized that if we are to stay ahead of the competition we have to become a preferred employer, as there's demand for good people in construction engineering because it's a growth sector. Giving employees a stake in the business was a very logical way of becoming a preferred employer without increasing our overheads and our cost base. This way you can have the cake and eat it - giving them a good compensation package and at the same time you don't weaken the company structure by increasing the overheads. We have been able to keep the company free of high overheads and high debt.

I tell people, if you are coming here for a job, go and look elsewhere. Because we have no jobs; we have careers.

The original shareholders gifted part of our shares to employees to drive home the philosophy of sharing, caring and the family concept. The original shareholders who started this company are still very much together. Secondly, we have always done what is best for the organization and not necessarily what is best for the individual. In the long term what is best for the organization will become what's best for the individual.

I tell people, if you are coming here for a job, go and look elsewhere. Because we have no jobs; we have careers. What you make of your career is more in your hands than mine. So our salaries may not be very high, although they match market rates, but our total reward scheme is high. We also distribute a certain percentage of profits among all the staff.

We believe in compensating performance. We don't believe in paying the same to those who work and those who don't. We are an equal opportunity employer but at the same time we discriminate where discrimination is required to recognize the good workers and also motivate the other workers to come up to the standard of a good worker.

And it's not only the compensation package. We also have an open culture. People have an opportunity to speak out, to voice their aspirations and say whether or not the organization is helping meet them. My office is always open. I am not hiding behind a closed door - anybody can walk in.

ACCESS GROUP CHAIRMAN SUMAL PERERA BELIEVES IN COMPENSATING PERFORMANCE AND DISTRIBUTES A CERTAIN PERCENTAGE OF PROFITS AMONG ALL THE STAFF.

Focus On - Technical

Bearer plants as PPE

Proposed method for measuring biological assets under IFRS will change the way plantations companies and others in agri-business account for their trees and plants

Agricultural companies have been given the option to measure bearer biological assets such as perennial crops like tea, rubber, and coconut, as property, plant and equipment. This is a more practical way of accounting for such assets, according to feedback from the industry.

CA Sri Lanka has issued an Exposure Draft about the proposed change under Sri Lanka's equivalent of IAS 16 Property, Plant and Equipment. The International Accounting Standards Board (IASB) in June published for public comment the Exposure Draft of proposals to include bearer plants within the scope of IAS 16 Property, Plant and Equipment.

This is an important amendment for those jurisdictions with large agriculture industries

The Malaysian Accounting Standards Board proposed similar measures given the importance of oil palm plantations there to the economy.

Bearer plants are a class of biological assets that, once mature, are held by an entity solely to grow produce over their productive life. Examples include rubber trees, oil palms and grape vines.

IAS 41 Agriculture requires all biological assets that are related to agricultural activity, including bearer plants, to be measured at fair value less costs to sell. This requirement is based on the principle that biological transformation is best reflected by fair value measurement.

However, according to the Exposure Draft, once mature, bearer plants no longer undergo significant biological transformation such as growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset. Furthermore, their operation is similar to that of manufacturing.

Consequently, the Exposure Draft proposes that bearer plants be accounted for by IAS 16 instead of IAS 41, allowing the use of either a cost model or a revaluation model. The produce growing on the bearer plants would remain under the fair value model in IAS 41.

"This is an important amendment for those jurisdictions with large agriculture industries and responds to feedback received from the IASB's agenda consultation as well as its Emerging Economies consultative group," says Hans Hoogervorst, Chairman of the IASB.

The Exposure Draft Agriculture: Bearer Plants was approved for publication by thirteen of the sixteen members of the IASB. One abstained and two voted against.

Biological assets within the scope of IAS 41 that are physically attached to land (for example, trees in a timber plantation) are measured at their fair value less costs to sell separately from the land.

The IASB says its principal decision underlying the Exposure Draft is that bearer plants in this form are similar to property, plant and equipment, for which the accounting is prescribed in IAS 16 Property, Plant and Equipment. IAS 16 permits the use of either a cost model or a revaluation model.

Interested parties have told the IASB that fair value measurement is not appropriate for mature bearer biological assets because they are no longer undergoing biological transformation. They also expressed concerns about the cost, complexity and reliability of fair value valuations of bearer biological assets in the absence of markets for them, and about the volatility from recognising changes in the fair value less costs to sell in profit or loss.

Investors, analysts and other users of financial statements have said they adjust the reported profit or loss to eliminate the effects of changes in

If these proposals affect you, the ED can be read at the following link and comments sent to technical@casrilanka.com by 28 October, 2013.

www.casrilanka.com/casl/index.php?option=com_content&view=article&id=235&Itemid=56

EASIER TO UNDERSTAND

Darrel Scott, Board Member of the International Accounting Standards Board, explained the concept in an interview with The Abacus during a visit to Colombo. Scott is also Chairman of the SME Implementation Group, and formerly CFO of the FirstRand Banking Group, one of the largest financial institutions in South Africa and a member of IASB's International Financial Reporting Interpretations Committee:

"When IASB originally looked at this - when a plant grows how do I measure the cost of that plant - we said it was easier for you to decide what the fair value was of the plant.

E.g. an apple tree starts as a very small plant and grows into a big tree. It's a bearer tree because it has apples on it - fruit that you can pick.

Realistically, as it grows, its value changes and we felt that fair value - a market value - was the best way to determine how to carry that - how to determine the value of that.

When the Sri Lankan authorities looked at the decision to implement IFRS, they looked at this and they took into account the fact that people were saying it's very difficult to tell what the value of a tree is. Because you can't sell the tree on its own. It stands on a piece of land that's part of or incorporated into something. People were telling the Sri Lankan institute it was very difficult to value that, so they would prefer to use cost.

Cost is the original seed, the fertiliser you give it, the cost of the care that you give to that tree. That's also difficult because it's difficult to track that cost but it's an easier concept to understand. And treating it the same way as an asset, you say what is the cost of getting that tree to come into bearing and you keep the cost the same for ever.

So at least once you've established the cost, it's easier to understand from there.

We, the Board, have heard the same concerns that the Sri Lankan board has heard and in fact we've been busy with a project over the last year to potentially change our accounting and the way that we suggested changing our accounting is exactly the same proposal as the Sri Lankan board. So in fact in this sense the international board - IASB- is moving towards the Sri Lankan board."

Focus On - Technical

Impact of proposals on how activities are reported

EFFECT	FAIR VALUE MODEL UNDER IAS 41	COST MODEL UNDER THE PROPOSALS	IMPACT
Financial position	Measured at fair value less costs to sell	Measured at cost less any accumulated depreciation and any accumulated impairment losses.	Proposals are expected to reduce net assets.
Profit or loss	Changes in fair value less costs to sell are recognised in profit or loss.	The depreciation charge for each period, and any impairment loss, will be recognised in profit or loss.	The change in the fair value of bearer plants is often a significant amount so the proposals will reduce the volatility of profit or loss from the remeasurement of bearer plants.

the fair values of bearer biological assets.

Given complexities that arise from measuring livestock, the IASB decided to limit the scope of the amendments to biological assets that are only used as bearer biological assets, with the title of the Exposure Draft being Bearer Plants, rather than Bearer Biological Assets.

The IASB noted that while fair value measurement may provide an indication of the quality and productive capacity of the bearer plants at a point in time, it is less important to users of financial statements than fair value information about biological assets that may be realised through sale.

Although bearer plants are dissimilar in form to plant and machinery, similarities in how they are used in the business provides support for accounting for them in the same way. The use of mature bearer plants to produce agricultural produce is similar to the use of machinery to manufacture goods. The progressive decline in the future earning potential of a bearer plant over its life is no different to other wasting assets like plant and machinery.

The use of mature bearer plants is similar to the use of machinery to manufacture goods.

The IASB acknowledged that measuring the produce growing on the bearer plants at fair value less costs to sell sometimes may be difficult to apply in practice. However, it was noted that similar difficulties are encountered when measuring produce growing in the ground. ■

Examples of biological assets, agricultural produce, and products that are the result of processing after harvest:

BIOLOGICAL ASSETS	AGRICULTURAL PRODUCE	PRODUCTS THAT ARE THE RESULT OF PROCESSING AFTER HARVEST
Tea bushes	Leaf	Tea
Rubber trees	Latex sap	Rubber products
Oil palms	Picked fruit	Palm oil
Trees in a timber plantation	Felled trees	Logs, lumber
Dairy cattle	Milk	Cheese
Sheep	Wool	Yarn, carpet
Pigs	Carcass	Sausages, cured hams

(The produce growing on bearer plants, for example, grapes, tea leaves, fruit and latex sap, is within the scope of IAS 41.)

This Standard does not apply to:

(a) property, plant and equipment classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.

(b) biological assets related to agricultural activity other than bearer plants (see IAS 41 Agriculture). This Standard applies to bearer plants but it does not apply to the produce on the bearer plants.

Update

“Significant practical aspects of innovation will be the focus of this year’s conference”

Nearly

1,250

chartered accountants attended last year’s conference

Innovation - Focus at national accountants’ conference

This year’s National Conference of the ICASL will be on the theme “Innovate to Grow” scheduled to be held from 24th to 26th October 2013.

The ceremonial inauguration will be held on 24th October at Water’s Edge, Battaramulla followed by two days of technical sessions on 25th and 26th October 2013, at the same venue.This year’s conference will focus on the various areas to which innovation could be applied.

A leading corporate head of India will be the chief guest and a distinguished foreign delegate who is a policy consultant to a number of governments around the world will make the keynote speech.

Chairman of the National Conference Committee Lasantha Wickremasinghe said the conference over the last three decades has built a reputation as a business summit that provokes thought and provides insights into broad economic and business issues, apart from its core emphasis on finance-related topics.

“Last year’s conference saw the participation of nearly 1,250 chartered accountants, including business leaders. This year too we will have a web telecast for members who are abroad.”

Chairman of the National Conference Technical Committee Dulitha Perera said that in today’s business context innovation is imperative for sustainable value creation, thereby creating competitive advantage leading to growth.

The conference will feature an eminent panel of experts who will share practical experiences of how innovative approaches adopted by both foreign and local organizations stimulate growth,

“The first day of our technical sessions will explore how innovation is embedded in manufacturing-oriented organizations, important elements in creating a conducive environment to foster innovation, how innovation has aided in conquering new markets and finally, how emergent technology and communication, especially social networking has been used innovatively in the current context and its potential. The second half day of our technical sessions will focus on means of managing risks in innovation and how the service sector should look at innovation.”

Update

World Bank grant to increase IFRS adoption

CA Sri Lanka recently launched an initiative backed by a World Bank grant to increase adoption of International Financial Reporting Standards (IFRS) across the country.

As the first step, the Institute conducted a special training programme for the benefit of preparers of financial statements, auditors and regulators.

This was aimed at raising awareness amongst stakeholders to ensure compliance in financial reporting standards and a common platform for financial reporting in line with international standards.

The programme was conducted by Mike Turner, one of the world's leading trainers on IFRS with over 20 years of experience.

During the programme, Turner provided valuable insights on how to successfully implement IFRS and the many benefits of the standards, including strengthening of the accounting profession as well as the contribution to the long term growth of the economy, through improved regulations and governance as well as enhanced transparency.

"Convergence with IFRS is a major breakthrough for companies in Sri Lanka as they now have a common, high quality and internationally accepted set of accounting and financial reporting standards to follow," CA Sri Lanka President Sujeewa Rajapakse said.

49th Annual Report Awards on Integrated Reporting theme

The 49th Annual Report Awards competition this year will be on the theme 'One Destination - Towards Integrated Reporting' focusing on the future of annual reporting in a more global context.

It is open to any organization that produces an annual report, from multinationals to small community groups.

This year, the CA Sri Lanka organizers have included a new sector solely focusing on the small and medium sized entities (SMEs), providing SME entrants with the opportunity to benchmark themselves against others in their respective industries.

"Held since 1964, the competition's importance has been showcased by the consistent increase in the number of applications we receive annually," CA Sri Lanka President Sujeewa Rajapakse said, noting it meant more organizations are committed to ensuring the highest level of transparency and accountability.

23
Categories of awards
will be given, each consisting of a winner, and first and second runners-up.

"In keeping with changing times, every year CA Sri Lanka upgrades the competition by revising the marking schemes to be on par with global developments. As the sole authority in formulating accounting and auditing standards in the country, it is CA Sri Lanka's responsibility to ensure that companies adhere to such standards thereby assisting in stabilizing the economy of the country."

Chairman of the Annual Report Awards Committee, Tishan Subasinghe, said that this year they changed the marking criteria to accommodate convergence of Sri Lanka's financial reporting framework with the international financial reporting framework which came into effect from January 2012.

"I believe this competition would contribute to the information efficiency of capital markets."

Chief Executive Officer of CA Sri Lanka Aruna Alwis said an essential ingredient of good corporate reporting is accurate, timely and comprehensive corporate disclosure.

"This not only helps cultivate the confidence of shareholders and investors of a company, but also contributes to the building up of the company's good public image and reputation."

CA Sri Lanka exams go global

The Strategic Level Examinations of the Institute of Chartered Accountants of Sri Lanka went global in June and July with exams being held in Qatar for CA Sri Lanka students living and working there.

CA Sri Lanka examinations supervisors supervised the exams to ensure the same level of standards as in Sri Lanka.

CA Sri Lanka President Sujeewa Rajapakse declared it was the first time an exam was conducted outside Sri Lanka.

The institute has over 41,000 students who are currently studying the institute's globally recognized qualification and some who have completed the preliminary stages have already secured employment overseas, he said.

It is for their benefit the CA examinations were held so they can complete their course of study no matter where they are located.

"We have a considerable number of members and students serving in various positions in the Middle East including in Qatar as well as in other parts of the world, and as a pilot project we decided to hold the examination in Qatar," Rajapakse said.

Chief Executive Officer of CA Sri Lanka Aruna Alwis said the decision to hold exams overseas was taken by the CA Sri Lanka Council following overwhelming requests from both students and members based outside Sri Lanka.

"CA Sri Lanka will add more countries based on the demand in the coming months."

High achievers get scholarships

42 high achieving students from across the country won scholarships

CA Sri Lanka rewarded 42 high achieving students from across the country with scholarships to follow the institute's chartered accountancy qualification.

At a ceremony held at the Institute's Colombo 7 premises, 12 students were awarded scholarships under the L. A. Weerasinghe Scholarship Fund while 30 others were awarded scholarships based on merit.

Students from Ampara, Anuradhapura, Batticaloa, Badulla, Colombo, Galle, Gampaha, Hambantota, Kandy, Kalutara, Kegalle, Kurunegala, Matara, Nuwara Eliya, Trincomalee and Vavuniya were awarded scholarships by the chief guest at the event, Arjuna Herath, Vice President of CA Sri Lanka.

CA Sri Lanka President Sujeewa Rajapakse emphasized that the national body of accountants, one of the largest tertiary education providers in the country outside the university system, has consistently strived to ensure that students from all over the country get equal opportunities to study the institute's course.

He noted that the scholarships are awarded from the CA Sri Lanka Scholarship Foundation launched in 2010 and is currently chaired by B. R. L. Fernando.

Rajapakse expressed his appreciation to CA Sri Lanka members based overseas as well as in Sri Lanka for supporting the foundation with continuous contributions to ensure the long-term success of this initiative.

"Our institute attracts the best and brightest of students from both the commerce and non-commerce streams," CA Sri Lanka's Chief Executive Officer Aruna Alwis said.

Update

Seven more training partners

Seven leading organisations came onboard to support strategic level students following the Institute's globally recognised chartered accountancy course.

They are Agstar Fertilizers, Blue Ocean Holdings, Ceylon Paper Sacks, Expolanka Holdings, HSBC Electronic Data Processing (Lanka), L B Finance and MBSL Insurance Co.

CA Sri Lanka President Sujeewa Rajapakse said training partners played a significant role in helping groom well qualified chartered accountants.

"Practical training is one of the most unique features of our programme and this has only been possible due to the large number of training partners from the public and private sectors supporting CA Sri Lanka who provide training to students following our programme," he noted.

CA Sri Lanka now has over 600 training partners, covering a large spectrum of industries in both public practice and non-public practice sectors. "Through our island-wide network of training partners, CA Sri Lanka expects to provide our students with a greater selection in finding a training partner of their choice in an area of their preference," he noted.

Chief Executive Officer of CA Sri Lanka Aruna Alwis stressed that the three-year long practical training is an integral part of the institute's study programme. ■

Cargills comes aboard as a lead sponsor

Cargills (Ceylon) PLC, a leading listed retail and FMCG company with roots going back to 1844, recently joined hands with the Institute of Chartered Accountants of Sri Lanka, becoming a lead sponsor for the year 2013. CA's other lead sponsors are Aitken Spence, C T Holdings, Hatton National Bank, John Keells Holdings, Sri Lanka Insurance Corporation and Sri Lanka Telecom.

The Cargills sponsorship cheque was presented to CA Sri Lanka President Sujeewa Rajapakse by Cargills (Ceylon) Managing Director M. Imtiaz Wahid. Deputy Chairman Cargills (Ceylon) Ranjit Page was also present at this occasion.

Speaking on the sponsorship, Wahid termed the tie up with CA Sri Lanka, the country's national accounting body, as an opportunity to empower youth across the country.

"Cargills has touched lives of people in each and every corner of this country and we are serious about our responsibility towards enriching their lives, not only in relation to our core business functions but also by engaging in various empowerment initiatives. Sustainability is part and parcel of our overall business strategy and corporate culture and our tie up with CA Sri Lanka is one such initiative," Wahid noted. ■

CA Calendar

Academic Events

Business School Convocation 2013
at the Cinnamon Lakeside Colombo,
By Invitation.
27th November 2013
Contact: Ashara
Email: ashara.piyadasa@casrilanka.com

Corporate Events

34th National Conference of Chartered Accountants
at the Water's Edge, Battaramulla
24th – 26th October 2013

Annual Report Awards Ceremony
at the Water's Edge, Battaramulla
10th December 2013
Contact: Dale
Email: events@casrilanka.com

Council Elections - 2013
20th December 2013
Contact: Wasana
Email: secretariat@casrilanka.com

CPD Events

Seal the Deal
Workshop on Effective Negotiation Skills with the British Council
07th November 2013 at CA Sri Lanka

Collaborative Approach to Business Relationship
Effective ways to build a lasting business relationship with stakeholders
14th November 2013 at the CA Sri Lanka

Supply-chain Management
28th November 2013 at CA Sri Lanka

IFRS for SMEs
Panel discussion
21st November 2013 at CA Sri Lanka
Contact: Nuwan
Email: nuwan.dishan@casrilanka.com

Seminar Series on PM - Managing Global Teams to deliver mega projects
31st October 2013 at CA Sri Lanka

Seminar Series on PM - Project Manager's Role in a Modern Business Context
5th November 2013 at CA Sri Lanka

Seminar Series on PM - Risk Management
7th November 2013 at CA Sri Lanka
Contact: Kaushala
Email: kaushala.perera@icasrilanka.com

Member Networking Events

TGIF - Jazz Evening
29th November 2013
Contact: Indunil
Email: indunil.pathirana@casrilanka.com

Implications of recently issued exposure drafts

The Institute of Chartered Accountants of Sri Lanka recently organized a CFO Forum on the implications of recently issues exposure drafts.

The forum specifically targeting Chief Financial Officers in the country covered four exposure drafts which were presented by the CA Sri Lanka Technical Division.

The exposure drafts included; Classification and Measurement: Limited Amendments to IFRS 9 (ED/2012/5), Equity Method: Share of other Net Asset Changes (ED/2012/3), Clarification of Acceptable Methods of Depreciation and Amortisation (ED/2012/5) and Acquisition of an Interest in a Joint Operation (ED/2012/7).

The presentations were followed by a panel discussion comprising industry experts Nishan Fernando, Managing Director of BDO Consulting (Pvt) Ltd., Reyaz Mihular, Managing Partner of KPMG and Manil Jayesinghe, Senior Partner of Ernst & Young. ■

Intake on for Australian MBA

The Institute of Chartered Accountants of Sri Lanka has commenced its mid-year intake for one of the country's most sought-after foreign MBA programmes.

The MBA of the University of Southern Queensland (USQ), recognized as one of Australia's top 20 MBAs, is offered in Sri Lanka through the CA Sri Lanka Business School.

Recently, a popular website based in Australia, My University ranked USQ as the second best university in Queensland on the grounds that the university produced the highest number of students who were able to secure full-time jobs subsequent to their study at USQ.

USQ also offers a range of exemptions for members of CA Sri Lanka, CIMA, CIM, ACCA, SLIM, CIM, AAT and CMA to follow its MBA.

Marketing Manager of Providence Network & Solutions (Pvt) Ltd., Roshan Duraipandian who followed the USQ MBA said: "When selecting an MBA programme it was crucial for me to find one that offered subjects most current to the recent management trends, which could be applied to day-to-day decision making and planning."

"It was a novel study experience with access to USQ's online pool of resources and forums along with CA Sri Lanka's pool of experienced lecturers, which equipped me as well as the others to follow the exams and assignments confidently," he added. ■

Life

Koh Samui: *from* virgin escape *to* tourist hotspot

Thai island Koh Samui has undergone a remarkable transformation in the last two decades to a luxury tourist hotspot. Its natural beauty remains the main draw

BY SRAVASTI GHOSH DASTIDAR

Four hundred and fifty kilometers south-west of vibrant Bangkok in Thailand, lies one of the most significant tropical islands of the Mu Koh Samui Archipelago, the sun-drenched Koh Samui. It is Thailand's second largest island after Phuket. Samui is characterised by a clear aquamarine sea, beaches of white smooth sand, secluded lagoons, dazzling corals, coconut palms and warm and humid tropical monsoon climate.

Easily accessible from the mainland, with flights (Thai and Bangkok Airways being the main operators) and ferries (from the Don Sak Pier of Surat Thani to Nathon Pier of Samui), it's a popular destination for tourists of all age groups and budgets. One and a half decades ago, the island started making ripples on the travellers' map. Now, its attractions are splashed in most of the major travel magazines of the world. In the 90's, if one wanted to visit a truly virgin island, Koh Samui was a likely choice. However, over the years, its popularity has sky-rocketed and the eastern part of the island is flooded with tourists, year round. The change in the look and feel of the island has to be seen to be believed.

Travelling is fairly easy as there are enough car, motorcycle and bicycle rental facilities along with good public transport

Touted as the most beautiful airport in the world, the Koh Samui International airport welcomes tourists to picturesque natural surroundings, with hills on one side and the airport terminal, in traditional Thai architecture, on the other. Colourful, environment-friendly and open Gate Transport buses render the first feel of the island's relaxed atmosphere. This particular feeling continues throughout the tours of Samui, till one departs from the helpful check-in counters and experiences the airport's USP - one-of-a-kind courtesy corner, near the departure gate which provides free wi-fi, snacks and drinks to all passengers, in a comfortable sitting area. For budget travellers, the ferry is a cheaper but time-consuming option.

Travelling on the island is fairly easy as there are enough car, motorcycle and bicycle rental facilities along with good public transport in the shape of Songthaews (pick up trucks converted with bench seats) and yellow metered air-conditioned taxis. Hiring cars and motorbikes is the most common but this comes without insurance. Since the island is only 25 kms in length and 21 kms in width, one can take the Ring Road and cover the entire island in less than one and a half hours. Though the price for the hire starts from 150 to 200 bahts for the bikes and 800 bahts for the cars per day, it is advisable not to look for very cheap options as the condition of the vehicle may not be so great and one may end up with a malfunctioning bike or car on a steep, mountainous road. Refuelling is convenient as there are modern petrol stations everywhere. However, what catches one's eyes while driving around, is the number of roadside stands selling gas from large oil drums with pumps attached to them, and the strange yet amusing sight of stacks of old liquor bottles filled with colourful gas.

Samui has ample hotels with 5-star resorts, private luxury villas and budget bungalows. The touristy Chaweng Beach in the east and the Lamai Beach in the south-east are quite crowded. The Bophut Beach and the Maenam Beach, in the north-east and north, are more virgin and isolated. Khao Pom, a 635 meter high uninhabitable jungle mountain is at the centre of the island. There are some impressive waterfalls in this area, of which the Hin Lad and the Namuang 1 and 2 are easily accessible. One can hitch a ride to the waterfalls either on an elephant or a 4x4 drive, and then dip into the cool waters of the falls.

A 12 meter high golden statue of the Buddha, known as the Big Buddha, dominates the skyline of north-eastern Samui. Among the other attractions, the Hin Ta and Hin Yai rocks (or Grandma and Grandpa rocks), the Mummy Monk, the Samui Aquarium with Tiger Show, the Butterfly Garden, the Snake Farm and the Ladyboy Cabaret Shows are worth mentioning. The Emerald Lake, a mountain top green lake in an extinct volcanic crater, in Ang Thong Bay, is breath-taking but can be quite crowded.

THE TOURISTY CHAWENG BEACH IN THE EAST OF THE ISLAND

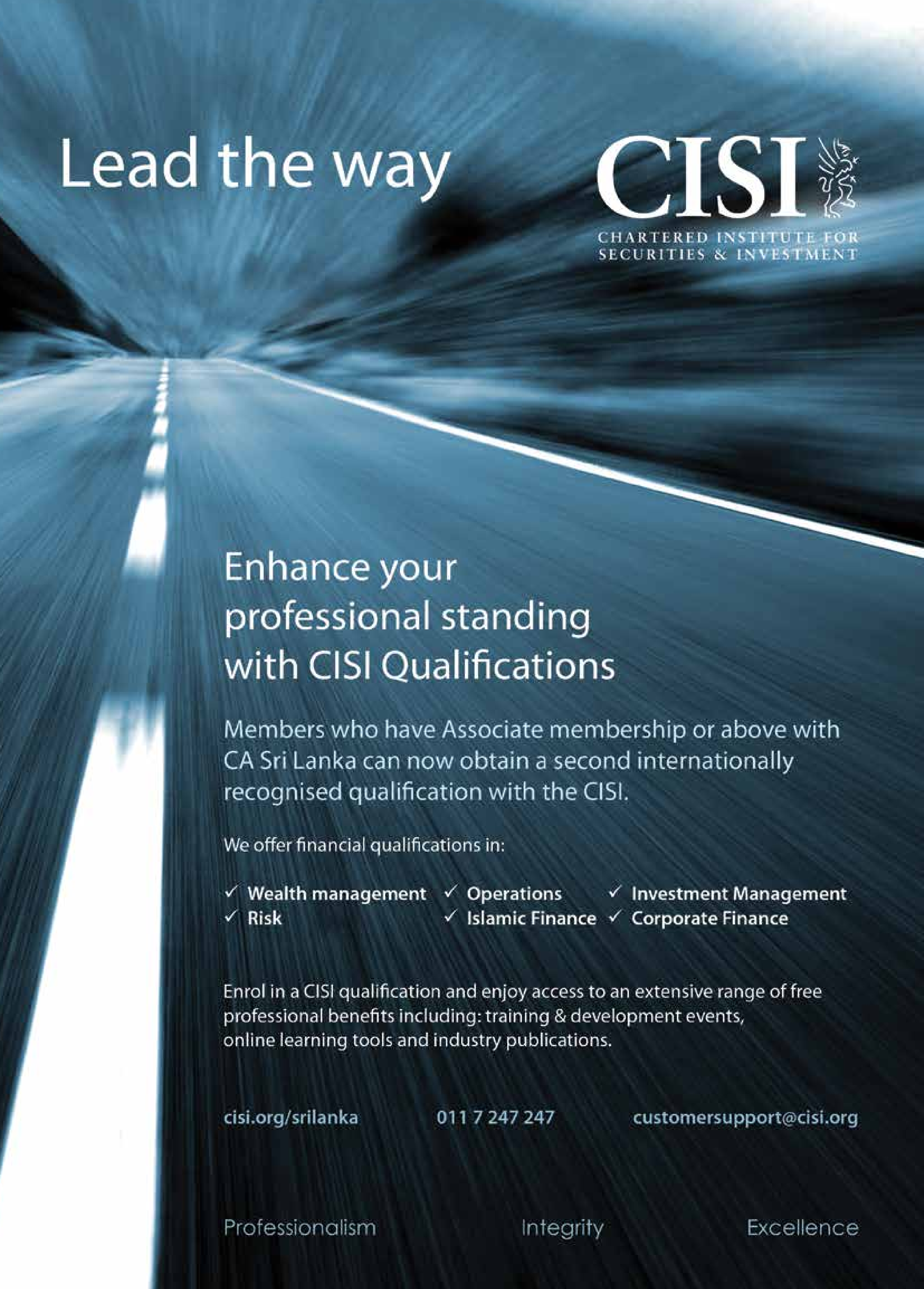
What can be better than a nourishing Thai massage after a day of hot sun, sea and sand or a humid tour of the island?

The usual array of water sports can be procured in most of the resorts and individual water sports centres along the Ring Road. Jet-skiing, water jet pack, water-skiing, knee-boarding, snorkelling, fishing, sea-kayaking, scuba-diving, para-sailing and yachting being the most popular ones. Diving is, however, better in the clearer waters of the Ang Thong Marine National Park (a day's trip on a ferry or boat from Nathon Pier). Sporty tourists can also get a flavour of the indigenous Samui Football Golf, where the players try and kick the football into the 18 holes in as few 'strokes' as possible.

Similar to other tourist destinations of the country, Koh Samui's Chaweng, Lamai and Nathon markets are bustling with retails goods from all over Thailand. Custom-made clothes can be ordered and delivered within hours. Fireworks on the Chaweng Beach during the Songkran or Thai New Year (April 13 to 15) is usually spectacular. The Thai local cuisine, Malaysian and Indian cuisine are hot favourites. Massage parlours and spas, including fish spas', are found in every street, lane and by-lane. What can be better than a nourishing Thai massage after a day of hot sun, sea and sand or a humid tour of the island?

A holiday on this paradise-like island can stretch from 3 days to a month. One cannot help but get addicted to the hedonistic life Samui offers. An ideal getaway from the much-touted and busy Bangkok-Pattaya-Phuket trio.

SIMILAR TO OTHER TOURIST DESTINATIONS OF THE COUNTRY, KOH SAMUI'S CHAWENG, LAMAI AND NATHON MARKETS ARE FILLED WITH FOOD STALLS AND RETAIL GOODS FROM ALL OVER THAILAND.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