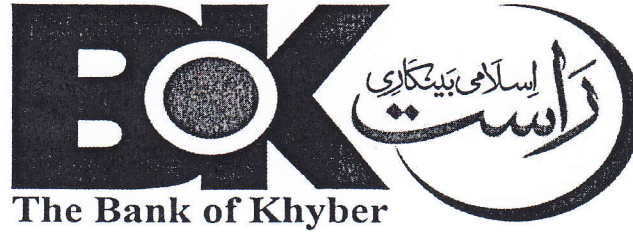


The Bank of Khyber
Islamic Banking Group

PROFIT & LOSS DISTRIBUTION POLICY



APPROVED BY

APPROVED IN 29TH MEETING OF SB
HELD ON 28TH APRIL, 2014

APPROVED BY BOD IN 128TH MEETING
HELD ON 30TH OCTOBER, 2014

AMMENDED APPROVED IN 33RD MEETING OF SB
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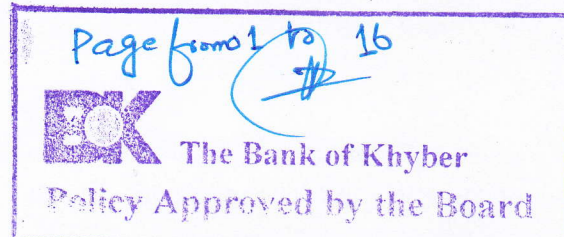


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**THE BANK OF KHYBER
ISLAMIC BANKING GROUP
PROFIT & LOSS DISTRIBUTION POLICY (AMENDED -2014)**

1. DEFINITIONS

- a. Bank shall mean The Bank of Khyber, Islamic banking Group.
- b. Deposits mean all Investment Accounts, Current Deposits and Certificates by whatever name called of any currency and in any pool.
- c. Investment Account means any Deposit which shares profit and loss in any currency and in any pool by whatever name called.
- d. Current Deposit means any Deposit on the basis of Qarz-Hasana.
- e. Certificate means any Investment Account of fixed maturity whether or not a certificate has been issued.
- f. Pool means a Pool of Deposits and its related assets and income and expenses emanating from such Deposits and assets including Sub Pool.
- g. Sub Pool means a Pool created by allocating resources from a Pool as equity contribution and creation of assets with those allocations and Deposits accepted for that Sub Pool.
- h. General Deposit Pool means Pool of Deposit in which general public deposits are accepted without any restriction.
- i. SB means Shariah Board of the Bank.

BASIS OF ACCEPTANCE OF DEPOSIT

- 2. Investment Accounts are accepted on the basis of MUSHARAKA.

CREATION OF POOL

- 3. A committee comprising of Group Head Islamic Banking Group as Chairman, Head Operation & Support Division IBG, Head of Shariah Compliance and RSBM as members called the Pool Management Committee shall approve creation of each Pool as well as transfer of assets from one Pool to another Pool or Sub Pool, profit distribution and all other related matters.
- 4. Each Pool shall be created through a circular which shall include following information:
 - a. Equity of the Pool.
 - b. Minimum proportion of equity in assets of the Pool.
 - c. Minimum balance to open account and size of deposit.
 - d. Category of Deposits and initial Weightages assigned to each category of Investment Account.
 - e. Type of customer.
 - f. Characteristics and nature of assets to be taken to such Pool.

- g. Investment strategy.
 - h. Tenor (if any) of deposits.
 - i. PER and IRR Ratio
 - j. Life or Term of liquidation of the Pool.
 - k. Notice period for withdrawal of deposit.
 - l. Basis of allocation of expenses among Pools.
 - m. Dispute settlement procedure.
 - n. Other Term and Conditions of the Pool.
5. Terms of a Pool, once declared or accepted by the customer, shall not be changed before liquidation of a Pool.

RISKS ASSOCIATED WITH POOL

6. While creation of each Pool category of related risk shall be clearly mentioned to which the Pool is exposed.
7. The risk category may include :
- a. Shariah Risk
 - b. Operational Risk
 - c. Credit Risk
 - d. Market Risk
 - e. Equity Risk
 - f. Liquidity Risk
 - g. Return Risk
 - h. Other Risk

PURPOSE OF CREATION OF POOL

8. While overall objective of creation of any Pool is to maximize the return of the Pool and in case of creation of Sub Pool return on equity of Sub Pool, a Pool may be created for the following purposes:
- a. General deposits collection.
 - b. Collection for special Deposits against specific assets allocated or to be allocated.
 - c. Treasury Operation
 - d. Reserves Creation

e. Foreign Currency Investment Accounts.

9. Assets of each Pool shall be properly assigned to a specific pool in General Ledger or Sub-Ledger.
10. Assets once allocated to a Pool shall remain intact till the liquidation or termination on maturity.
11. Any movement in the allocation of assets for creation of new Pool shall be made in consultation with the RSBM.

INVESTMENT STRATEGY

12. The deposits shall be invested in any profitable venture or avenue as identified by the Bank and which conform to Shariah and its principles.
13. None of the business undertaken by the Bank, financing arrangements and transactions shall involve directly or indirectly any element of Riba, Gharar, Qimar or any other element prohibited under Shariah.
14. Assets acquired are not on any Negative List of the Bank.
15. All investments and placements of the Bank shall be with the institutions on the Approved List of the Bank.
16. Pool Assets in the nature of "Dain" mainly comprising of Murabaha shall be restricted up to 30% of the total assets of the Pool. In case these assets exceed the limit, profit shall be accrued for that period but shall not be paid to Investment Account holder. However, Certificate holders may be paid profit with permission of the RSBM keeping in view income from Ijarah assets and investments.

INVESTMENT PRIORITY

17. In investing funds, Investment Accounts shall be invested in Earning Assets and Pool's CRR (Cash Reserve Requirement) as first priority with simultaneous investment of minimum Equity required for each disbursement and declared by the Bank at the time of creation of the Pool.
18. After investment of all Investment Accounts, remaining equity shall be invested in the Earning Assets and Pool's CRR as second priority.
19. After investment of Investment Accounts and equity, current accounts shall be invested as last priority.

NEGATIVE LISTS AND APPROVED LISTS.

20. Bank shall maintain following Negative and Approved lists:

APPROVED LISTS

- a. Listed Companies Shares which may be purchased by the Bank. Bank may also approve criteria which shall be used for selection of the Companies instead of individual company. All companies which fulfill the Dow Jones criteria or Meezan Index are to be considered on the approved list from Shariah point of view.



- b. List of Islamic Funds.
- c. List of Islamic banks with which Bank may place funds on PLS basis. Bank may also approve criteria which shall be used for selection of the Banks instead of individual bank. All Islamic Banks and Islamic Windows having Islamic Banking license from SBP are to be considered on the approved list from Shariah point of view.
- d. List of Takaful Companies.
- e. Approved Lists shall represent Shariah Clearance only. All financial and other administrative approvals must be obtained from competent authorities keeping in view all related rules, regulations and risk assessments.

NEGATIVE LISTS

- a. Negative List of Unacceptable Securities and Collaterals.
- b. Negative List for Murabaha
- c. Negative List for Ijarah and Sale and Lease Back.
- d. Negative list for other financing

DISTRIBUTION OF PROFIT

- 21. Depositors shall share profits and Losses on the basis of average balances at the day end in the account during the tenure of the Pool i.e. from start till its constructive or actual liquidation whichever is earlier.
- 22. All direct expense of a Pool shall be charged to the Pool. The direct expenses to be charged to the Pool may include depreciation of Ijarah assets as well as other assets, cost of sales of inventories, Takaful expenses of assets of the Pool, stamp fee or documentation charges, brokerage fee for purchase of securities and commodities etc., impairment or losses due to physical damages to specific assets in a Pool, write offs etc. However, this is not an exhaustive list; IBG Circular may identify or specify any other similar expenses to be charged to the Pool.
- 23. Any loss of income or expense which is caused due to negligence of the Bank employees shall be borne by the Bank itself and its effect shall not be transferred to the Deposits.
- 24. Administrative Expenses of Sub Pool may be absorbed by the Pool from which it is created. However, a basis shall be decided to allocate administrative expenses chargeable to Sub Pool, if material, in consultation with RSBM.
- 25. New Assets created shall automatically be assigned to a Pool from where its payments have been made. Transfer of assets from one Pool to another Pool shall only be allowed at dissolution of a Pool i.e. at month end in case of constructive liquidation and at any time in case of actual liquidation. Transfer of assets from Pool to its Sub Pool for creation of Sub Pool is permissible at any time. It shall however, be ensured that Pool Depositors get benefitted with creation of sub Pool.

26. Transfer of assets from one Pool to another Pool or to its Sub Pool shall be considered as sale purchase between Pools.
27. Excess resources shall be considered as un-utilized.
28. In case Bank contributes less equity than its minimum requirements declared at start of a period, its approval shall be obtained from RSBM. RSBM may reduce the declared ratio of Bank's Additional Profit keeping in view of reduction in contribution. While declaring minimum equity contribution of the Bank in a Pool, the word "upto" shall be used to cover forced reduction in equity at any point of time.
29. All income and expense shall be accounted for in the period in which such income or expense are accrued and made part of books. Back date effects shall not be required for such income or expense e.g. various expense provisions made or reversed and income accrued.
30. All Provisions required to be made or Reserves to be created as per SBP regulations or any other Regulatory Authority shall not be passed on to the Investment Accounts as expense including NPL Provisioning and other Reserves. However, Income Reversals due to classification of assets and losses due to actual writing off of any facility shall be considered expenses of the Pool.
31. Bank's Additional Profit Ratio shall be declared before start of a Pool which shall not exceed 1/2 (50%) of the share of Investment Accounts in Distributable Income

INCOME DISTRIBUTION PROCESS

GROSS INCOME OF POOL (GIP)

32. Income from all sources including income from non-fund base sources, capital gain, income from revaluation of fixed assets of the related Pool and income from purchase of Certificates before maturity dates is aggregated to arrive at Gross Income of the Pool (GIP).
33. Any income which may be considered doubtful shall immediately be transferred to a specific reserve where it shall remain placed till its clearance from RSBM or SB.
34. Dividend Income Reserve shall also be adjusted to arrive at GIP.

NET INCOME OF POOL:

35. All direct expenses and administrative expenses are deducted from GIP to arrive at Net Income of the Pool (NIP) while observing following procedure:
 - a. All direct expenses shall be deducted from Gross Income of the Pool (GIP).
 - b. All administrative Expenses shall be deducted from the GIP.
 - c. All provisions required to be made as per SBP regulations or any other Regulatory Authority shall not be passed on to the Investment Accounts as expense especially NPL provisioning and other Reserve. However, income reversals due to classification of assets and losses due to actual write off of any facility shall be considered expense of the related Pool.

DISTRIBUTABLE INCOME (DI):

36. NIP shall be adjusted for Profit Equalization Reserve (PER) to arrive at Distributable Income (DI).
37. PER shall be managed as per Reserve Rules attached as Annexure-2.
38. Distributable Income shall be distributed between equity and Investment Accounts in the ratio of Average Deposits and Average Equity.
39. Bank may relinquish its share of profit upto 60% of its share in favor of Investment Accounts.

NET DISTRIBUTABLE INCOME (NDI) FOR INVESTMENT ACCOUNTS

40. Bank shall deduct Bank's Additional profit from share of Profit of Investment Accounts in DI Income to arrive at Net Distributable Income (NDI) of Investment Accounts.
41. Net Distributable Income of Investment Accounts shall be further adjusted with creation or reversal of Investment Risk Reserve (IRR) is among Investment Accounts as per declared Weightages.
42. IRR shall be managed as per Reserve Rules attached as Annexure-2.
43. Adjusted NDI shall be distributed among Investment Accounts as per declared Weightages.
44. Bank may relinquish its share of Bank's Additional Profit upto 60% of its share in favor of Investment Accounts.

LOSS DISTRIBUTION:

45. In case of Loss following policy shall be followed:
 - a. PER and IRR shall be used to meet the specific loss causing the declaration of loss in accordance with PER and IRR Rules respectively.
 - b. Loss shall be shared as per investment of each category of Investment Account and equity of the Bank and Weightages shall be ignored.
 - c. While recovering loss from single account holder or Certificate if accrued profit exist - specially where profit are paid after six monthly, annually or on maturity, losses shall be set off against such accrued profit and balance shall be recovered from Deposits by debiting their account forthwith.
 - d. Reasons for incurring such loss shall be declared in the press note, circular to branches and declared on website.
 - e. In case, a depositor desires to close his account after declaration of loss, he shall be allowed to close as per procedure of the Bank i.e. a Notice period may be required as per term and conditions of the Account.
 - f. Full detail of the loss shall be provided to a customer on demand.
 - g. Loss, if any, shall be calculated after vetting by the RSBM and shall be declared with the approval of the Managing Director of the Bank.

WEIGHTAGES:

46. Weightages shall be declared at least three working days before start of any period for which a Pool is created and shall be displayed on Notice Board as well as Website of BOK. However this may be ignored in special cases such as creation of new Pool or Sub Pool and in cases where holidays are announced in last days of month etc. with the reason to be recorded and approved by the RSBM.
47. Weightages are to be decided by the Bank in consultation with the RSBM.

PARAMETERS / CRITERIA TO DECIDE WEIGHTAGES:

48. For this purpose Bank may adopt following parameters or criteria to decide Weightages of different classes of Investment Account such as Investment Account holders and Certificate Holders:
- Period of investment days, months, years etc.
 - profit payment option (monthly, quarterly, six monthly, yearly, maturity or any other period of profit payment)
 - Purpose of Deposit (Hajj, Umra, New House, Marriage, Education, Jaheez, etc.)
 - Type of Customer (Pensioners, Widows, Orphans, Permanent Disabled Patients, Newly Converted Muslims etc.)

PARAMETERS / CRITERIA TO ALLOCATE DEPOSITS AMONG POOLS:

49. Bank may adopt following parameters or criteria to allocate deposits among Pools:
- Currency Type
 - Size of Deposit
 - Tenor of Deposit
 - Geographic area
 - Branch-wise.
 - Type of Customer i.e. individual, salaried, pensioner, student, minor etc.
 - Strategy of deployment of funds of the Pool i.e. Aggressive, Balanced, Conservative.
50. In every Pool, there shall be Investment Account category which shall serve as base category for deciding Weightages. Weightage of any category shall not exceed three times of the Weightages of the base category. The Bank may use any or all of the above basis and factors or any of their combination to decide Weightages.
51. Any addition of Parameter or factor shall be approved by the RSBM to be ratified by the SB Subsequently.
52. Separate Pool shall be created for each currency type if it is Investment Account. Current Deposits of any currency type shall be part of General Deposit Pool.
53. Criteria set for determining Weightages shall be applied uniformly within a Pool.

54. Although Bank may give different Weightages on the basis of differences in amounts, justice demands that Weightage may not be different for different amounts of the same category of Investment Account.
55. Weightages of any category of deposit shall not be Negative.
56. Loss shall be shared as per investment of each category of Investment Accounts and equity of the Bank and Weightages shall be ignored.
57. Special Weightages shall not be allowed to any particular customer (Specially Government Accounts) to shift more profit to that customer as it is against social justice.
58. Weightages once declared by the Bank, shall not be changed before liquidation of a Pool.

DIVIDEND INCOME RESERVE

59. Five percent of all Dividend Income and Capital gain on shares shall be transferred to a Dividend Income Reserve at the time of liquidation of the Pool. Part of this income corresponding to Interest Income of the company to Total Income during that year as declared in published accounts (whether audited or un-audited) shall be paid in Charity and remaining income shall be made part of Net Distributable Income.

TERMINATION OF CERTIFICATES BEFORE MATURITY

60. Certificate denotes customer willingness to invest his funds for a specific period on specific terms and conditions. In case any term is changed after his investment which effectively reduces his share in income, he shall be given two months time period to withdraw his investment without any loss. However, in case he desires to withdraw his investment before completion of time period for which it was originally invested, proportionate assets equal to his investment shall be purchased by the Pool Deposits or Equity holders for an amount which is less than its face value. Procedure to determine such value shall be framed with the approval of RSBM.

MISCELLANEOUS

61. The rates shall be calculated and declared monthly as the Pool is constructively liquidated at end of each month and created simultaneously.
62. Fixed Assets purchased by IBG may be financed by its equity. In such cases the expenses of depreciation of such assets as well as their valuation differences shall be borne by the IBG. IBG may charge rent for its usage for the benefits of the General Pool.
63. There shall not be any Minimum Balance requirement for participation in the profit.
64. Before start of each Pool following information shall be displayed on the website of the Bank as well as on Notice Board of the Branches:
 - a. Nature of each Pool along with the key features of risk and reward characteristics.
 - b. Major Sectors where deposits deployed.
 - c. Profit allocation parameters.
 - d. Expenses allocation parameters.
 - e. Bank's Additional Profit.

- f. Weightages of each class or type of depositors.
- g. Starting date of creating Pool.
- h. Hiba transferred to Deposits during last periods.
- i. Profit distribution frequency to each category of Deposits.

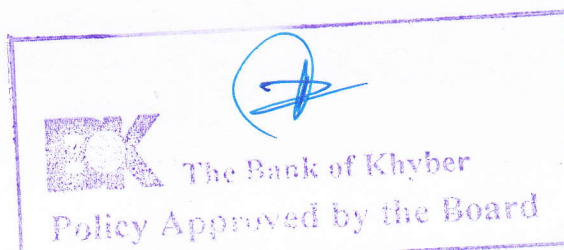
DISCLOSURE IN FINANCIAL ACCOUNTS.

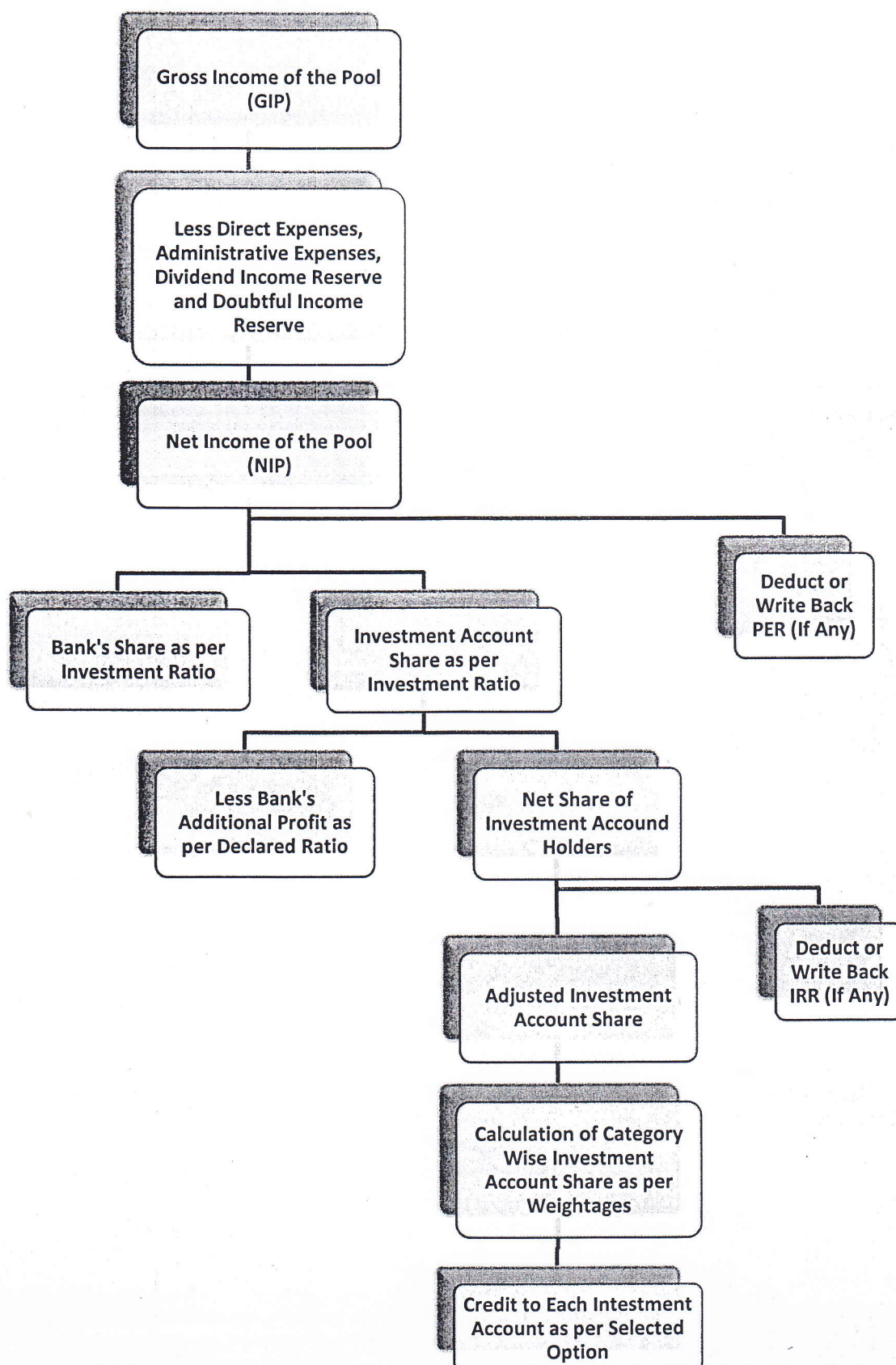
65. In addition to information required by SBP to be disclosed in financial statements, following information shall also be disclosed:
 - a. Basis of acceptance of deposits.
 - b. Main feature of the profit's loss Distribution policy.
 - c. Introduction of SB members and RSBM
66. Rates shall be declared and paid where required within five working days of the constructive liquidation.
67. In case of actual liquidation, Bank may calculate actual profit and loss and distribute profit in reasonable time period.
68. Current accounts are considered to be taken up by the Pool and profit from deployment of such current deposits as well as the risk of loss be borne by the Pool. As such return of current deposits is virtually guaranteed before payment to any Investment Account or equity holder.
69. A depositor shall not share any profit and shall not be liable for any loss if he closes his account before liquidation of the Pool.
70. No gift (Hiba) shall be allowed in favor of any particular customer or a particular class or category of customers or investors.
71. Income on termination of Ijarah or loss shall be treated as Profit or loss of the Pool to which the asset relates.
72. Takaful Cover shall be obtained of all assets which are in the ownership of the Islamic Banking.
73. One Pool resources may be invested in another Pool. In that case the resources so invested shall have their own Weightages at par with an investor and may also be considered as equity for that Pool provided Pool's terms and conditions do not restrict such investment.

ANNEXURES

Annexure-1 – PROCESS FLOW OF PROFIT DISTRIBUTION OF BOK ISLAMIC BANKING.

Annexure-2 –RESERVE RULES.





Annexure-2

Rules of Creation and Use of Reserves Relating to Distribution of Profit to Customers**Profit Equalization Reserve Rules (PER)**

Profit Equalization Reserve (PER) is a voluntary contribution by the Bank and Investment Accounts out of Net Income of the Pool (NIP) as defined in the Profit Distribution Policy.

Following Rules shall be followed for its creation and use:

RULES

1. It shall be voluntary contribution from Investment Accounts and Equity.
2. It shall not be more than 1/50th (2%) of Net Income of the Pool (NIP) as defined in the Profit Distribution Policy. However, the Bank may decide any amount instead of a Ratio provided the same does not exceed declared ratio.
3. Maximum PER ratio shall be declared for each pool at the time of creation of Pool.
4. The Bank may, in the best interest of the depositors, allocate less amount of PER at time of distribution of profit.
5. PER created from a Pool shall be utilized for the same Pool.
6. PER ratio shall be such that the rate remains attractive and does not have a negative yield and customers do not feel penalized for choosing the Islamic Banking.
7. It shall be effective with prospective effects. It shall not have retrospective effects.
8. PER shall be created only if the remaining profit is sufficient so that the rate in any deposit category does not fall below total of 2.5% p.a. plus withholding taxes and any other taxes.
9. IBG shall declare the ratio or any change in the ratio after approval from Committee constituted for approval of Pool.
10. The ratio of PER shall be displayed on the Notice Board of the branches and shall also be available at the website of the Bank.
11. Accumulated balance in PER shall not exceed 30% of the IBF or equity of the IBG whichever is higher at any time.
12. Accumulated balance in PER shall be invested in SLR eligible Shariah Compliant Securities as soon as possible.



13. 50% of the PER shall be reflected as liability and remaining 50% shall be reflected as Reserve in Accounts.
14. In case of actual termination of a Pool, it's PER shall be distributed to the Pool.
15. Only those losses shall be set off by the PER of a Pool which directly relate to that Pool.
16. PER may be utilized for following purposes:
 - a. Utilize the PER to smoothening returns to Investment Accounts during period when the Pools profits are below market expectation.
 - b. Utilize the PER to cover losses, if any, incurred by the Pool to which this PER relates.
 - c. Off-set any specific loss or expense directly from PER which is expected to be recovered or recouped in future. Amount drawn from PER shall be passed through NIP and when loss is recovered it shall also be routed through NIP.
 - d. Adjustment of minor differences and mistakes in calculations or distribution of profit in Pool or its Sub Pool shall be made through PER.

Investment Risk Reserve Rules (IRR):

Investment Risk Reserve (IRR) is a voluntary contribution by the Investment Accounts only out Investment Account share.

Following Rules shall be followed for its creation and use:

RULES

1. It shall be voluntary contribution from Investment Accounts only.
2. It shall not be more than 1/100th (1%) of share of income of Investment Accounts. However, the Bank may decide any amount instead of a Ratio provided the same does not exceed declared ratio.
3. Maximum IRR ratio shall be declared for each pool at the time of creation of each pool.
4. IRR created from a Pool shall be utilized for the same Pool.
5. The Bank may, in the best interest of the depositors, allocate less amount of IRR at time of distribution of profit.
6. It shall be effective with prospective effects. It shall not have retrospective effects.
7. IRR shall be created only if the remaining profit is sufficient so that the rate in any deposit category does not fall below total of 2.5% p.a. plus withholding taxes and any other taxes.



8. IBG shall declare the ratio or any change in the ratio after approval from Committee constituted for approval of Pool.
9. The ratio of IRR shall be displayed on the Notice Board of the branches and shall also be available at the website of the Bank.
10. Accumulated balance in IRR shall be invested in SLR eligible Shariah Compliant Securities as soon as possible.
11. IRR shall be reflected as liability in accounts.
12. In case of actual termination of a Pool, its IRR shall be distributed to the Pool.
13. Only those losses shall be set off by the IRR of a Pool which directly relate to that Pool.
14. IRR may be utilized for following purposes:
 - a. Utilize the IRR to cover losses due to unusual large write-offs and/ or significant losses on sale of the Pool Investments.
 - b. Utilize the IRR to cover losses, if any, incurred by the Pool to which this IRR relates.
 - c. Profit is declared up-to two digits after decimal. A difference arises at the time of actual distribution of profit. Net difference shall be paid from or transferred to IRR.

Doubtful Income Reserve Rules

In case any income is considered as doubtful from Shariah point of view, it shall be transferred to Doubtful Income Reserve.

RULES

1. In case, such income has been distributed, income of the month during which this is detected shall be debited to create the Reserve.
2. It shall be made part of Net Income of the Pool, if it is cleared from Shariah point of view.
3. It shall be made part of distributable income of the month during which it is cleared from RSBM.
4. It shall be reflected as liability in the accounts.
5. It shall be paid in Charity as per Charity policy of the Bank.
6. In case this has been declared non Shariah Compliant due to negligence on part of the Bank or its employees as determined by the RSBM, its effects shall not be transferred to Deposits.
7. Each Pool may have its own Doubtful Income Reserve and shall be utilized for the same Pool.

Income Purification of Shares Reserve Rules (IPSR):

Income received from sale of shares of a company through Stock Exchange or Dividend received on such shares is classified as Shares Income. As there may be interest income in the total income of company whose shares were held by the Bank, part of income corresponding to that interest income has to be

transferred to Charity. In order to purify the income, a Reserve shall be created from such income at the time of accrual which shall be called Income Purification of Shares Reserve (IPSR).

RULES

1. IPSR shall be created equal to 5% of all Dividend Income at the time of accrual and 5% of income derived from sale of shares at the time of actual sale.
2. It shall not be created for capital gain unless shares have been sold.
3. Published Balance Sheets of the companies (Annual or Quarterly) shall be analyzed and total interest income for the period shall be extracted. Then percentage of interest income to Net Income Before Tax shall be calculated. The same percentage shall be paid out of the IPSR with following formula:

$$\text{Charity Amount} = \text{Income from Listed Shares} * \text{Interest Income} \div \text{NIBT}$$

4. Balance amount in IPSR shall be made part of distributable income of the month in which charity amount is calculated.
5. It shall be reflected as liability in the accounts.
6. Amount of Charity shall be used as per Charity policy of the Bank.
7. In case Interest Income is more than 5% of the NIBT, share shall be struck off from approved list for investment and required amount for Charity shall be transferred from available income from shares.