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# ACCA Pakistan technical e-newsletter

## Table of Contents

Sarbanes-Oxley and Pakistan: A Way Forward? - A Discussion Paper by <i>ACCA Pakistan</i>	1
Perspective on Fair Tax - Published Research by ACCA	5
Accounting and Auditing Standards Update	6

*ACCA Pakistan* considers this monthly newsletter to be a worthwhile contribution to discussion but does not guarantee the accuracy of statements made by contributors or accepts any responsibility for any statement which may have been made in this newsletter.

# 1. Sarbanes-Oxley and Pakistan: A Way Forward? - A Discussion Paper by ACCA Pakistan

*No business legislation in recent history has elicited a broader range of reaction among financial professionals than the Sarbanes-Oxley Act of 2002. (CPA Journal, 2004)*

The jurisdiction of the much talked about Sarbanes-Oxley Act<sup>1</sup>, also known as SOX, extends beyond the United States of America. A number of multinationals and local listed companies have also been affected by the Act. ACCA Pakistan has come up with a discussion paper "Sarbanes-Oxley and Pakistan: A Way Forward?" to provide an opportunity to various stakeholders to critically analyse the extent to which the Sarbanes-Oxley requirements can be possibly adopted or not in Pakistan as best practice, with or without modifications, even when there is no obligation to comply. The discussion paper has been finalised after a number of interviews with various stakeholders including the partners of 'Big Four' auditing firms, partners of smaller auditing firms, finance directors / controllers of multinationals in Pakistan that are implementing the Act, finance directors / controllers of local-listed companies, financial analysts in securities firms, and regulators.

**Table 1: Brief explanation of the important provisions of the Sarbanes-Oxley Act**

Selection	Brief explanation
101	The Sarbanes-Oxley Act established the Public Company Accounting Oversight Board (PCAOB 'the Board'), which is responsible, with SEC oversight, for establishing or adopting standards for quality control, ethics, independence, and anything relating to the preparation of audited financial statements. The Board also conducts investigations and disciplinary proceedings, and imposes sanctions on individuals or audit firms.
201	An auditor is prohibited from providing a current audit client with non-audit services, including bookkeeping; actuarial services; internal-audit outsourcing services; human resources services; broker-dealer, investment adviser, or investment banking services; legal services and expert services unrelated to the audit.
302	Officers must certify annual or quarterly reports submitted to the SEC. The certifications include that: <ul style="list-style-type: none"> <li>◆ the signing officers have reviewed the report</li> <li>◆ the report does not contain any material untrue statements or material omission or anything that could be considered misleading</li> <li>◆ the financial statements and related information fairly present the financial condition and the results in all material respects</li> <li>◆ the signing officers are responsible for internal controls and have evaluated these internal controls within the previous 90 days and have reported on the findings.</li> </ul> Officers must provide: <ul style="list-style-type: none"> <li>◆ a list of all deficiencies in the internal controls and information on any fraud that involves employees who are involved with internal activities</li> <li>◆ details of any significant changes in internal controls or related factors that could have a negative impact on the internal controls.</li> </ul>
401	The SEC must implement rules requiring issuers to disclose material off-balance sheet transactions.

<sup>1</sup>[www.sarbanes-oxley.com/section.php:level=2&pub\\_id=Sarbanes-Oxley&chap\\_id=PCAOB1](http://www.sarbanes-oxley.com/section.php:level=2&pub_id=Sarbanes-Oxley&chap_id=PCAOB1)

<b>404</b>	Issuers are required to publish information in their annual reports concerning the scope and adequacy of the internal control structure and procedures for financial reporting. This statement shall also assess the effectiveness of such internal controls and procedures.
<b>406</b>	The SEC must issue rules requiring issuers to disclose whether they have adopted a code of ethics for senior financial officers, or if not, why not.
<b>802</b>	Any accountant who conducts an audit of an issuer is required to maintain all audit or review work papers for a period of five years from the end of the fiscal period in which the audit or review was concluded.
<b>906</b>	Each 'periodic report containing financial statements' filed by an issuer must 'be accompanied by' a certification by the issuer's CEO and CFO that the information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.

## 1.1 Aims and Objectives of the Discussion Paper

The main aims / objectives of the discussion paper were:

- a) to gain a clearer understanding of the reasons why some companies in Pakistan are already complying with the Act
- b) to gain a clearer understanding of the level and extent to which businesses in Pakistan are complying with the Act
- c) to ascertain whether there is a need for greater transparency and accountability in the affairs of listed companies in Pakistan and, if so, whether certain provisions of the Act can address this
- d) to investigate the costs and obstacles to compliance with the Act in Pakistan
- e) to stimulate a positive and healthy discussion on provisions of Sarbanes-Oxley Act in particular and future Corporate Governance reforms in general.

Following are the key findings and recommendations of the discussion paper:

## 1.2 Key Findings

- a) Although the Act is external legislation, a number of companies in Pakistan, mainly multinationals or local-listed companies aspiring for a listing on a

US stock exchange or a merger or acquisition with a US listed company, were affected by the SOX legislation.

- b) SOX-compliant companies in Pakistan are generally implementing only section 404 of the Act in Pakistan.
- c) Most of the multinationals in Pakistan have been 'de-scoped' from complete compliance even with section 404 of the Act. This means that even though the parent company is implementing the Act on a global level, the subsidiary or affiliate company in Pakistan is not doing so. The de-scoped locations of a global concern would thus not be subject to internal control verification by an external auditor.
- d) The perceived benefits of SOX compliance are more effective and transparent internal controls, creation of a better audit environment, increased value for investors, and the creation of the Public Company Accounting Oversight Board. Interviewees were generally in favour of the COSO model of internal controls, which is advocated by the US SEC, and were of the opinion that the same model should be adopted in Pakistan to ensure better and effective internal controls.
- e) The perceived barriers to implementation of the Act are the time and effort involved in implementing the internal controls it requires, unavailability of qualified human resources to implement, test and verify those controls, as required by section 404, and the increased cost of hiring consultants to do

this work. One of the greatest obstacles to the implementation of the provisions of this Act in Pakistan is the shortage of accountants and auditors who are qualified to understand and implement Sarbanes-Oxley provisions as best practices in Pakistan. This shortage of qualified personnel needs to be resolved on an urgent basis.

- f) A comparison of the Sarbanes-Oxley Act with the current Corporate Governance regulation in Pakistan, primarily the SECP Code of Corporate Governance was also undertaken. The SECP Code was a much-needed first step in instilling good Corporate Governance practices in Pakistani businesses. Financial collapses have continued to surface in Pakistan even after the implementation of the Code, which has been in place for about five years now. This leads us to the further conclusion that the Code can be strengthened and enhanced.

**Table 2: Comparison of SECP Code of Corporate Governance and the Sarbanes-Oxley Act**

	<b>SECP Code of Corporate Governance</b>	<b>Sarbanes-Oxley Act</b>
<b>Status</b>	A voluntary Code enforceable through listing regulations of stock exchange.	Enacted legislation and enforceable as law.
<b>Audit partner rotation</b>	Requires listed companies to change the firm of external auditors it appoints every five years, and if this is not practical then to rotate the partner in charge of the audit engagement after obtaining the consent of the SECP. However, the 'change of firm' condition has been relaxed for listed companies, other than financial institutions, and rotation of partner is enough.	Sets a five-year limit on the lead and reviewing partner who provides services to an issuer. It also requires a second partner review and approval of audit reports.
<b>Conflict of interest</b>	Requirements stipulate that no listed company shall appoint a person as the CEO, CFO, or internal auditor or as a director of the listed company who was a partner in the firm of its external auditors (or an employee involved in the audit of the listed company) at any time during the two years preceding such appointment, or one who is a close relative of such a partner or employee.	Prohibits registered public accounting firms from auditing issuers whose CEO, CFO or chief accounting officer was employed by the accounting firm and participated in the audit of the issuer in any capacity during the one-year period prior to initiation of the audit.
<b>Assessment of internal controls</b>	Requires only that the Directors' Report should state that the system of internal control is sound in design and has been effectively implemented and monitored. The auditor has no responsibility in this regard. External auditors are required to submit a 'review report' on compliance with the Code of Corporate Governance.	Requires that an issuer's annual report contain a report from management on internal control stating their responsibility for establishing and maintaining an adequate internal control structure and their assessment of the effectiveness of internal control over financial reporting. The external auditor is required to attest to management's assertion concerning its assessment of internal control as part of audit. External auditors are required to express an 'audit report' on internal controls.

<b>Audit committee</b>	Lays out the responsibilities, powers and functions of the board of directors and the audit committee and also requires every listed company to have an internal audit function. It requires only that a majority be non-executive directors and there is no requirement to have a financial expert on the committee.	Requires every issuer to have an audit committee with defined terms of reference and also requires board oversight. Also requires that all members shall be independent and that one audit committee member is a 'financial expert'.
<b>Penalties for non-compliance</b>	Does not contain any provisions related to fines, penalties resulting from non-compliance with the Code. Lawmakers have stated that non-compliance will attract the same penalties, fines, etc as would any non-compliance with the listing regulations and in some areas, the Companies Ordinance, 1984.	Material non-compliance, incorrect certifications of financial conditions and results by the CEO and/or CFO may lead to fines of US\$ 1-5 million and/or 10-20 years' imprisonment for the CEO and CFO
<b>Whistle-blower protection</b>	Not covered under the Code	Whistle-blower protection is extended to employees of companies and accounting firms by SOX.
<b>Disclosure of material changes</b>	Not covered under the Code	Requires disclosure by companies on material changes in financial condition or operations on a rapid and current basis.

### 1.3 Main Recommendations

On the basis of the interviews conducted for the finalisation of the discussion paper the following recommendations have been made:

- a) Some of the provisions of the Sarbanes-Oxley Act may be incorporated in the Code of Corporate Governance of Pakistan. In this context the discussion paper recommends that the Code should require the management's assessment of internal controls and external auditors' verification of this assessment, in line with Section 404 of the Sarbanes-Oxley Act. Guideline should be developed for the management of companies on how to complete their assessment of internal control over financial reporting. The concept of whistle-blowing<sup>2</sup> also needs to be introduced in the revised Code of Corporate Governance.
- b) The discussion paper based on interviews conducted with stakeholders also recommends that the SECP, while formulating a revised Code modeled on the international best practice, may consider regulating the auditing profession in Pakistan through an independent oversight board.
- c) In order to strengthen the control framework of listed companies, SECP and the stock exchanges should encourage companies to adopt the COSO framework of internal control, recommended by the US SEC.
- d) Bearing in mind the problems regarding lack of suitable human resources that interviewees reported, a crucial recommendation of this discussion paper is that all the professional accounting bodies must play a key role in nurturing and cultivating auditors equipped with modern knowledge and skills.

The complete discussion paper is available on [www.pakistan.accaglobal.com/pakistan/publicinterest/T A/SO/](http://www.pakistan.accaglobal.com/pakistan/publicinterest/T A/SO/)

<sup>2</sup> Whistle blowing is the release of information by a member (or former member) of an organisation that is evidence of illegal, unethical or immoral conduct within the organisation.

## 2. Perspective on Fair Tax - Published Research by ACCA

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*It is essential that tax policy is based on clear principles. These are to encourage work, savings and investment, and fairness. Fairness by ensuring that everyone bears their fair share of taxation and pays the correct amount and which is seen to be fair by vigorous pursuit of tax avoidance and evasion (Gordon Brown, former Chancellor of the Exchequer (UK), Financial Statement and Budget Report (FSBR) July 1997).*

### 2.1 Objectives

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The main aim of the research is to review the debate around 'fair taxation'. The research reports the views of economists and accounting scholars on the problems of defining 'fair taxation', and also examines proposals for alternative tax systems. Additionally, responses from a survey among ACCA members in six countries are reported.

There are three components to this research. The first is a review of previous research papers that either discuss or refer to the concept of 'fair taxes'. The second is quantitative research by means of an online questionnaire which sought the views of tax professionals in six countries. Thirdly, it was decided to obtain qualitative responses from tax professionals in each of the countries by holding focus groups. The countries covered in the research are Australia, Canada, Hong Kong, Singapore, United States of America and UK.

### 2.2 Key Findings

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The key findings of the research are:

a) A fundamental issue for governments is to decide on the structure and purpose of the tax system, and to communicate the rationale behind the individual taxes to citizens in a clear manner.

- b) It is apparent from the research that policymakers' views of the purpose of tax policy and the need for equity therein have changed over time, resulting in a system which has been adapted to suit later intentions, thereby increasing complexity.
- c) The research concludes that certainty is a key issue in evaluating fairness and that transparency and complexity have an important bearing on this. The message to governments thus is to reduce the volume of laws, regulations and directives and communicate compliance requirements clearly.
- d) Another issue related to economic change is the fact that the tax system typically cannot keep up with the pace of change. Governments should thus explore the creation of flexibility in the tax structure to allow a swift response to changing economic conditions.
- e) Taxpayer ethics will operate at a higher level within a 'trusting' constitution. The implication of this for the state is that by creating a 'trusting' tax system and thus raising the level of taxpayers' ethics, more taxpayers will feel inclined to comply, thereby reducing administrative costs.
- f) Another factor influencing public attitudes is whether other taxpayers are paying their fair share. There appears to be a need for governments to strive to be seen to be neutral in their dealings with all citizens and to be aware of the importance of communication in achieving that objective.
- g) For a tax system to be perceived as fair by citizens, governments should strive to maintain a trusting constitution where citizens consider they have played a part in setting the system and that the system treats them with respect. Additionally, governments should maintain neutrality in their dealings with all citizens and all sectors of society and be seen to do so. Although it may be difficult to achieve, there appears to be support for exploring mechanisms for flexibility within the tax system to allow a quick response to rapidly changing economic conditions, thereby ensuring that the tax system keeps pace with changes in the economy.

- h) Complexity was seen as a major issue with regard to certainty and thus fairness. Respondents from all countries believed that the chief contributing factor to complexity was the volume of directives, laws and regulations. Therefore, a key message for governments arising out of this study is the need to reduce, or at least contain, the volume of directives, laws and regulations and thereby moderate complexity.

The full paper is available in PDF, from the ACCA website:

<http://newsweaver.co.uk/eletra/go.cfm?z=accatechnical%2C268663%2Cb5nJt1dQ%2C1703946%2CbcLF3MD>

### **3. Accounting and Auditing Standards Update**

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#### **3.1 Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards and IAS 27 Consolidated and Separate Financial Statements**

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The International Accounting Standards Board (IASB) issued amendments to International Financial Reporting Standards (IFRSs) for determining the cost of an investment in the separate financial statements.

The amendments to IFRS 1 and IAS 27 respond to concerns that retrospectively determining cost and applying the cost method in accordance with IAS 27 on first-time adoption of IFRSs cannot, in some circumstances, be achieved without undue cost or effort.

For further information please visit:  
[www.iasb.org/NR/rdonlyres/87C73D9E-177D-49E4-8B1D-FA0AF71BBE14/0/PR\\_Cost\\_of\\_an\\_Investment.pdf](http://www.iasb.org/NR/rdonlyres/87C73D9E-177D-49E4-8B1D-FA0AF71BBE14/0/PR_Cost_of_an_Investment.pdf)

#### **3.2 Report on Improvements to Financial Reporting**

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In March 2008, IFAC issued a report 'Financial Reporting Supply Chain: Current Perspectives and Directions'. The report states that there has been a significant improvement in the financial reporting, corporate governance and auditing in the recent years, but there is still room for improvement and the financial reports can still be more useful.

The report is available at:  
[www.ifac.org/Store/Details.tmp?SID=12047547112246020](http://www.ifac.org/Store/Details.tmp?SID=12047547112246020) and any comments on the report can be submitted through IFAC web page.

#### **3.3 Comments Sought on Recent IPSASB Documents**

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Exposure draft, Social Benefits: Disclosure of Cash Transfers to Individuals or Households, and accompanying consultation paper. Comments are requested by July 15, 2008.

Consultation paper, Accounting and Financial Reporting for Service Concession Arrangements. Comments are requested by August 1, 2008.

The documents can be viewed at:  
[www.ifac.org/eds](http://www.ifac.org/eds). Comments may be emailed to [edcomments@ifac.org](mailto:edcomments@ifac.org).

## about ACCA

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ACCA (Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

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