

# Annual Report 2012



MCB

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# ISLAMIC INCOME FUND

# MCB ISLAMIC INCOME FUND

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## **Vision**

To become synonymous with Savings

## **Mission**

To become a preferred Savings and Investment Manager in the domestic and regional markets, while maximizing stakeholder's value.

## **Core Values**

The Company takes pride in its orientation towards client service. It believes that its key success factors include continuous investment in staff, systems and capacity building, and its insistence on universal best practices at all times.

# MCB ISLAMIC INCOME FUND

## FUND'S INFORMATION

<b>Management Company</b>	Arif Habib Investments Limited 8th Floor, Techno City, Corporate Tower, Hasrat Mohani Road, Karachi	
<b>Board of Directors of the Management Company</b>	Mian Mohammad Mansha Mr. Nasim Beg Mr. Yasir Qadri Syed Salman Ali Shah Mr. Haroun Rashid Mr. Ahmed Jahangir Mr. Samad A. Habib Mr. Mirza Mahmood Ahmad	Chairman(subject to the approval of SECP) Executive Vice Chairman Chief Executive (subject to the approval of SECP) Director (subject to the approval of SECP) Director (subject to the approval of SECP) Director (subject to the approval of SECP) Director Director (subject to the approval of SECP)
<b>Audit Committee</b>	Mr. Haroun Rashid Mr. Nasim Beg Mr. Samad A. Habib Mr. Ali Munir	Chairman Member Member Member
<b>Human Resource Committee</b>	Dr. Salman Shah Mr. Nasim Beg Mr. Haroun Rashid Mr. Ahmed Jehangir Mr. Yasir Qadri	Chairman Member Member Member Member
<b>Company Secretary &amp; CFO of the Management Company</b>	Mr. Muhammad Saqib Saleem	
<b>Trustee</b>	Central Depository Company of Pakistan Limited CDC House, 990B, Block 'B', S.M.C.H.S, Main Shahrah-e-Faisal, Karachi-74400	
<b>Bankers</b>	MCB Bank Limited Bank Al-Falah Limited Standard Chartered Bank Limited United Bank Limited	
<b>Auditors</b>	A.F. Ferguson & Co.-Chartered Accountants State Life Building No. 1-C, I.I. Chundrigar Road, Karachi-74000	
<b>Legal Advisor</b>	Bawaney & Partners 404, 4th Floor, Beaumont Plaza, Beaumont Road, Civil Lines, Karachi-75530	
<b>Transfer Agent</b>	Arif Habib Investments Limited 8th Floor, Techno City, Corporate Tower, Hasrat Mohani Road, Karachi	
<b>Rating</b>	AM2 - Management Quality Rating assigned by PACRA	



# **MCB ISLAMIC INCOME FUND REPORT OF THE DIRECTOR OF THE MANAGEMENT COMPANY FOR THE YEAR ENDED JUNE 30, 2012**

The board of Directors of Arif Habib Investment Limited, the Management Company of MCB Islamic Income Fund (MCB IIF), is pleased to present the Annual Report on the affairs of MCB IIF for the year ended June 30, 2012.

## **Economy and Money Market Overview**

Despite continued macro-economic challenges throughout the period, the year under review (July '11-June '12) could be classified as a mixed bag for the economy and capital markets as some of the key macroeconomic indicators have depicted positive trend during the period under review despite having burgeoning fiscal challenges.

The external account, which was the top performing sector during the previous year, couldn't maintain its positive trend during FY12 owing to widening trade deficit on the back of lower cotton and higher oil prices despite having record-high workers' remittances. During the year, export dipped by 3% while imports grew by 12% causing the overall trade deficit to widen to around US\$ 15.4 billion, 46% higher YoY. Despite record-high level of workers' remittances flow of US\$ 13.2 billion, higher trade and income deficit caused the current account balance to post a deficit of US\$ 4.5 billion as against a surplus of US\$ 214 million last year. Given higher current account deficit coupled with meager financial account flows, country's balance of payment position declined significantly during the year by around US\$ 3.3 billion - taking the FX reserves down to a level of US\$ 15.3 billion, while also causing sizeable depreciation of 10% in the PKR-USD exchange rate during the year.

Inflationary pressures, on the other hand, have remained largely on the lower side during the period with YoY CPI Inflation averaging 11.0% amid change in CPI methodology as well as high base-effect of last year. Moreover, real economy has shown a relatively improved picture during the year with FY12 real GDP growth stood at 3.7%, slightly higher than the revised GDP growth of 3.0% during the last year.

Fiscal indiscipline continued to remain a cause of concern for the economic managers as the country is expected to witness a higher deficit of over 8% of the GDP during FY12 (including one-off circular debt adjustments). Even during the first 9M of the fiscal year, the country witnessed a fiscal deficit of Rs. 895 billion, 4.3% of the GDP. Although growth in tax revenue collection has been strong, lower non-tax revenue on the back of non-realization of CSF proceeds coupled with higher current expenditure has been the chief reason behind ballooning fiscal deficit. Unfortunately, development expenditure is expected to be under-spent for yet another year to meet revised fiscal deficit targets. In addition of having a higher fiscal deficit, the financing mix is also alarming as the country had to resort to domestic sources of funding to a large extent in the absence of sizeable foreign flows during the period under review. Government borrowing from Central Bank has gone up by Rs. 508 billion during FY12, which is staggering 44% of total outstanding stock.

Considering the volatility in the macroeconomic variables, the State Bank of Pakistan has also altered its monetary stance at least twice during the year. Given benign YoY CPI Inflation coupled with lower GoP borrowing from SBP as well as contained external current account deficit during the earlier part of the year, the SBP cut its policy discount rate cumulatively by 200 bps to 12.0%. However, gradual deterioration in the macro-economic environment lately has compelled the central bank to keep its policy DR unchanged for the next 4 policies during the latter part of the year. Due to an overall relatively lower interest rate environment, 1 year PKRV averaged at around 12.4% during FY12, much lower than the average 13.4% a year ago.

During FY12, key monetary indicators have shown reasonable improvement with money supply (M2) posting a strong growth of 14.4%. Although Net Domestic Asset (NDA) growth has been a key contributor behind M2 growth during this year as well, sizeable YoY decline of 32% in Net Foreign Assets (NFA) has been very alarming - also reflecting weak BOP position. Significant credit demand by the government coupled with an attractive risk-return profile has kept government papers a very attractive investment vehicle for the investors during this year also. Moreover, GoP Ijarah Sukuk (GIS), like previous year, has remained an attractive instrument during the year for conventional markets in general and Shariah compliant markets in particular. In addition of giving strong interest yield, GIS has also provided potential for capital gains due to its demand-supply gap and therefore has seen significant activities during this year also in both primary as well as secondary markets.

## **Future outlook**

Although medium term macroeconomic picture remains gloomy, benign CPI inflation trend coupled with the release of US\$ 1.18 billion under Coalition Support Fund by the US does provide a short term breather thereby creates a potential room for monetary easing by the State Bank of Pakistan in the upcoming monetary policy announcement. We continue to emphasize that the realization of sizeable foreign inflows holds the key in rejuvenating economic engine, while a potential return to IMF program in the next 6-8 months would adversely affect the liquidity and interest rate scenario.

## **Funds Performance**

The net assets of the fund grew to a size of PKR 1.5 billion as on June 30, 2012 in just over a year of its launch. The investment objective of the fund is to generate superior risk adjusted returns by investing in short, medium and long-term Shariah Compliant Fixed income instruments. The fund is benchmarked against an average of the most recently published three-month profit rates of three Islamic Banks rated A and above. During the period, the fund was able to yield an annualized return of 10.4% during the period under review which was significantly higher than the Fund's benchmark return of 6.6% during the same period.

The fund continued to deploy assets cautiously, without aggressively chasing available instruments, and has maintained a strong focus on the credit quality of the instruments. Considering the risk-return profile of government papers, the fund has maintained sizeable exposure towards GoP Ijarah Sukuk (GIS) while also kept a decent exposure towards bank deposits.

The Fund yields for the period under review remained as follows:

**MCB ISLAMIC INCOME FUND  
REPORT OF THE DIRECTOR OF THE MANAGEMENT COMPANY  
FOR THE YEAR ENDED JUNE 30, 2012**

Performance Information (%)	MCBIIF	Benchmark
Last twelve Months Return (Annualized)	10.4%	6.6%
Since Inception (CAGR)	10.3%	6.6%

During the year your fund earned net income of Rs 98.724 million. The Board in the meeting held on June 25, 2012 has declared final distribution amounting to Rs. 33.723 million (i.e. Rs. 2.3242 per unit). In addition to final distribution, the Board / CE has approved following interim distribution during the year ended June 30, 2012.

<b>Date of distribution</b>	<b>Distribution PKR / Unit</b>
26 January 2012	Re. 6.4087 per unit
28 March 2012	Re. 1.3000 per unit

During the period, units worth Rs.1.889 million (including Rs. 97.30 million worth of bonus units) were issued and units with a value of Rs. 532.650 million were redeemed. As on 30 June 2012 the NAV of the Fund was Rs. 100.10 per unit.

#### Update on Workers' Welfare Fund

Through the Finance Act, 2008 an amendment was made in section 2(f) of the Workers' Welfare Fund Ordinance, 1971 (the WWF Ordinance) whereby the definition of 'Industrial Establishment' has been made applicable to any establishment to which West Pakistan Shops and Establishment Ordinance, 1969 applies. As a result of this amendment it appears that WWF Ordinance has become applicable to all Collective Investment Schemes (CISs) whose income exceeds Rs. 0.5 million in a tax year. In light of this, the Mutual Funds Association of Pakistan (MUFAP) filed a constitutional petition in the Honorable Sindh High Court challenging the applicability of WWF on CISs which was dismissed mainly on the ground that MUFAP is not an aggrieved party.

Subsequently, clarifications were issued by the Ministry of Labour and Manpower (the Ministry) which stated that mutual funds are not liable to contribute to WWF on the basis of their income. These clarifications were forwarded by the Federal Board of Revenue (FBR) (being the collecting agency of WWF on behalf of the Ministry) to its members for necessary action. Based on these clarifications, the FBR also withdrew notice of demand which it had earlier issued to one of the mutual funds for collection of WWF. Other mutual funds to whom notices were issued by the FBR also took up the matter with FBR for their withdrawal.

Further, a fresh Constitutional Petition filed with the Honorable High Court of Sindh by a CIS / mutual fund and a pension fund through their trustee and an asset management company inter alia praying to declare that mutual funds / voluntary pension funds being pass through vehicles / entities are not industrial establishments and hence, are not liable to contribute to the WWF under the WWF Ordinance. The proceedings of the Honorable Court in this matter have concluded and the Honorable Court has reserved its decision.

Subsequent to the year ended June 30, 2011, the Honorable Lahore High Court (LHC) in a Constitutional Petition relating to the amendments brought in the WWF Ordinance, 1971 through the Finance Act, 2006, and the Finance Act, 2008, has declared the said amendments as unlawful and unconstitutional. The Management Company is hopeful that the decision of the LHC, will lend further support to the Constitutional Petition which is pending in the SHC.

In view of the afore mentioned developments, the Management Company firmly believes that there is no compelling reason to make provision on account of WWF contribution in the financial statements. Further, the Management Company also expects that the constitutional petition pending in the Honorable High Court of Sindh on the subject as referred above will be decided in favour of the Mutual Funds. However the auditor of the Fund because of pending adjudication of the Constitutional petition in Honorable Sindh High Court and included a emphasis of matter paragraph in auditor' report highlighting the said issue.

The aggregate unrecognized amount of WWF as at June 30, 2012 amounted to Rs.1.830 million.

#### Corporate Governance

The Fund is committed to high standards of corporate governance and the Board of Directors of the Management Company is accountable to the unit holders for good corporate governance. Management is continuing to comply with the provisions of best practices set out in the code of corporate governance particularly with regard to independence of non-executive directors. The Fund remains committed to conduct business in line with listing regulations of Lahore Stock Exchange.

The following specific statements are being given to comply with the requirements of the Code of Corporate Governance:

- Financial statements present fairly the statement of affairs, the results of operations, cash flows and Change in unit holders' fund.
- Proper books of accounts of the Fund have been maintained during the year.
- Appropriate accounting policies have been consistently applied in preparation of financial statements. Accounting estimates are based on reasonable prudent judgment.
- Relevant International Accounting Standards, as applicable in Pakistan, provisions of the Non Banking Finance Companies (Establishment & Regulations) Rules, 2003, Non Banking Finance Companies and Notified Entities Regulations, 2008, requirements of the respective Trust Deeds and directives issued by the Securities & Exchange Commission of Pakistan have been followed in the preparation of financial statements.

**MCB ISLAMIC INCOME FUND  
REPORT OF THE DIRECTOR OF THE MANAGEMENT COMPANY  
FOR THE YEAR ENDED JUNE 30, 2012**

- e. The system of internal control is sound in design and has been effectively implemented and monitored.
- f. There are no significant doubts upon the Fund's ability to continue as going concern.
- g. There has been no material departure from the best practices of Corporate Governance, as detailed in the listing regulations.
- h. Key financial data as required by the Code of Corporate Governance has been summarized in the financial statements.
- i. Outstanding statutory payments on account of taxes, duties, levies and charges, if any have been fully disclosed in the financial statements.
- j. The statement as to the value of investments of provident fund is not applicable on the Fund but applies to the Management Company, hence appropriate disclosure has been made in the Directors' Report of the Management Company.
- k. The detailed pattern of unit holding, as required by NBFC Regulations and the Code of Corporate Governance are enclosed.
- l. The details of attendance of Board of Directors meeting is disclosed in note 21 to the attached financial statements. During the year four meetings of Audit Committee were held on 19th September 2011, 26th October 2012, 26 January 2012 and 24th April 2012, the details of attendance is as follows:

S. No.	Name	Designation	Attendance required	Attended	Leave granted
1.	Mr. Haroun Rashid	Chairman	4	3	1
2.	Mr. Nasim Beg	Member - Executive Vice Chairman	4	4	-
3.	Mr. Samad A. Habib	Member	4	2	2
4.	Mr. Ali Munir	Member	4	2	2

- m. As required by the Code, all the directors of the Management Company will attend the training Program for directors by the year 2016. Currently, two of the directors are exempt from obtaining mandatory training having the requisite qualification and experience. Further Directors' have also being briefed about the recent changes made in laws and regulations to enable them to effectively manage the affairs of the management company.
- n. No trades in the Units of the Fund were carried out during the year by Directors, CEO, Company Secretary & Chief Financial Officer of the Management Company and their spouses and minor children.

**External Auditors**

The fund's external auditors, A.F. Ferguson & Co., Chartered Accountants, have retired after the conclusion of audit for current year. Since AFF have consented to act as the External Auditors of the Management Company, they are not eligible for reappointment as statutory auditors of the Fund. The audit committee of the Board has recommended appointment of KPMG Taseer Hadi & Co., Chartered Accountants, (who have given consent to such appointment) as auditors for the year ending June 30, 2013.

**Acknowledgement**

The Board of Directors of the Management Company is thankful to the valued investors of the Fund for their reliance and trust in Arif Habib Investments Limited. The Board also likes to thank the Securities and Exchange Commission of Pakistan, State Bank of Pakistan, Central Depository Company of Pakistan Limited (the Trustee of the Fund) and the management of the Lahore Stock Exchange for their continued cooperation, guidance, substantiation and support. The Board also acknowledges the efforts put in by the team of the Management Company for the growth and meticulous management of the Fund.

For and on behalf of the board

**Yasir Qadri**  
Chief Executive Officer

Karachi: August 15, 2012

# MCB ISLAMIC INCOME FUND REPORT OF THE FUND MANAGER FOR THE YEAR ENDED JUNE 30, 2012

## Fund Type and Category

MCB Islamic Income Funds is an Open-End Shariah Compliant (Islamic) Income Scheme.

## Fund Benchmark

The benchmark for MCB IIF is an average of the most recently published three-month profit rates of three Islamic Banks rated A and above.

## Investment Objective

To generate superior risk adjusted returns by investing in short, medium and long-term Shariah Compliant Fixed income instruments.

## Investment Strategy

The Fund shall seek to provide the investors with a rate of return consistent with a broadly diversified portfolio of long, medium and short term, high quality Shariah Compliant fixed income instruments.

## Manager's Review

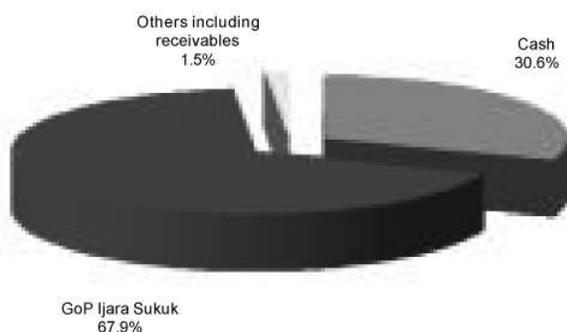
Within just over 12 months of its launch, the fund grew significantly to a size of around PKR 1.5 billion by Jun'12 from PKR 178 million a year ago.

During the year, the fund generated an annualized return of 10.4% as against its benchmark return of 6.6%, an out-performance of 3.8% over its benchmark. The fund has gradually been building its exposure in GoP Ijarah Sukuk (GIS) at attractive levels and has kept an allocation of around 68% at year-end while 31% assets were kept in cash and bank deposits.

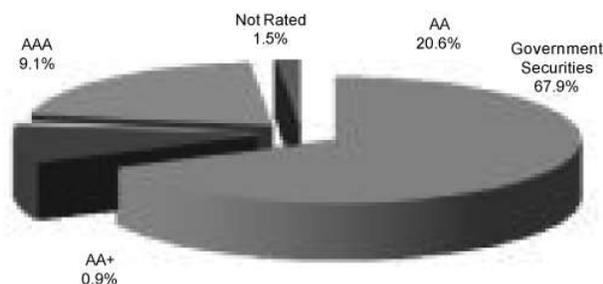
Given the attractive risk-return profile of government papers and its strong appetite in the market, the fund plans to keep a major portion of its assets in GIS to enhance returns instead of putting them in corporate Sukuk.

We believe that the well-timed accumulation of GIS should contribute towards healthy returns going forward, while the fund would remain cognizant of the changes in macroeconomic environment in order to deploy assets efficiently in Shariah compliant instruments.

Asset Allocation as on June 30, 2012 (% of total assets)



Asset Quality as on June 30, 2012 (% of total assets)



Syed Akbar Ali, CFA  
Fund Manager

Karachi: August 15, 2012

**MCB ISLAMIC INCOME FUND  
TRUSTEE REPORT TO THE UNIT HOLDERS  
FOR THE YEAR ENDED JUNE 30, 2012**

**CENTRAL DEPOSITORY COMPANY  
OF PAKISTAN LIMITED**

**Head Office**

CDC House, 99-B, Block 'B'  
S.M.C.H.S. Main Shahra-e-Faisal  
Karachi - 74400. Pakistan.  
Tel: (92-21) 111-111-500  
Fax: (92-21) 34326020 - 23  
URL: www.cdcpakistan.com  
Email: info@cdcpak.com



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**TRUSTEE REPORT TO THE UNIT HOLDERS**

**MCB ISLAMIC INCOME FUND**

**Report of the Trustee pursuant to Regulation 41(h) and Clause 9 of Schedule V  
of the Non-Banking Finance Companies and Notified Entities Regulations, 2008**

We Central Depository Company of Pakistan Limited, being the Trustee of MCB Islamic Income Fund (the Fund) are of the opinion that Arif Habib Investments Limited being the Management Company of the Fund has in all material respects managed the Fund during the year ended June 30, 2012 in accordance with the provisions of the following:

- (i) Limitations imposed on the investment powers of the Management Company under the constitutive documents of the Fund;
- (ii) The pricing, issuance and redemption of units are carried out in accordance with the requirements of the constitutive documents of the Fund; and
- (iii) The Non-Banking Finance Companies (Establishment and Regulations) Rules, 2003, the Non-Banking Finance Companies and Notified Entities Regulations, 2008 and the constitutive documents of the Fund.

  
**Muhammad Hanif Jakhura**  
Chief Executive Officer  
Central Depository Company of Pakistan Limited

Karachi: October 17, 2012



**MCB ISLAMIC INCOME FUND  
REPORT OF THE SHARIAH ADVISORY COUNCIL  
FOR THE YEAR ENDED JUNE 30, 2012**

I, the Shariah Advisor of the Fund, am please to issue this report in accordance with the clause 9.2.5 of the Trust Deed of the MCB Islamic Income Fund (MCB-IIF). The scope of the report is to express an opinion on the Shariah compliance of the Fund's activities.

In the capacity of the Shariah Advisor, we have prescribed criteria and procedure to be followed in ensuing Shariah Compliance in every investment.

It is the responsibility of M/s Arif Habib Investments Limited, the Management Company of the Fund, to establish and maintain a system of internal controls and to ensure compliance with the Shariah guidelines. My responsibility is to express an opinion, based on my review of the representations made by the Management Company, to the extent where such compliance can be objectively verified. A review is limited primarily to inquiries to the Management Company's personnel and review of various documents prepared by the management company to comply with prescribed criteria. In the light of the above, we hereby certify that:

- We have reviewed and approved the modes of investments of MCB-IIF in the light of the Shariah guidelines.
- All the provisions of the scheme and investments made on account of MCB IIF by Management Company are Shariah Complaint and in accordance with the criteria established.
- On the basis of information provided by the Management Company, all the operations of MCB-IIF for period from July 01, 2012 to June 30, 2012 have been in compliance with the Shariah principles.

May Allah bless us with Tawfeeq to accomplish these cherished tasks, make us successful in this world and in the hereafter, and forgive our mistakes.

Karachi: August 15, 2012

**Dr Muhammad Zubair Usmani**  
Shariah Advisor

# MCB ISLAMIC INCOME FUND

## STATEMENT OF THE COMPLIANCE WITH THE CODE OF CORPORATE GOVERNANCE FOR THE YEAR ENDED JUNE 30, 2012

This statement is being presented by the Board of Directors of Arif Habib Investments Limited ("the Management Company"), the Management Company of MCB Islamic Income Fund ("the Fund") to comply with the Code of Corporate Governance contained in Listing Regulations of Lahore Stock Exchange for the purpose of establishing a framework of good governance, whereby a listed company is managed in compliance with the best practices of corporate governance.

MCB Islamic Income Fund is an open end mutual fund and is listed at Lahore Stock Exchange. The Fund, being a unit trust scheme, does not have its own Board of Directors. The Management Company, Arif Habib Investments Limited, on behalf of the Fund, has applied the principles contained in the Code in the following manner:

1. The Management Company encourages representation of independent non-executive directors on its Board of Directors. At present the Board includes

Category	Names
Independent Directors	1. Dr. Salman Shah 2. Mr. Haroun Rashid 3. Mr. Mirza Mehmood
Executive Directors	1. Mr. Nasim Beg - Executive Vice Chairman 2. Mr. Yasir Qadri - Chief Executive Officer
Non - Executive Directors	1. Mian Mohammad Mansha 2. Mr. Ahmed Jehangir 3. Mr. Samad Habib

The independent directors meets the criteria of independence under clause i (b) of the Code.

2. The directors have confirmed that none of them is serving as a director in more than ten listed companies, including the Management Company.
3. All the resident directors of the Management Company are registered as taxpayers and none of them has defaulted in payment of any loan to a banking company, a DFI or an NBFIs, or, being a member of a stock exchange, has been declared as a defaulter by that stock exchange.
4. During the period no casual vacancy occurred on the board of the Management Company
5. The Management Company had prepared a 'Code of Conduct' and ensured that appropriate steps had been taken to disseminate it throughout the company along with its supporting policies and procedures.
6. The Board has developed vision / mission statement, overall corporate strategy and significant policies of the Management Company. A complete record of particulars of significant policies along with the dates on which they were approved or amended has been maintained.
7. All the powers of the Board have been duly exercised and decisions on material transactions, including appointment and determination of remuneration and terms and conditions of employment of the Chief Executive Officer, other executive and non-executive directors, have been taken by the Board. No new appointment of Chief Executive Officer, other executive and non-executive directors were made during the year.
8. The meetings of the Board were presided over by the Chairman and, in his absence, by a director elected by the Board for this purpose and the Board met at least once in every quarter. Written notices of the Board meetings, along with agenda and working papers, were circulated at least seven days before the meetings. The minutes of the meetings were appropriately recorded and circulated.
9. As required by the Code, all the directors of the Management Company will attend the training Program for directors by the year 2016. Currently, two of the directors are exempt from obtaining mandatory training having the requisite qualification and experience. Accordingly, the Management Company is compliant with this requirement for the current year. Further Directors' have also being briefed about the recent changes made in laws and regulations to enable them to effectively manage the affairs of the management company.
10. No new appointments of Chief Financial Officer and Company Secretary were made during the year. The Board has approved the remuneration and terms and conditions of employment, as determined by the Chief Executive Officer. Subsequent to the year end, the Management Company has appointed Head of Internal Audit who is also planned to be designated as the secretary to the Audit Committee in the upcoming Audit Committee meeting.
11. The Directors' Report of the fund for the year ended June 30, 2012 has been prepared in compliance with the requirements of the Code and fully describes the salient matters required to be disclosed.
12. The financial statements of the Fund were duly endorsed by Chief Executive Officer and Chief Financial Officer of the Management Company before approval of the Board.
13. The Directors, Chief Executive Officer and executives of the Management Company do not hold any interest in the units of the Fund other than that disclosed in the pattern of unit holding.
14. The Management Company has complied with all the corporate and financial reporting requirements of the Code.

**MCB ISLAMIC INCOME FUND  
STATEMENT OF THE COMPLIANCE WITH THE CODE OF CORPORATE GOVERNANCE  
FOR THE YEAR ENDED JUNE 30, 2012**

15. The Board has formed an Audit Committee for the Management Company. It comprises of four members, three of whom are the directors of the Management Company. Two are non-executive directors and the Chairman of the Committee is an independent director.
16. The meetings of the audit committee were held at least once every quarter prior to approval of the interim and final results of the Fund and as required by the Code. The terms of reference of the committee have been approved by the Board and advised to the committee for compliance.
17. The Board has formed an HR and Remuneration Committee. It comprises four members, of whom two are non-executive directors and the chairman of the committee is an independent director.
18. During the year, the Management Company has outsourced the internal audit function to Ernst & Young Ford Rhodes Sidat Hyder & Co. Chartered Accountants who are considered to be suitably qualified and experienced for the purpose and is conversant with the policies and procedures of the Management Company.
19. The statutory auditors of the Fund have confirmed that they have been given a satisfactory rating under the quality control review program of the Institute of Chartered Accountants of Pakistan (ICAP), that they or any of the partners of the firm, their spouses and minor children do not hold shares of the Company and units of the fund. The firm and all its partners are also in compliance with International Federation of Accountants guidelines on code of ethics as adopted by ICAP.
20. The statutory auditors or the persons associated with them have not been appointed to provide other services except in accordance with the listing regulations and the auditors have confirmed that they have observed International Federation of Accountants guidelines in this regard.
21. The 'closed period', prior to the announcement of interim/final results, and business decisions, which may materially affect the market price of company's securities and Fund's unit, was determined and intimated to directors, employees and stock exchange(s).
22. Material/price sensitive information has been disseminated among all market participants at once through stock exchange(s).
23. We confirm that all other material principles enshrined in the Code have been complied with towards which reasonable progress is being made by the company to seek compliance by the end of next accounting year.

On behalf of the Board

**Yasir Qadri**  
Chief Executive Officer

Karachi: August 15, 2012

**MCB ISLAMIC INCOME FUND  
REVIEW REPORT TO THE UNIT HOLDERS ON THE  
STATEMENT OF COMPLIANCE WITH THE BEST PRACTICES  
OF THE CODE OF CORPORATE GOVERNANCE  
FOR THE YEAR ENDED JUNE 30, 2012**



**A. F. FERGUSON & CO.**

**REVIEW REPORT TO THE UNIT HOLDERS ON THE STATEMENT OF COMPLIANCE  
WITH THE BEST PRACTICES OF THE CODE OF CORPORATE GOVERNANCE**

We have reviewed the Statement of Compliance with the best practices contained in the Code of Corporate Governance prepared by the Board of Directors of **Arif Habib Investments Limited**, the Management Company of **MCB Islamic Income Fund**, to comply with the Listing Regulation No. 35 (Chapter XI) of the Lahore Stock Exchange where the Fund is listed.

The responsibility for compliance with the Code of Corporate Governance is that of the Board of Directors of the Management Company. Our responsibility is to review, to the extent where such compliance can be objectively verified, whether the Statement of Compliance reflects the status of the Fund's compliance with the provisions of the Code of Corporate Governance and report if it does not. A review is limited primarily to inquiries of the Company's personnel and review of various documents prepared by the Company to comply with the Code.

As part of our audit of the financial statements, we are required to obtain an understanding of the accounting and internal control systems sufficient to plan the audit and develop an effective audit approach. We have not carried out any special review of the internal control system to enable us to express an opinion as to whether the Board's statement on internal control covers all controls and the effectiveness of such internal controls.

Regulation 35 (x) of the Listing Regulations requires the Management Company to place before the Board of Directors for their consideration and approval, related party transactions distinguishing between transactions carried out on terms equivalent to those that prevail in arm's length transactions and transactions which are not executed at arm's length price recording proper justification for using such alternate pricing mechanism. Further, all such transactions are also required to be separately placed before the audit committee. We are only required and have ensured compliance of the above requirements to the extent of approval of related party transactions by the Board of Directors and placement of such transactions before the Audit Committee. We have not carried out any procedures to determine whether the related party transactions were undertaken at arm's length prices or not.

Based on our review, nothing has come to our attention, which causes us to believe that the Statement of Compliance does not appropriately reflect the Management Company's compliance for and on behalf of the Fund, in all material respects, with the best practices contained in the Code of Corporate Governance as applicable to the Fund for the year ended June 30, 2012.

We draw attention to paragraph 10 of the annexed statement which highlights that subsequent to the year end the Management Company has appointed the Head of Internal Audit who is also planned to be designated as the secretary to the Audit Committee in the upcoming Audit Committee meeting.

  
Chartered Accountants

Karachi

Dated: September 17, 2012

A. F. FERGUSON & CO., Chartered Accountants, a member firm of the PwC network  
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**MCB ISLAMIC INCOME FUND  
INDEPENDENT AUDITOR'S REPORT TO THE UNIT HOLDERS  
FOR THE YEAR ENDED JUNE 30, 2012**



**A. F. FERGUSON & CO.**

**INDEPENDENT AUDITORS' REPORT TO THE UNIT HOLDERS**

**REPORT ON THE FINANCIAL STATEMENTS**

We have audited the accompanying financial statements of **MCB Islamic Income Fund (here in after referred to as "the Fund")**, which comprise the statement of assets and liabilities as at June 30, 2012, and the related income statement, distribution statement, statement of movement in unit holders' fund and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

**Management Company's responsibility for the financial statements**

The Management Company is responsible for the preparation and fair presentation of these financial statements in accordance with approved accounting standards as applicable in Pakistan, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the International Standards on Auditing as applicable in Pakistan. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the financial statements give a true and fair view of the financial position of the Fund as at June 30, 2012, and of its financial performance, cash flows and transactions for the year then ended in accordance with approved accounting standards as applicable in Pakistan.

**REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

In our opinion, the financial statements have been prepared in all material respects in accordance with the relevant provisions of the Non-Banking Finance Companies and Notified Entities Regulations, 2008.

  
Chartered Accountants

Engagement Partner: **Salman Hussain**

Dated: September 17, 2012

Karachi

A. F. FERGUSON & CO., Chartered Accountants, a member firm of the PwC network  
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# **FINANCIAL STATEMENTS**

**MCB ISLAMIC INCOME FUND  
STATEMENT OF ASSETS AND LIABILITIES  
AS AT JUNE 30, 2012**

	Note	2012 ----- Rupees in '000 -----	2011 ----- Rupees in '000 -----
<b>ASSETS</b>			
Bank balances	4	464,118	79,505
Investments	5	1,025,522	100,250
Profit and other receivable	6	19,989	2,491
Prepayments		101	-
Preliminary expenses and floatation costs	7	792	993
<b>Total assets</b>		1,510,522	183,239
<b>LIABILITIES</b>			
Payable to the Management Company	8	2,380	1,599
Payable to the Trustee	9	171	20
Payable to the Securities and Exchange Commission of Pakistan	10	534	4
Accrued expenses and other liabilities	11	665	59
<b>Total liabilities</b>		3,750	1,682
<b>NET ASSETS</b>		<u>1,506,772</u>	<u>181,557</u>
<b>UNIT HOLDERS' FUND (AS PER STATEMENT ATTACHED)</b>		<u>1,506,772</u>	<u>181,557</u>
<b>CONTINGENCIES AND COMMITMENTS</b>			
	12		
		----- Number of units-----	
<b>NUMBER OF UNITS IN ISSUE</b>		<u>15,052,815</u>	<u>1,810,991</u>
		-----Rupees-----	
<b>NET ASSET VALUE PER UNIT</b>	3.12	<u>100.10</u>	<u>100.25</u>
<b>FACE VALUE PER UNIT</b>		<u>100.00</u>	<u>100.00</u>

The annexed notes 1 to 27 form an integral part of these financial statements.

  
\_\_\_\_\_  
Chief Executive Officer

For Arif Habib Investments Limited  
(Management Company)

  
\_\_\_\_\_  
Director

**MCB ISLAMIC INCOME FUND  
INCOME STATEMENT  
FOR THE YEAR ENDED JUNE 30, 2012**

	Note	For the year ended June 30, 2012	For the period from May 1, 2011 to June 30, 2011
----- Rupees in '000 -----			
<b>INCOME</b>			
Profit on bank deposits		24,807	465
Net gain on sale of investments		760	-
Income from government securities		58,493	111
Amortisation of premium on ijarah sukuks		(1,165)	-
		<b>82,895</b>	<b>576</b>
Net unrealised diminution on re-measurement of investments classified as financial assets at 'fair value through profit or loss	5.1.2	<b>(4,674)</b>	-
<b>Total income</b>		<u>78,221</u>	<u>576</u>
<b>EXPENSES</b>			
Remuneration of the Management Company		7,768	51
Sindh sales tax on remuneration of the Management Company		1,243	-
Remuneration of the Trustee		1,144	20
Annual fee - Securities and Exchange Commission of Pakistan	10.1	534	4
Amortisation of preliminary expenses and floatation costs	7.1	201	7
Auditors' remuneration	13	624	50
Brokerage and settlement charges		30	-
Other expenses		354	23
<b>Total expenses</b>		11,898	155
<b>Net income from operating activities</b>		<u>66,323</u>	<u>421</u>
Net element of income and capital gains included in the prices of units issued less those in units redeemed		<b>32,474</b>	46
Provision for Workers' Welfare Fund	11.1	<b>(73)</b>	(9)
<b>Net income for the year / period before taxation</b>		<u>98,724</u>	<u>458</u>
Taxation	14	-	-
<b>Net income for the year / period after taxation</b>		<u>98,724</u>	<u>458</u>
Other comprehensive income for the year / period		-	-
<b>Total comprehensive income for the year / period</b>		<u><u>98,724</u></u>	<u><u>458</u></u>
<b>Earning per unit</b>	15		

The annexed notes 1 to 27 form an integral part of these financial statements.

  
\_\_\_\_\_  
Chief Executive Officer

For Arif Habib Investments Limited  
(Management Company)

  
\_\_\_\_\_  
Director

**MCB ISLAMIC INCOME FUND  
DISTRIBUTION STATEMENT  
FOR THE YEAR ENDED JUNE 30, 2012**

	For the year ended June 30, 2012	For the period from May 1, 2011 to June 30, 2011
	----- Rupees in '000 -----	
<b>Undistributed income brought forward</b>		
- Realised income	458	-
- Unrealised income	-	-
	458	-
Final distribution for the year ended June 30, 2011		
Rs 0.2532 per unit declared on July 4, 2011		
Issue of bonus units	(458)	-
Net income for the year / period after taxation	98,724	458
<b>Interim distributions during the year / period</b>		
Rs 6.4087 per unit declared on January 26, 2012		
- Issue of bonus units	(49,680)	-
- Cash distribution	(248)	-
Rs 1.3000 per unit declared on March 28, 2012		
- Issue of bonus units	(13,532)	-
- Cash distribution	(50)	-
Final distribution for the year ended June 30, 2012		
Rs 2.3242 per unit declared on June 25, 2012		
- Issue of bonus units	(33,630)	-
- Cash distribution	(93)	-
Undistributed income carried forward	1,491	458
<b>Undistributed income comprising</b>		
Realised income	6,165	458
Unrealised (loss)	(4,674)	-
	1,491	458

The annexed notes 1 to 27 form an integral part of these financial statements.

  
\_\_\_\_\_  
Chief Executive Officer

For Arif Habib Investments Limited  
(Management Company)

  
\_\_\_\_\_  
Director

**MCB ISLAMIC INCOME FUND  
STATEMENT OF MOVEMENT IN UNIT HOLDERS' FUND  
FOR THE YEAR ENDED JUNE 30, 2012**

	For the year ended June 30, 2012	For the period from May 1, 2011 to June 30, 2011
	----- Rupees in '000 -----	
<b>Net assets at the beginning of the year / period</b>	181,557	-
Issue of 17,519,167 units (2011: 1,780,843 units)	1,792,006	181,145
Issue of 972,679 bonus units (2011: Nil units)	97,300	-
Redemption of 5,250,022 units (2011: Nil units)	(532,650)	-
	1,356,656	181,145
Net element of income and capital gains included in the prices of units issued less those in units redeemed	(32,474)	(46)
Net unrealised diminution on re-measurement of investments classified as financial assets at 'fair value through profit or loss	(4,674)	-
Net gain on sale of investments	760	-
Other income (net of expenses) for the year / period	102,638	458
	98,724	458
<b>Final distribution for the year ended june 30, 2011</b> (Rs 0.2532 per unit declared on July 4, 2011)		
Issue of bonus units	(458)	-
<b>Interim distributions during the year / period</b>		
Rs 6.4087 per unit declared on January 26, 2012		
- Issue of bonus units	(49,680)	-
- Cash distribution	(248)	-
Rs 1.3000 per unit declared on March 28, 2012		
- Issue of bonus units	(13,532)	-
- Cash distribution	(50)	-
<b>Final distribution for the year ended june 30, 2012</b> Rs 2.3242 per unit declared on June 25, 2012		
- Issue of bonus units	(33,630)	-
- Cash distribution	(93)	-
	(97,691)	-
<b>Net assets at the end of the year / period</b>	1,506,772	181,557

The annexed notes 1 to 27 form an integral part of these financial statements.

  
\_\_\_\_\_  
Chief Executive Officer

**For Arif Habib Investments Limited  
(Management Company)**

  
\_\_\_\_\_  
Director

**MCB ISLAMIC INCOME FUND  
CASH FLOW STATEMENT  
FOR THE YEAR ENDED JUNE 30, 2012**

	Note	For the year ended June 30, 2012	For the period from May 1, 2011 to June 30, 2011
----- Rupees in '000 -----			
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income for the year / period before taxation		98,724	458
<b>Adjustments for non-cash charges and other items</b>			
Net gain on sale of investments		(760)	-
Amortisation of preliminary expenses and floatation costs		201	7
Net element of income and capital gains included in the prices of units issued less those in units redeemed		(32,474)	(46)
		<u>65,691</u>	<u>419</u>
<b>Increase in assets</b>			
Investments - net		(924,512)	(100,250)
Profit and other receivable		(17,498)	(2,491)
Prepayments		(101)	-
		<u>(942,111)</u>	<u>(102,741)</u>
<b>Increase in liabilities</b>			
Payable to the Management Company		781	599
Payable to the Trustee		151	20
Payable to the Securities and Exchange Commission of Pakistan		530	4
Accrued expenses and other liabilities		606	59
		<u>2,068</u>	<u>682</u>
<b>Net cash used in operating activities</b>		<u>(874,352)</u>	<u>(101,640)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Receipts from issue of units		1,792,006	181,145
Payments on redemption of units		(532,650)	-
Dividends paid		(391)	-
<b>Net cash generated from financing activities</b>		<u>1,258,965</u>	<u>181,145</u>
<b>Net increase in cash and cash equivalents during the year / period</b>		<u>384,613</u>	<u>79,505</u>
Cash and cash equivalents at the beginning of the year / period		79,505	-
<b>Cash and cash equivalents at the end of the year / period</b>	4	<u><u>464,118</u></u>	<u><u>79,505</u></u>

The annexed notes 1 to 27 form an integral part of these financial statements.

  
\_\_\_\_\_  
Chief Executive Officer

For Arif Habib Investments Limited  
(Management Company)

  
\_\_\_\_\_  
Director

# MCB ISLAMIC INCOME FUND

## NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

### FOR THE YEAR ENDED JUNE 30, 2012

#### 1 LEGAL STATUS AND NATURE OF BUSINESS

1.1 MCB Islamic Income Fund (the Fund) was established under a trust deed executed between MCB Asset Management Company Limited as the Management Company, a company incorporated under the Companies Ordinance, 1984 and Central Depository Company of Pakistan Limited (CDC) as the Trustee. The Trust Deed was approved by the Securities and Exchange Commission of Pakistan on January 25, 2011 and was executed on March 7, 2011.

1.2 Based on shareholders' resolutions of MCB-Asset Management Company Limited and Arif Habib Investments Limited the two Companies have merged as of June 27, 2011 through operation of an order from the SECP issued under section 282L of the Companies Ordinance 1984 (Order through letter No.SCD/NBFC-II/MCBAMCL and AHIL / 271/ 2011 dated June 10, 2011). Arif Habib Investments being a listed Company, was the surviving entity and in compliance of SBP's approval, it became a subsidiary of MCB Bank Limited. However, subsequent to the completion of the merger, the SECP issued an order postponing the effective date of the merger to July 30, 2011 (through letter No.SCD/PR and DD/AMCW/MCB-AMCL and AHI/348/2011 dated June 27, 2011). Since the merger had already taken place and the subsequent order of the SECP could not be complied with, the Company has sought a ruling by the Honorable Sindh High Court (SHC). The honorable SHC held the SECP's subsequent order in abeyance and instructed SECP to treat the companies as merged pending a final ruling. Irrespective of the final ruling, the Fund's assets and NAV remain unaffected.

The Management Company of the Fund has been licensed to act as an Asset Management Company under the NBFC Rules through a certificate of registration issued by the SECP. The registered office of the management company is situated at 8th Floor, Techno City Corporate Tower, Hasrat Mohani Road, Karachi.

1.3 The Fund has been categorised as an open-end Shariah Compliant (Islamic) Income Scheme and offers units for public subscription on a continuous basis. The units of the Fund are transferable and can also be redeemed by surrendering them to the Fund. The Fund is listed on the Lahore Stock Exchange.

1.4 According to paragraph 19.3 of the Trust Deed, the first accounting period of the Fund shall commence from the date on which the trust property is first paid or transferred to the trustee i.e. May 01, 2011.

1.5 The objective of the Fund is to seek to generate superior risk adjusted returns by investing in short, medium and long-term high quality Shariah Compliant fixed income instruments.

1.6 Title to the assets of the Fund is held in the name of Central Depository Company of Pakistan Limited as Trustee of the Fund.

1.7 The Pakistan Credit Rating Agency (PACRA) Limited has assigned an asset manager rating of 'AM2' to the Management Company and a stability rating of AA-(f) to the Fund.

#### 2 BASIS OF PREPARATION

##### 2.1 Statement of compliance

These financial statements have been prepared in accordance with approved accounting standards as applicable in Pakistan. Approved accounting standards comprise of such International Financial Reporting Standards IFRs issued by the International Accounting Standards Board as are notified under the Companies Ordinance, 1984, the requirements of the Trust Deed, the Non-Banking Finance Companies (Establishment and Regulation) Rules, 2003 (the NBFC Rules), the Non-Banking Finance Companies and Notified Entities Regulations, 2008 (the NBFC Regulations) and directives issued by the Securities and Exchange Commission of Pakistan (SECP). Wherever the requirements of the Trust Deed, the NBFC Rules, the NBFC Regulations or directives issued by the SECP differ with the requirements of IFRSs, the requirements of the Trust Deed, the NBFC Rules, the NBFC Regulations or the directives issued by the SECP prevail.

##### 2.2 Standards, interpretations and amendments to published approved accounting standards that are effective in the current year

The following standards, amendments and interpretations to approved accounting standards have been published and are mandatory for the Fund's accounting period beginning on or after July 1, 2011:

- a) IFRS 7, 'Financial Instruments: Disclosures'. This amendment is effective from January 1, 2011. The amendment emphasises the interaction between quantitative and qualitative disclosures about the nature and extent of risks associated with financial instruments. The amendment did not have any significant impact on the Fund's financial statements during the current year.

# MCB ISLAMIC INCOME FUND

## NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

### FOR THE YEAR ENDED JUNE 30, 2012

- b) IFRS 7, 'Financial instruments: Disclosures'. This amendment is effective from July 1, 2011. The amendment aims to promote transparency in the reporting of transfer transactions and improve users' understanding of the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position, particularly those involving securitisation of financial assets. The amendment does not have any impact on the Fund's financial statements during the current year.
- c) IAS 1, 'Presentation of financial statements' (effective January 1, 2011). The amendment clarifies that an entity will present an analysis of other comprehensive income for each component of equity, either in the statement of changes in equity or in the notes to the financial statements. The amendment does not have any impact on the Fund's financial statements during the current year.
- d) IAS 24 (revised), 'Related party disclosures', issued in November 2009. It superseded IAS 24, 'Related Party Disclosures', issued in 2003. IAS 24 (revised) is mandatory for periods beginning on or after January 1, 2011. The revised standard clarifies and simplifies the definition of a related party and removes the requirement for government-related entities to disclose details of all transactions with the government and other government-related entities. The revised standard does not have any impact on the Fund's financial statements.

There are other new and amended standards and interpretations that are mandatory for accounting periods beginning on or after July 1, 2011 but are considered not to be relevant or do not have any significant effect on the Fund's operations and are therefore not detailed in these financial statements.

#### 2.3 Standards, interpretations and amendments to published approved accounting standards that are not yet effective

The following revised standard has been published and is mandatory for accounting periods beginning on or after July 1, 2012:

- a) IAS 1, 'Financial statement presentation' (effective July 1, 2012). The main change resulting from these amendments is a requirement for entities to group items presented under 'other comprehensive income' (OCI) in the Income statement on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments). The amendment will not have any significant effect on the Fund's financial statements.
- b) IAS 32, 'Financial instruments: Presentation', (effective January 1, 2014). This amendment clarifies some of the requirements for offsetting financial assets and financial liabilities on the balance sheet. The management of the Fund is in the process of assessing the impact of this amendment on the Fund's financial statements.

There are other new and amended standards and interpretations that are mandatory for accounting periods beginning on or after July 1, 2012 but are considered not to be relevant or do not have any significant effect on the Fund's operations and are, therefore, not detailed in these financial statements.

#### 2.4 Critical accounting estimates and judgements

The preparation of financial statements in conformity with the approved accounting standards requires the management to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities, income and expenses. It also requires the management to exercise judgment in application of its accounting policies. The estimates, judgments and associated assumptions are based on the management's experience and various other factors that are believed to be reasonable under the circumstances. These estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of revision and future periods if the revision affects both current and future periods.

The areas involving a higher degree of judgement or complexity, or areas where estimates and assumptions are significant to the financial statements are as follows:

- i) classification and valuation of financial assets (notes 3.2 and 5);
- ii) amortisation of preliminary expenses and floatation costs (notes 3.6 and 7)

#### 2.5 Accounting convention

These financial statements have been prepared under the historical cost convention except for certain investments which are carried at fair value in accordance with the requirements of International Accounting Standard (IAS 39) : 'Financial Instruments: Recognition and Measurement.'

# **MCB ISLAMIC INCOME FUND**

## **NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**

### **FOR THE YEAR ENDED JUNE 30, 2012**

#### **2.6 Functional and presentation currency**

These financial statements are presented in Pakistani Rupees which is the Fund's functional and presentation currency.

#### **3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied unless otherwise stated.

##### **3.1 Cash and cash equivalents**

Cash and cash equivalents comprise bank balances and short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried in the statement of assets liabilities at cost.

##### **3.2 Financial assets**

###### **3.2.1 Classification**

The Fund classifies its financial assets either as 'financial assets at fair value through profit or loss' or as 'loans and receivables'. The classification depends on the purpose for which the financial assets were acquired. Management determines the appropriate classification of its financial assets at initial recognition and re-evaluates this classification on a regular basis.

###### **a) Financial assets at fair value through profit or loss**

Financial assets that are acquired principally for the purpose of generating profits from short-term fluctuations in prices are classified as held for trading in the 'financial assets at fair value through profit or loss' category.

###### **b) Loans and receivables**

These are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

###### **3.2.2 Regular way contracts**

Regular purchases and sales of financial assets are recognised on the trade date - the date on which the Fund commits to purchase or sell the asset.

###### **3.2.3 Initial recognition and measurement**

Financial assets are initially recognised at fair value plus transaction costs except for financial assets carried at fair value through profit or loss. Financial assets carried 'at fair value through profit or loss' are initially recognised at fair value and transaction costs are expensed in the Income Statement.

###### **3.2.4 Subsequent measurement**

###### **a) Financial assets 'at fair value through profit or loss'**

###### **Basis of valuation of government securities**

The investment of the Fund in government securities is subsequently stated at fair value which is determined on the basis of rates announced by the Financial Market Association of Pakistan in accordance with the requirements of the NBFC Regulations, 2008.

Net gains and losses arising on changes in the fair value of financial assets carried at fair value through profit or loss are taken to the Income Statement.

###### **b) Loans and receivables**

Subsequent to initial recognition financial assets classified as 'loans and receivables' are carried at amortised cost using the effective interest method.

Gain or loss is also recognised in the Income Statement when financial assets carried at amortised cost are derecognised or impaired.

# **MCB ISLAMIC INCOME FUND**

## **NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**

### **FOR THE YEAR ENDED JUNE 30, 2012**

#### **3.2.5 Impairment**

The carrying value of the Fund's assets are reviewed at each reporting date to determine whether there is any indication of impairment. If such an indication exists, the recoverable amount of such asset is estimated. An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in the Income Statement.

Provision for non-performing exposures is made in accordance with the criteria specified in circular 1 dated January 6, 2009 and circular 13 dated May 4, 2009 issued by SECP. The provisioning policy has been duly formulated and approved by the Board of Directors of the Management Company.

#### **3.2.6 Derecognition**

Financial assets are derecognised when the right to receive cash flows from the financial assets have expired or have been transferred and the Fund has transferred substantially all risks and rewards of ownership.

#### **3.3 Derivatives**

Derivative instruments are initially recognised at fair value and subsequent to initial measurement each derivative instrument is remeasured to its fair value and the resultant gain or loss is recognised in the Income Statement.

#### **3.4 Financial liabilities**

All financial liabilities are recognised at the time when the Fund becomes a party to the contractual provisions of the instrument. They are initially recognised at fair value and subsequently stated at amortised cost.

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or has been expired.

#### **3.5 Offsetting of financial assets and financial liabilities**

Financial assets and financial liabilities are offset and the net amount is reported in the 'Statement of Assets and Liabilities' when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously.

#### **3.6 Preliminary expenses and floatation costs**

Preliminary expenses and floatation costs represent expenditure incurred prior to the commencement of operations of the Fund. These costs are being amortised over a period of five years commencing from June 19, 2011, as per the requirements of the Trust Deed of the Fund and NBFC Regulations, 2008.

#### **3.7 Provisions**

Provisions are recognised when the Fund has a present, legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the obligation can be made. Provisions are regularly reviewed and adjusted to reflect the current best estimate.

#### **3.8 Taxation**

The income of the Fund is exempt from income tax under clause 99 of Part I of the Second Schedule to the Income Tax Ordinance, 2001 subject to the condition that not less than ninety percent of its accounting income for the year, as reduced by capital gains, whether realised or unrealised, is distributed among the unit holders.

The Fund is also exempt from the provisions of section 113 (minimum tax) under clause 11A of Part IV of the Second Schedule to the Income Tax Ordinance, 2001.

# **MCB ISLAMIC INCOME FUND**

## **NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**

### **FOR THE YEAR ENDED JUNE 30, 2012**

The Fund provides for deferred taxation using the balance sheet liability method on all major temporary differences between the amounts used for financial reporting purposes and amounts used for taxation purposes. In addition, the Fund also records deferred tax asset on unutilised tax losses to the extent that it is no longer probable that the related tax benefit will be realised. However, the Fund has not recognised any amount in respect of deferred tax in these financial statements as the Fund intends to continue availing the tax exemption in future years by distributing at least ninety percent of its accounting income for the year as reduced by capital gains, whether realised or unrealised, to its unit holders every year.

#### **3.9 Proposed distributions**

Distributions declared subsequent to the reporting date are considered as non-adjusting events and are recognised in the financial statements in the period in which such distributions are declared.

#### **3.10 Issue and redemption of units**

Units issued are recorded at the offer price as per constitutive documents, determined by the Management Company for the applications received by the distributors during business hours of that date. The offer price represents the net asset value per unit as of the close of the business day when the funds are realised, plus the allowance of any front-end load, any provision for transaction costs and any provision for duties and charges, if applicable.

Units redeemed are recorded at the redemption price as per constitutive documents, applicable to units for which the distributors receive redemption applications during business hours of that day. The redemption price represents the net asset value per unit as of the close of the business day less any back-end load, any duties, taxes, charges on redemption and any provision for transaction costs, if applicable.

#### **3.11 Element of income / (loss) and capital gains / (losses) included in prices of units issued less those in units redeemed**

An equalisation account called the 'element of income / (loss) and capital gains / (losses) included in prices of units issued less those in units redeemed' is created, in order to prevent the dilution income of per unit and distribution of income already paid out on redemption.

The Fund records that portion of the net element of income / (loss) and capital gains / (losses) relating to units issued and redeemed during an accounting period which pertains to unrealised gains / (losses) held in the Unit Holders' Funds in a separate reserve account and any amount remaining in this reserve account at the end of an accounting period (whether gain or loss) is included in the amount available for distribution to the unit holders. The remaining portion of the net element of income / (loss) and capital gains / (losses) relating to units issued and redeemed during an accounting period is recognised in the Income Statement.

#### **3.12 Net asset value per unit**

The Net Asset Value per unit as disclosed on the Statement of Assets and Liabilities is calculated by dividing the net assets of the Fund by the number of units in circulation at the year / period end.

#### **3.13 Revenue recognition**

- Realised capital gains / (losses) arising on sale of investments are included in the Income Statement on the date at which the transaction takes place.
- Income on issue and repurchase of units is recognised when units are issued and redeemed at the transaction date.
- Unrealised gains / (losses) arising on re-measurement of investments classified as financial assets 'at fair value through profit or loss' are included in the income statement in the period in which they arise.
- Profit on bank deposits is recognised on an accrual basis.
- Income on government securities is recognised on an accrual basis.

#### **3.14 Foreign currency translation**

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the Income Statement.

**MCB ISLAMIC INCOME FUND**  
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		Note	2012	2011
			----- Rupees in '000 -----	
<b>4</b>	<b>BANK BALANCES</b>			
	In current account		11,858	-
	In savings accounts	4.1	<u>452,260</u>	<u>79,505</u>
			<u><b>464,118</b></u>	<u><b>79,505</b></u>

4.1 These carry mark-up at rates ranging from 6% to 11.60% (2011: 5% to 13.2%) per annum.

		Note	2012	2011
			----- Rupees in '000 -----	
<b>5</b>	<b>INVESTMENTS</b>			
	Financial assets 'at fair value through profit or loss'			
	Investment in government securities - GoP ijara sukuks	5.1	<u><b>1,025,522</b></u>	<u><b>100,250</b></u>

5.1 Investment in government securities - GoP ijara sukuks

Issue Date	Tenor	Face value			Balance as at June 30, 2012			Appreciation/ (Diminution)	Market value as a percentage of net assets	Market value as a percentage of total investment
		As at July 1, 2011	Purchased during the year	Disposed / matured during the year	As at June 30, 2012	Carrying Value	Market Value			
----- (Rupees in '000) -----										
15-Nov-10	3 Years	-	777,000	79,500	697,500	701,005	697,849	(3,156)	46.31%	68.05%
16-May-11	3 Years	100,000	374,000	194,000	280,000	281,691	280,140	(1,551)	18.59%	27.32%
26-Dec-11	3 Years	-	47,500	-	47,500	47,500	47,533	33	3.15%	4.63%
29-Dec-08	3 Years	-	150,000	150,000	-	-	-	-	-	0.00%
17-Sep-09	3 Years	-	15,000	15,000	-	-	-	-	-	0.00%
<b>Total</b>		<b>100,000</b>	<b>1,363,500</b>	<b>438,500</b>	<b>1,025,000</b>	<b>1,030,196</b>	<b>1,025,522</b>	<b>(4,674)</b>	<b>68.05%</b>	<b>100%</b>

5.1.1 The Ijara sukuks carry profit rates ranging between 11.9366% and 11.9405% (2011: 13.45%) and are maturing on various dates latest by December 26, 2014 (2011: May 16, 2014)

		Note	2012	2011
			----- Rupees in '000 -----	
5.1.2	Net unrealised diminution on the re-measurement of the investments classified as financial assets at 'fair value through profit or loss'			
	Market value of investments	5.1	<u><b>1,025,522</b></u>	100,250
	Less: Carrying value of investments		<u><b>1,030,196</b></u>	<u>100,250</u>
			<u><b>(4,674)</b></u>	<u>-</u>

**6 PROFIT RECEIVABLE**

	Profit accrued on saving deposits		4,973	795
	Income on Ijara Sukuks		<u><b>15,016</b></u>	<u>1,696</u>
			<u><b>19,989</b></u>	<u>2,491</u>

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	Note	2012	2011
----- Rupees in '000 -----			
<b>7</b>	<b>PRELIMINARY EXPENSES AND FLOATATION COSTS</b>		
	Opening balance	993	-
	Preliminary expenses and floatation costs incurred	-	1,000
	Less: amortisation for the year / period	7.1 <u>201</u>	<u>7</u>
	Closing balance	<u>792</u>	<u>993</u>

**7.1** Preliminary expenses and floatation costs represent expenditure incurred prior to the commencement of operations of the Fund. and are being amortised over a period of five years commencing from June 19, 2011 as per the requirements set out in the Trust Deed of the Fund.

	Note	2012	2011
----- Rupees in '000 -----			
<b>8</b>	<b>PAYABLE TO THE MANAGEMENT COMPANY</b>		
	Remuneration of the Management Company	8.1 <u>1,254</u>	51
	Sindh Sales Tax on Management Company's remuneration	8.2 <u>201</u>	-
	Preliminary expenses and floatation costs	-	1,000
	Sales load payable	<u>925</u>	145
	Others	<u>-</u>	<u>403</u>
		<u>2,380</u>	<u>1,599</u>

**8.1** Under the provisions of the Non-Banking Finance Companies and Notified Entities Regulations, 2008, the Management Company of the Fund is entitled to a remuneration during the first five years of the Fund, of an amount not exceeding three percent of the average annual net assets of the Fund and, thereafter, of an amount equal to two percent of such assets of the Fund. The Management Company has charged remuneration at the rate of 10% of the gross earnings of the Fund. This fee is subject to a minimum of 0.25% of the average daily net assets of the Fund not exceeding the maximum rate of remuneration permitted under the NBFC Regulations. The remuneration is paid monthly in arrears.

**8.2** During the current year, the provincial government has levied Sindh Sales Tax at the rate of 16% on the remuneration of the Management Company through the Sindh Sales Tax on Services Act, 2011 effective from July 1, 2011.

	Note	2012	2011
----- Rupees in '000 -----			
<b>9</b>	<b>PAYABLE TO THE TRUSTEE</b>		
	Trustee fee	9.1 <u>171</u>	<u>20</u>

**9.1** The Trustee is entitled to a monthly remuneration for services rendered to the Fund under the provisions of the Trust Deed as per the tariff specified therein, based on the daily net asset value of the Fund.

Based on the Trust Deed, the tariff structure applicable to the Fund as at June 30, 2012 is as follows:

Net Assets	Tariff per annum
Upto Rs 1 billion	Rs 0.6 million or 0.17 percent per annum of NAV whichever is higher
Rs 1 billion to Rs 5 billion	Rs 1.7 million plus 0.085 percent per annum of NAV exceeding Rs 1 billion
Over Rs 5 billion	Rs 5.1 million plus 0.07 percent per annum of NAV exceeding Rs 5 billion

	Note	2012	2011
----- Rupees in '000 -----			
<b>10</b>	<b>PAYABLE TO THE SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN</b>		
	Annual Fee	10.1 <u>534</u>	<u>4</u>

**MCB ISLAMIC INCOME FUND**  
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**10.1** Under the provision of the Non-Banking Finance Companies and Notified Entities Regulations, 2008 a collective investment scheme categorised as an 'income scheme' is required to pay as annual fee to the SECP, an amount equal to the 0.075 percent of the average annual net assets of the Fund.

	Note	As on June 30, 2012	As on June 30, 2011
<b>11 ACCRUED EXPENSES AND OTHER LIABILITIES</b>		----- Rupees in '000 -----	
Auditors' remuneration payable		474	50
Brokerage payable		2	-
Printing charges payable		103	-
Zakat Payable		2	-
WHT payable		2	-
Provision for Workers' Welfare Fund	11.1	<u>82</u>	<u>9</u>
		<u><u>665</u></u>	<u><u>59</u></u>
<b>11.1 Provision for Workers' Welfare Fund</b>			

The Finance Act, 2008 introduced an amendment to the Workers' Welfare Fund Ordinance, 1971 (WWF Ordinance). As a result of this amendment it may be construed that all Collective Investment Schemes / mutual funds (CISs) whose income exceeds Rs 0.5 million in a tax year, have been brought within the scope of the WWF Ordinance, thus rendering them liable to pay contribution to WWF at the rate of two percent of their accounting or taxable income, whichever is higher. In this regard, a constitutional petition has been filed by certain CISs through their trustees in the Honorable High Court of Sindh (SHC), challenging the applicability of WWF to the CISs, which is pending adjudication.

During the year ended June 30, 2011, a clarification was issued by the Ministry of Labour and Manpower (the Ministry) which stated that mutual funds are not liable to contribute to WWF on the basis of their income. However, on December 14, 2010, the Ministry filed its response against the constitutional petition requesting the court to dismiss the petition. According to the legal counsel who is handling the case, there is a contradiction between the aforementioned clarification issued by the Ministry and the response filed by the Ministry in Court.

Subsequent to the year ended June 30, 2011, the Honorable Lahore High Court (LHC) in a constitutional petition relating to the amendments brought in the WWF Ordinance, 1971 through the Finance Act, 2006, and the Finance Act, 2008, has declared the said amendments as unlawful and unconstitutional and struck them down. Since the Management Company is hopeful that the decision of the LHC will lend further support to the Constitutional Petition which is pending in the SHC, it has discontinued the provision of WWF with effect from August 24, 2011. However, provision made till date has not been reversed. The provision in respect of WWF amounts to Rs.1.974 for the year ended June 30, 2012. Out of this amount, the management has only provided for Rs. 0.073 million during the current year.

**12 CONTINGENCIES AND COMMITMENTS**

There were no contingencies and commitments outstanding as at June 30, 2012 except as explained in note 11.1.

	2012	2011
<b>13 AUDITORS' REMUNERATION</b>	----- Rupees in '000 -----	
Annual audit fee	225	50
Half yearly review fee	125	-
Other certifications and services	250	-
Out of pocket expenses	<u>24</u>	<u>-</u>
	<u><u>624</u></u>	<u><u>50</u></u>

**14 TAXATION**

The income of the Fund is exempt from income tax under clause 99 of Part I of the Second Schedule to the Income Tax Ordinance, 2001 subject to the condition that not less than 90 percent of its accounting income for the year, as reduced by capital gains, whether realised or unrealised, is distributed amongst the unit holders. The Fund has not recorded any tax liability in respect of income relating to the current year as the management company has distributed the required minimum percentage of the Fund's accounting income for the year as reduced by capital gains (whether realised or unrealised) to its unit holders.

**15 EARNING PER UNIT**

Earnings per unit (EPU) for the year ended June 30, 2012 has not been disclosed as in the opinion of the management, determination of weighted average units for calculating EPU is not practicable.

**MCB ISLAMIC INCOME FUND  
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FOR THE YEAR ENDED JUNE 30, 2012**

**16 FINANCIAL INSTRUMENTS BY CATEGORY**

	-----As on June 30, 2012-----		
	Loans and receivables	At fair value through profit or loss	Total
<b>Financial assets</b>	-----Rupees in '000-----		
Bank balances	464,118	-	464,118
Investments	-	1,025,522	1,025,522
Profit and other receivables	19,989	-	19,989
	<u>484,107</u>	<u>1,025,522</u>	<u>1,509,629</u>
	-----As on June 30, 2012-----		
	At fair value through profit or loss	At amortised cost	Total
<b>Financial liabilities</b>	-----Rupees in '000-----		
Payable to the Management Company	-	2,380	2,380
Payable to the Trustee	-	171	171
Accrued expenses and other liabilities	-	579	579
	<u>-</u>	<u>3,130</u>	<u>3,130</u>
	-----As on June 30, 2011-----		
	Loans and receivables	At fair value through profit or loss	Total
<b>Financial assets</b>	-----Rupees in '000-----		
Bank balances	79,505	-	79,505
Investments	-	100,250	100,250
Profit and other receivables	2,491	-	2,491
	<u>81,996</u>	<u>100,250</u>	<u>182,246</u>
	-----As on June 30, 2011-----		
	At fair value through profit or loss	At amortised cost	Total
<b>Financial liabilities</b>	-----Rupees in '000-----		
Payable to the Management Company	-	1,599	1,599
Payable to the Trustee	-	20	20
Accrued expenses and other liabilities	-	50	50
	<u>-</u>	<u>1,669</u>	<u>1,669</u>

**17 TRANSACTIONS WITH CONNECTED PERSONS**

Connected persons of the Fund include the Management Company, other collective investment schemes being managed by the Management Company, the Trustee and directors and key management personnel and other associated undertakings.

The transactions with connected persons are in the normal course of business, and carried on at contracted rates and terms determined in accordance with market rates.

Remuneration to the Management Company and Trustee are determined in accordance with the provisions contained in the NBFC Regulations, 2008 and the Trust Deed respectively.

**MCB ISLAMIC INCOME FUND**  
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	For the year ended June 30, 2012	For the period from May 1, 2011 to June 30, 2011
<b>17.1 Details of the transactions with connected persons are as follows:</b>	----- Rupees in '000 -----	
<b>Arif Habib Investment Limited</b>		
<b>Management company</b>		
Remuneration for the year / period	7,768	51
Sindh sales tax on remuneration of the Management Company	1,243	-
Preliminary expenses and floatation cost paid by the Management Company on behalf of the Fund	-	1,000
Sales load	925	145
Issue of 105,733 bonus units (2011: 1,000,000 units)	10,577	100,000
Other Payable	-	403
<b>MCB Bank Limited</b>		
Profit on bank deposits	318	178
<b>Central Depository Company of Pakistan Limited</b>		
Remuneration for the year / period	1,144	20
<b>Key management personnel</b>		
Issue of 89,980 units (2011: Nil units)	9,341	-
Issue of 6,040 bonus units (2011: Nil units)	595	-
Redemption of 45,299 units (2011: Nil units)	4,626	-

**17.2 Amounts outstanding at the year end**

<b>Arif Habib Investments Limited</b>		
<b>Management company</b>		
Units held: 1,105,733 units (2011: 1,000,000 units)	110,684	100,250
Payable to the management company	2,380	1,599
<b>MCB Bank Limited</b>		
Balance in saving account	1,454	22,843
Profit receivable on bank deposits	-	508
Balance in current account	11,858	-
<b>Central Depository Company of Pakistan Limited</b>		
Remuneration payable	171	20
<b>Key management personnel</b>		
Units held 37,870 units (2011: Nil units)	3,791	-

**18 PARTICULARS OF INVESTMENT COMMITTEE AND FUND MANAGER**

Details of members of the investment committee of the Fund are as follows:

S.no.	Name	Designation	Experience in years	Qualification
1	Mr. Yasir Qadri	Chief Executive Officer	17 Years	MBA
2	Mr. Kashif Rafi	Senior Vice President - Investments	11 Years	MBA & CFA (Level I)
3	Mr. Muhammad Asim	Vice President - Head of Equities	9 Years	MBA & CFA
4	Mr. Syed Akbar Ali	Vice President - Head of Research	7 Years	MBA & CFA
5	Mr. Mohsin Pervaiz	Vice President - Investments	11 Years	MBA & CFA (Level I)

**MCB ISLAMIC INCOME FUND**  
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**18.1** Syed Akbar Ali is the Fund Manager. Other Funds being managed by him are as follows:

- a) Pakistan Stock Market Fund
- b) Pakistan International Element Islamic Asset Allocation Fund
- c) Pakistan Islamic Pension Fund

<b>19</b>	<b>BROKERS / DEALERS BY PERCENTAGE OF COMMISSION PAID</b>	<b>2012</b>
1	Invest Capital Market Limited	9.33%
2	Invisor Market (Private) Limited	21.07%
3	JS Global Capital Limited	26.39%
4	BMA Capital Management Limited	23.31%
5	KASB Securities Limited	3.25%
6	C&M Management (Private) Limited	16.65%
		<b>2011</b>
1	BMA Capital Management Limited	100%

**20** PATTERN OF UNIT HOLDING

-----As at June 30, 2012-----

Category	Number of unit holders	Number of units held	Net assets value of the amount invested	Percentage of total investment
(Rupees in '000)				
Individuals	856	13,128,755	1,314,175	87.22%
Associated Companies / Directors	1	1,105,733	110,683	7.35%
Retirement Fund	6	174,466	17,464	1.16%
Public Limited Companies	1	251,730	25,198	1.67%
Others	3	392,131	39,252	2.60%
	<b>867</b>	<b>15,052,815</b>	<b>1,506,772</b>	<b>100.00%</b>

-----As at June30, 2011-----

Category	Number of unit holders	Number of units held	Net assets value of the amount invested	Percentage of total investment
(Rupees in '000)				
Individuals	161	474,048	47,525	26.18%
Associated Companies / Directors	1	1,000,000	100,253	55.22%
Retirement Fund	6	86,943	8,716	4.80%
Public Limited Companies	1	150,000	15,038	8.28%
Others	1	100,000	10,025	5.52%
	<b>170</b>	<b>1,810,991</b>	<b>181,557</b>	<b>100.00%</b>

**21** ATTENDANCE AT MEETINGS OF BOARD OF DIRECTORS OF THE MANAGEMENT COMPANY

The 89th, 90th, 91st, 92nd, 93rd, 94th, 95th, 96th and 97th meeting of the board of Directors of the Management Company of the Fund were held on July 4, 2011, August 8, 2011, September 10, 2011, September 20, 2011, October 26, 2011, January 27, 2012, March 29, 2012, April 27, 2012 and June 25, 2012 respectively. Information in respect of attendance by Directors in the meetings is given below:

**MCB ISLAMIC INCOME FUND**  
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	Name of Directors	Number of meetings held	Number of Meetings		Meetings not attended
			Attended	Leave granted	
1	Mian Muhammad Mansha	9	4	5	89th, 90th, 93rd, 96th and 97th meetings
2	Mr. Nasim Beg	9	9	-	Not applicable
3	Syed Salman Ali Shah	9	8	1	92nd meeting
4	Mr. Haroun Rashid	9	6	3	91st, 92nd and 95th meetings
5	Mr. Ahmed Jahangir	9	7	2	91st and 92nd meetings.
6	Mr. Samad A. Habib	9	6	3	89th, 91st and 96th meetings
7	Mr. Mirza Mahmood Ahmad	9	7	2	89th and 97th meetings
8	Mr. Yasir Qadri (Chief Executive Officer)	9	9	-	Not applicable

**22 FINANCIAL RISK MANAGEMENT**

The Fund's activities expose it to a variety of financial risks: market risk, credit risk and liquidity risk.

**22.1 Market risk**

Market risk is the risk that the fair value or the future cash flows of a financial instrument may fluctuate as a result of changes in market prices.

The Management Company manages market risk by monitoring exposure on marketable securities by following the internal risk management policies and investment guidelines approved by the Investment Committee and regulations laid down by the Securities and Exchange Commission of Pakistan.

Market risk comprises of three types of risk: currency risk, yield / interest rate risk and other price risk.

**22.1.1 Currency risk**

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Fund, at present is not exposed to currency risk as its operations are geographically restricted to Pakistan and all transactions are carried out in Pakistani Rupees.

**22.1.2 Yield / interest rate risk**

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

a) Sensitivity analysis for variable rate instruments

Presently, the Fund holds GOP ijarah sukuk exposing the Fund to cashflow interest rate risk. In case of 100 basis points increase/decrease in 6 months weighted average yield of Ijara Sukuks bills on June 30, 2012 with all other variables held constant, the net assets of the Fund and net income for the year / period would have been higher / lower by: Rs 1.265 million (2011: Rs. 0.008 million)

b) Sensitivity analysis for fixed rate instruments

Fixed rate instruments comprise savings accounts maintained with banks. The Fund's income from these deposits is substantially independent of changes in market interest rates except for changes, if any, as a result of fluctuations in their respective fair values.

Yield / interest rate sensitivity position for financial instruments recognised on the Statement of Assets and Liabilities is based on the earlier of contractual repricing or maturity date and for off-balance sheet instruments is based on the settlement date.

The composition of the Fund's investment portfolio and rates announced by Financial Market Association of Pakistan is expected to change over time. Accordingly, the sensitivity analysis prepared as of June 30, 2012 is not necessarily indicative of the impact on the Fund's net assets of future movements in interest rates.

**MCB ISLAMIC INCOME FUND**  
**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**  
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-----As at June 30, 2012-----

Effective yield / interest rate	Not exposed to yield / interest rate risk	Exposed to yield / interest rate risk			Total
		Upto three months	More than three months and upto one year	More than one year	

------(Rupees in '000)-----

**On-balance sheet financial instruments**

**Financial assets**

Bank balances	6% to 11.60%	11,858	452,260	-	-	464,118
Investments	11.9366% to 11.9405%	-	-	-	1,025,522	1,025,522
Profit and other receivables		19,989	-	-	-	19,989
<b>Sub-total</b>		<b>31,847</b>	<b>452,260</b>	<b>-</b>	<b>1,025,522</b>	<b>1,509,629</b>

**Financial liabilities**

Payable to the Management Company		2,380	-	-	-	2,380
Payable to the Trustee		171	-	-	-	171
Accrued expenses and other liabilities		579	-	-	-	579
<b>Sub-total</b>		<b>3,130</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>3,130</b>

**On-balance sheet gap**

		<b>28,717</b>	<b>452,260</b>	<b>-</b>	<b>1,025,522</b>	<b>1,506,499</b>
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**Off-balance sheet financial instruments**

		-	-	-	-	-
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**Off-balance sheet gap**

		-	-	-	-	-
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-----As at June 30, 2011-----

Effective yield / interest rate	Not exposed to yield / interest rate risk	Exposed to yield / interest rate risk			Total
		Upto three months	More than three months and upto one year	More than one year	

------(Rupees in '000)-----

**On-balance sheet financial instruments**

**Financial assets**

Bank balances	5% to 13.15%	-	79,505	-	-	79,505
Investments	13.45%	-	100,250	-	-	100,250
Profit and other receivables		2,491	-	-	-	2,491
<b>Sub-total</b>		<b>2,491</b>	<b>179,755</b>	<b>-</b>	<b>-</b>	<b>182,246</b>

**Financial liabilities**

Payable to the Management Company		1,599	-	-	-	1,599
Payable to the Trustee		20	-	-	-	20
Accrued expenses and other liabilities		50	-	-	-	50
<b>Sub-total</b>		<b>1,669</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,669</b>

**On-balance sheet gap**

		<b>822</b>	<b>179,755</b>	<b>-</b>	<b>-</b>	<b>180,577</b>
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**Off-balance sheet financial instruments**

		-	-	-	-	-
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**Off-balance sheet gap**

		-	-	-	-	-
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**MCB ISLAMIC INCOME FUND  
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED JUNE 30, 2012**

**22.1.3 Price risk**

Price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk) whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market. Currently, the Fund does not hold any security which exposes the Fund to price risk.

**22.2 Credit risk**

Credit risk represents the risk of a loss if the counter parties fail to perform as contracted. The Fund is exposed to counterparty credit risks on balances with banks and profit and other receivables. Risk attributable to investments in GoP ijarah sukuk is limited as these are guaranteed by the Federal Government while bank balances are maintained with banks with a reasonably high credit rating. The Fund's policy is to enter into financial instrument contracts by following internal guidelines approved by the investment committee. In addition, the risk is managed through assignment of credit limits and by following strict credit evaluation criteria laid down by the Management Company.

The analysis below summarises the credit quality of the Fund's bank balances:

**Bank Balances by rating category**

Published Rating	As at June	As at June
	30, 2012	30, 2011
	----- Percentage of total -----	
A1+	100.00%	99.99%
A-1+	0.00%	0.01%

The maximum exposure to credit risk before any credit enhancement as at June 30, 2012 is the carrying amount of the financial assets. None of these assets are 'impaired' nor past due but not impaired.

**Concentration of credit risk**

Concentration of credit risk exists when changes in economic or industry factors similarly affect groups of counterparties whose aggregate credit exposure is significant in relation to the Fund's total credit exposure. The Fund's most significant investment is made GOP ijara Sukkuks which are government guaranteed

**22.3 Liquidity risk**

Liquidity risk is the risk that the Fund may not be able to generate sufficient cash resources to settle its obligations in full as they fall due or can only do so on terms that are materially disadvantageous.

The Fund is exposed to daily cash redemptions at the option of unit holders. The Fund's approach to managing liquidity is to ensure, as far as possible, that the Fund will always have sufficient liquidity to meet its liabilities when due under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Fund's reputation. Its policy is therefore to invest the majority of its assets in investments that are traded in an active market and can be readily disposed and are considered readily realisable.

The Fund has the ability to borrow in the short term to ensure settlement. The maximum amount available to the Fund from the borrowing would be limited to fifteen percent of the net assets upto 90 days and would be secured by the assets of the Fund. The facility would bear interest at commercial rates. However, no borrowing was obtained by the Fund during the current year.

In order to manage the Fund's overall liquidity, the Fund also has the ability to withhold daily redemption requests in excess of ten percent of the units in issue and such requests would be treated as redemption requests qualifying for being processed on the next business day. Such procedure would continue until the outstanding redemption requests come down to a level below ten percent of the units then in issue. The Fund did not withhold any significant redemptions during the year.

The table below analyses the Fund's liabilities into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The amounts in the table are the contractual undiscounted cash flows.

**MCB ISLAMIC INCOME FUND**  
**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED JUNE 30, 2012**

-----As at June 30, 2012-----			
Upto three months	More than three months and upto one year	More than one year	Total

(Rupees in '000)

**Financial liabilities**

Payable to the Management Company	2,380	-	-	2,380
Payable to the Trustee	171	-	-	171
Accrued expenses and other liabilities	579	-	-	579
	<u>3,130</u>	<u>-</u>	<u>-</u>	<u>3,130</u>

-----As at June 30, 2011-----

Upto three months	More than three months and upto one year	More than one year	Total
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(Rupees in '000)

**Financial liabilities**

Payable to the Management Company	1,599	-	-	1,599
Payable to the Trustee	20	-	-	20
Accrued expenses and other liabilities	50	-	-	50
	<u>1,669</u>	<u>-</u>	<u>-</u>	<u>1,669</u>

**23 FAIR VALUE OF FINANCIAL INSTRUMENTS**

Fair value is the amount for which an asset could be exchanged or liability settled, between knowledgeable willing parties in an arm's length transaction. Consequently, differences can arise between carrying values and the fair value estimates.

Underlying the definition of fair value is the presumption that the Fund is a going concern without any intention or requirement to curtail materially the scale of its operations or to undertake a transaction on adverse terms.

Financial assets which are tradable in an open market are revalued at the market prices prevailing at the close of trading on the reporting date. The estimated fair value of all other financial assets and liabilities is considered not to be significantly different from book values as the items are either short- term in nature or are periodically repriced.

International Financial Reporting Standard 7, 'Financial Instruments: Disclosure' requires the Fund to classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1);
- inputs other than quoted prices included within level 1 that are observable for the asset or liability, whether directly (i.e. as prices) or indirectly (i.e. derived from prices) (level 2); and
- inputs for the asset or liability that are not based on observable market data (unobservable inputs) (level 3).

Investments of the Fund carried at fair value are categorised as follows:

----- As at June 30, 2012 -----				
Level 1	Level 2	Level 3	Total	
----- Rupees in '000 -----				

**ASSETS**

Financial assets at fair value through profit or loss	-	1,025,522	-	1,025,522
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----- As at June 30, 2011 -----				
Level 1	Level 2	Level 3	Total	
----- Rupees in '000 -----				

**ASSETS**

Financial assets at fair value through profit or loss	-	100,250	-	100,250
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**MCB ISLAMIC INCOME FUND  
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED JUNE 30, 2012**

**24 UNIT HOLDERS' FUND RISK MANAGEMENT**

The unit holders' fund is represented by redeemable units. They are entitled to dividends payment of a proportionate share based on the Fund's net asset value per share on the redemption date. The relevant movements are shown on the Statement of Movement in Unit Holders' Fund. The Fund has no restrictions on the subscription and redemption of units.

The Fund's objectives when managing unit holders' funds are to safeguard its ability to continue as a going concern so that it can continue to provide returns for unit holders and to maintain a strong base of assets under management.

In accordance with the risk management policies as stated in note 22, the Fund endeavors to invest the subscriptions received in appropriate investments while maintaining sufficient liquidity to meet redemption requests, such liquidity being augmented by disposal of investments or short - term borrowings, where necessary.

**25 CORRESPONDING FIGURES**

Corresponding figures have been rearranged or reclassified, wherever necessary, for the purpose of comparison and better presentation. No significant rearrangements or reclassifications were made in these financial statements in the current year.

**26 DATE OF AUTHORISATION FOR ISSUE**

These financial statements were authorised for issue by the Board of Directors of the Management Company on **August 15, 2012**.

**27 GENERAL**

Figures have been rounded off to the nearest thousand rupees unless otherwise specified.

  
\_\_\_\_\_  
Chief Executive Officer

**For Arif Habib Investments Limited  
(Management Company)**

  
\_\_\_\_\_  
Director

**MCB ISLAMIC INCOME FUND  
PATTERN OF HOLDING AS PER REQUIREMENT OF  
CODE OF CORPORATE GOVERNANCE  
FOR THE YEAR ENDED JUNE 30, 2012**

<b>Category</b>	<b>No. of Unit Holders</b>	<b>Units</b>
<b>Associated Companies, undertakings and related Parties</b>		
Arif Habib Investment Limited	1	1,105,733
Trust	7	224,166
Public Sector Companies and Corporation	3	594,106
Individuals	856	13,128,810
	<u>867</u>	<u>15,052,815</u>

**MCB ISLAMIC INCOME FUND  
PATTERN OF UNIT HOLDING BY SIZE  
FOR THE YEAR ENDED JUNE 30, 2012**

<b>No. of Unit Holders</b>	<b>Units Holdings</b>	<b>Total Units Held</b>
440	(SHAREHOLDING FROM 1.0000 TO 5000.0000)	709,052.86
134	(SHAREHOLDING FROM 5001.0000 TO 10000.0000)	974,711.57
59	(SHAREHOLDING FROM 10001.0000 TO 15000.0000)	674,114.61
44	(SHAREHOLDING FROM 15001.0000 TO 20000.0000)	796,760.71
28	(SHAREHOLDING FROM 20001.0000 TO 25000.0000)	625,133.44
25	(SHAREHOLDING FROM 25001.0000 TO 30000.0000)	697,965.50
28	(SHAREHOLDING FROM 30001.0000 TO 35000.0000)	914,330.96
17	(SHAREHOLDING FROM 35001.0000 TO 40000.0000)	650,597.11
3	(SHAREHOLDING FROM 40001.0000 TO 45000.0000)	122,786.21
15	(SHAREHOLDING FROM 45001.0000 TO 50000.0000)	732,268.36
13	(SHAREHOLDING FROM 50001.0000 TO 55000.0000)	663,910.39
4	(SHAREHOLDING FROM 55001.0000 TO 60000.0000)	230,397.27
8	(SHAREHOLDING FROM 60001.0000 TO 65000.0000)	500,805.83
4	(SHAREHOLDING FROM 65001.0000 TO 70000.0000)	270,244.64
3	(SHAREHOLDING FROM 70001.0000 TO 75000.0000)	218,492.97
4	(SHAREHOLDING FROM 75001.0000 TO 80000.0000)	313,147.43
2	(SHAREHOLDING FROM 80001.0000 TO 85000.0000)	169,200.82
2	(SHAREHOLDING FROM 85001.0000 TO 90000.0000)	175,923.60
2	(SHAREHOLDING FROM 90001.0000 TO 95000.0000)	180,907.72
7	(SHAREHOLDING FROM 95001.0000 TO 100000.0000)	690,494.22
6	(SHAREHOLDING FROM 100001.0000 TO 105000.0000)	610,821.00
1	(SHAREHOLDING FROM 110001.0000 TO 115000.0000)	112,907.07
1	(SHAREHOLDING FROM 115001.0000 TO 120000.0000)	119,113.57
1	(SHAREHOLDING FROM 130001.0000 TO 135000.0000)	132,283.13
1	(SHAREHOLDING FROM 135001.0000 TO 140000.0000)	138,104.95
1	(SHAREHOLDING FROM 145001.0000 TO 150000.0000)	146,129.50
1	(SHAREHOLDING FROM 150001.0000 TO 155000.0000)	151,162.75
1	(SHAREHOLDING FROM 190001.0000 TO 195000.0000)	191,976.32
1	(SHAREHOLDING FROM 205001.0000 TO 210000.0000)	207,178.01
1	(SHAREHOLDING FROM 215001.0000 TO 220000.0000)	216,818.18
1	(SHAREHOLDING FROM 220001.0000 TO 225000.0000)	221,635.48
1	(SHAREHOLDING FROM 225001.0000 TO 230000.0000)	226,245.86
1	(SHAREHOLDING FROM 250001.0000 TO 255000.0000)	251,730.21
1	(SHAREHOLDING FROM 295001.0000 TO 300000.0000)	297,545.10
1	(SHAREHOLDING FROM 300001.0000 TO 305000.0000)	301,368.67
1	(SHAREHOLDING FROM 310001.0000 TO 315000.0000)	310,870.58
1	(SHAREHOLDING FROM 1105001.0000 TO 1110000.0000)	1,105,732.63
<b>867</b>	<b>Total :</b>	<b>15,052,815.23</b>

**MCB ISLAMIC INCOME FUND  
PERFORMANCE TABLE  
FOR THE YEAR ENDED JUNE 30, 2012**

<b>Performance Information</b>	<b>2012</b>	<b>2011</b>
Total Net Assets Value – Rs. in million	1,506.77	178.00
Net Assets value per unit – Rupees	100.10	100.25
Highest offer price per unit	106.14	100.25
Lowest offer price per unit	100.00	100.00
Highest Redemption price per unit	106.14	100.25
Lowest Redemption price per unit	100.00	100.00
Distribution per unit (annual) – Rs.	2.32	
Net Assets Value before distribution	102.17	
Net Assets Value after distribution	99.85	
Distribution per unit (annual) – Rs.	8.73	0.25
Net Assets Value before distribution	106.41	100.25
Net Assets Value after distribution	100.00	100.00
<b>Average Annual Return - %</b>		
One year	10.40	7.80
Two year	-	NA
Three year	-	NA
Net Income / (loss) for the period – Rs. in million	98.724	0.46
Income Distribution – Rs. in million	97.691	0.46
Accumulated Capital Growth – Rs. in million	1.033	-
Weighted average Portfolio Duration (Days) – 30 June 2012	386.9	492.750

**Disclaimer**

The past performance is not necessarily indicative of future performance and unit prices and investments and returns may go down, as well as up.

\* The Comparative information is not comparable as the fund started operations with effect from May 01, 2011.