

ACCA Pakistan technical e-newsletter



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Editor's Welcome

Welcome to the fifth issue of *ACCA Pakistan* technical e-newsletter. Many of the readers of the e-newsletter have asked the editorial board about why *ACCA Pakistan* decided to produce a technical e-newsletter. So the editorial board thought that we needed to share with our readers our vision for this technical e-newsletter.

At *ACCA Pakistan* we have a young, enthusiastic Policy Development team who love to read, research and write about current and emerging financial reporting, business, taxation and auditing challenges. The challenges of accounting in the telecom sector in the last two months have been one of our favourite research areas.

Indeed, the telecom sector of Pakistan is a success story. It has been instrumental in the creation of thousands of job opportunities and has enabled millions of Pakistanis to become connected. One of the reasons for the phenomenal growth of the telecom sector has been its ability to innovate. These innovations have, however, made the Policy Development team recognise a number of accounting challenges.

For example, Raza, a farmer who lives in the village, is going to get married. In order to do his shopping he decides to visit Lahore. He has a mobile phone through which he keeps in touch with his family whenever he visits Lahore. He gets onto the bus and reaches Lahore on 12 February 2008. As his mobile does not have any balance, he buys a card worth Rs300 from a mobile operator outlet. He activates the card soon after the purchase. During his two-day visit to Lahore he makes phone calls worth Rs250 to his family. He returns to the village on 13 February 2008 and gets married in early April 2008. In the

village he does not need to use the mobile phone. The card expires on 12 May 2008 with Rs50 unused credit. When should the Rs300 that Raza had paid be recognised in the accounting books? There are four possible points at which the Rs300 might be recognised (ignoring tax implications):

- when the card is bought and activated by Raza, ie on 12 February 2008
- in accordance with the matching concept, ie on the basis of use of the card
- on the basis of the prudence concept, ie when the card expires on 12 May 2008
- in accordance with IAS 18 and that is earlier of usage of card and expiry of card on 12 May 2008 in which case Rs250 will be recognised on 12 and 13 Feb when the calls are made and Rs50 unused credit will be recognised on 12 May 2008 when the card expires.

Then there are talk shows, music shows and other programmes on TV where millions of people send SMS or make phone calls at premium rates using telecom network operators. Some of the questions that the Policy Development team likes discussing are the following.

- On what basis is the revenue shared between the television channel and the telecom network operator?
- How is the revenue recognised in the books of the mobile network operators – gross or net?
- In the case of lost SMS where the sender is charged, in whose books is the revenue recognised?

Telecom operators pay millions in fees for telecom licences. How are telecom licences amortised – straight line or according to use of licence?

Certain telecom operator networks have come up with 'free talk time' and 'special events' offers where phone calls can be made either free or at reduced rates. Here, the usual costs are being incurred but revenue is either not being earned or is reduced. How is this accounted for in the accounting books?

There are numerous challenges of accounting in the telecom sector that we at *ACCA Pakistan* like discussing but through this e-newsletter we also want to involve our stakeholders in the discussions. We want to engage with you by sharing with you our views on some of the challenges that we consider are important and we would like your views on these issues. We would like to know your opinion about the issues outlined in this e-newsletter and we would like to have your feedback on any other issues that interest you. We look forward to active engagement with you.

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What to look for in the next issue

In the next issue we explore the state-owned investment funds known as sovereign wealth funds. We also consider how banks such as Barclays have benefited from sovereign wealth funds. We will explore why some economists call these funds the 'Next Wall Street'.

Global Standards: The Business Benefits

In 2007, ACCA used the launch of the ACCA Qualification to highlight the importance of professionalism and ethics to individuals and business. During the year, a series of 38 professionalism and ethics events took place in 23 countries. This global series demonstrated how ACCA is able both to lead and to shape the debate on key international issues. The theme selected for this year is 'global standards: the business benefits'.

We live in a global world – a world where news travels fast. Information, goods, services, human skills and knowledge cannot be confined by geographical demarcations. Globalisation has resulted in a number of business benefits, including access to international markets and stock exchanges, but this means that the need for transparency has never been greater. Global standards and best practices enable businesses to achieve transparency.

There has thus been an increasing emphasis on global standards, including:

- international financial reporting standards
- audit and ethical standards
- standards in education, learning and development
- global ethics codes and corporate governance standards
- sustainability guidelines
- public sector reporting standards.

International Financial Reporting Standards (IFRS) are standards and interpretations adopted by the International Accounting Standards Board (IASB) and are the most visible and widely adopted set of global standards within the profession. The aim of these standards is to facilitate comparability and transparency at the global level.

Of 157 major jurisdictions considered by Deloitte on their IASPlus website, to date, 80 require IFRS and 25 permit

IFRS reporting. In addition, Canada (from 2011), Brazil (re listed companies from 2010), India (as Indian FRS from 2011), South Korea (Korean FRS from 2011) and Chile (from 2009) will all be adopting IFRS. IFRS were mandated for listed companies in key markets, including Australia and the EU. Even though US companies are not currently mandated to comply with IFRS, a Deloitte study (2007) of about 300 US companies showed that 20% would consider adopting IFRS if given a choice. Almost two-thirds of those would consider adopting the international standard within the next three years.

Listed companies in Pakistan have to comply with IFRS. There are a number of benefits of compliance with IFRS, including transparency and comparability, resulting in greater investor confidence. There are, however, problems that we face in complying with IFRS. The major problem is lack of human capital and financial capital. Due to [the] brain drain and a number of other reasons, we do not have many qualified accountants in Pakistan who have the knowledge and the skills to prepare financial statements that comply with IFRS. I think that we may be complying with IFRS only for the sake of compliance and we are not aware of the benefits. Training workshops on awareness of benefits need to be held.

CFO of a medium sized listed company

International Standards on Auditing (ISAs) are issued by the International Auditing and Assurance Standards Board (IAASB), which functions as an independent standard-setting body under the auspices of the International Federation of Accountants (IFAC). ISAs are professional standards for the performance of audits of financial information. They aim to provide a high level of assurance to users of financial statements that the numbers and the information they contain are not materially misstated in any way. The auditing standards have been expedient in enhancing the uniformity of auditing practice by professional accountants throughout the world, thus consolidating the public confidence in the global auditing profession.

International Education Standards (IES) The IFAC International Accounting Education Standards Board develops the International Education Standards with which all IFAC member bodies are required to comply in the preparation and continual development of professional accountants. They also establish the essential elements of the content and process of education and development at a level that is aimed at gaining international recognition, acceptance and application.

The IFAC Education Standards do provide an assurance that national systems and processes of education are the same as global best practices. This enhances the mobility of the accounting and finance professionals. In Pakistan, the implementation of these standards in [their] true spirit requires awareness of the standards and understanding the value of the standards. Our businesses will benefit greatly if they are able to easily recruit accountants who have been trained according to international best standards and practices.

Interview with an academic

The IFAC Code of Ethics for Professional Accountants

As a consequence of scandals such as Enron in 2002/2003, the IFAC Code of Ethics for Professional Accountants was revised, following an extensive process of consultation.

The Code sets the standards of conduct for professional accountants and states the fundamental principles that should be observed by them. The IFAC Code of Ethics has been adopted by standard-setting organisations in more than 100 countries, while others are in the process of converging with the Code.

The Code of Corporate Governance of Pakistan requires every listed company to come up with a Code of Ethics. Ethics is important for accounting and finance professionals, as we are the providers and auditors of information. We face ethical dilemmas, as we provide information to our stakeholders. The Code of Ethics of a company very rarely assists in resolving the accounting and finance dilemmas. Best practices like the IFAC Code of Ethics thus may be helpful in the development of a code of ethics for companies.

CFO of a listed company

International Public Sector Accounting Standards (IPSAS)

All over the world, the public sector is a significant player in national economies. The gradual introduction of IPSAS has the potential to enable the public sector to exercise improved financial management over a variety of revenue streams and expenditure heads.

Corporate Governance Standards

Even though there is currently no global corporate governance standard, sets of high level 'principles' exist at the international level (primarily the various OECD codes and Commonwealth guidelines). Corporate governance codes have tended to remain locally defined (for example, the *Combined Code* in the UK or the Code of Corporate Governance of Pakistan).

Social and environmental standards

Standards for regulating the measurement, reporting and assurance of corporate social and environmental impacts have been slower to emerge. The sustainability reporting guidelines of the Global Reporting Initiative (GRI) are an attempt to standardise the reporting of sustainability impacts. Nonetheless, sustainability reporting remains voluntary

in nature and there is a long way to go before the GRI Guidelines reach the authoritative status of the reporting and assurance standards issued by the IASB and the IAASB respectively.

ACCA is a global organisation with members and stakeholders in almost every country in the world. Appropriately, therefore, ACCA has been a champion of global standards for almost two decades. Global standards provide ACCA with many advantages, including providing a common language for education, training and monitoring, reducing the delivery costs of programmes, and increasing the mobility of our membership. We believe that global standards bring benefits to our members in their businesses and in progressing their personal career aspirations – and are a core foundation for supporting the global economy, both in developed and developing markets. Given the large investment in global standards, it is important that the benefit of these standards to business and other stakeholders is assessed.

The ACCA Pakistan technical conference 'Global standards: the business benefits' on 15–16 October 2008 in Lahore will provide an opportunity for stakeholders to assess the relevance of global standards to businesses in Pakistan.

Board Changes at PIA

The board of Pakistan International Airlines was reconstituted by the government recently. The board now includes Minister of Defence Ch. Ahmed Mukhtar, Syed Naseer Ahmed, Malik Nazir Ahmed, Mr Javed Akhter, Capt. Mohmmad Aijaz Haroon, Prof. Mian Ijaz Ul Hassan, Mr Mubashir Iftikhar, Mr Hussain Lawai, Mr Farrukh Qayyum and Mr Kamran Rasool.

The Code of Corporate Governance of Pakistan sets out the qualifications and eligibility criteria for directors.

Board Membership Criteria for Hewlett-Packard Company (HP)

Directors should have the highest professional and personal ethics and values, consistent with HP's longstanding values and standards. They should have broad experience at the policy-making level in business, government, education, technology or public service. They should be committed to enhancing stockholder value and should have sufficient time to carry out their duties and to provide insight and practical wisdom based on experience. Their service on other boards of public companies should be limited to a number that permits them, given their individual circumstances, to perform responsibly all director duties. Each director must represent the interests of all stockholders.

Extract from Hewlett-Packard Company Corporate Governance Guidelines

The board of directors of a company has a critically significant role in setting the direction of a company.

While the executive management of a company run the business, the board sets the direction of the business (see Figure 1).

Figure 1 Direction vs Management¹



The board's key responsibilities are providing strategic guidance and oversight of management, ensuring that corporate governance frameworks and policies are in place, acting as stewards of shareholders' interests, and overseeing compliance with applicable national and international laws and standards. The board is expected to have due consideration for, and deal fairly with, other stakeholders. In all its decisions it must exercise objective and independent judgement and promote the success of the company by directing and supervising the company's affairs. It should also provide entrepreneurial leadership within a framework of prudent controls that enable risk to be assessed and managed. The entrepreneurial flair and decision-making ability of a board of directors is enhanced by the inclusion of independent non-executive directors.

Why do boards fail?

- reporting structure inappropriate
- inadequate information
- insufficient challenge and debate
- no post-mortems
- won't take hard decisions
- not pushing the management
- finance not kept under review
- power too concentrated
- rubber stamping
- no rigorous review or appraisals

The Code of Corporate Governance of Pakistan encourages the inclusion of independent non-executive directors on the board alongside the full-time executive directors. An independent director is independent in character and mind and has no material relationship with the company beyond his or her directorship. An independent non-executive director can act as the conscience of the company, contributing constructively to the decisions made by the board as well as ensuring that shareholders' rights are protected.

¹ Tricker, R.I. (1984). *Corporate governance: Practices, procedures and powers in British companies and their boards of directors*. London: Gower Publishing.

The UK Combined Code of Corporate Governance outlines the following criteria for independence.

Role of NEDs - 11 'C's

- contributor
- Challenger of executives' proposals
- contact provider
- confidante
- conciliator
- checker of Board processes
- crisis manager
- coach/mentor to executive directors
- consultant
- compensation
- conscience of the company

A person will be considered independent if he or she:

- has not been an employee of the company or group within the last five years
- has not currently or within the last three years, had a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company
- has not received and is not currently receiving additional remuneration from the company, apart from a director's fee, does not participate in the company's share option or a performance-related pay scheme, and is not a member of the company's pension scheme

- has no close family ties with any of the company's advisers, director or senior employees
- holds no cross-directorships and has no significant links with other directors through involvement in other companies or bodies
- does not represent a significant shareholder, and
- has not served on the board for more than nine years from the date of their first election.

The [*Survey of Corporate Governance of Pakistan – 2007*](#) indicated that local listed companies are reluctant to include independent directors on the board. Their reasons included an inability to find independent non-executive directors with the right mix of skills and knowledge, dissatisfaction with the performance of non-executive directors, and concerns about losing control of the company. The *Survey* suggests that in keeping with international best practices, whenever the review of the Code of Corporate Governance takes place, a 'comply or explain' approach needs to be adopted towards inclusion of independent non-executive directors on the board, ie either a company should have a specified number of independent non-executive directors on the board or should explain why it does not have them.

Accounting and Auditing Standards Update

IAASB issues standards on Written Representations and Subsequent Events

The IAASB (International Auditing and Assurance Standards Board) has issued the following two International Standards on Auditing (ISAs), as part of its Clarity Project.

ISA 580 (Revised and Redrafted), Written Representations

This ISA deals with the auditors' responsibility to obtain written representations from management and, where appropriate, those charged with governance.

For further details please visit:
[ifac website: ISA 580](#)

ISA 560 (Redrafted), Subsequent Events

This ISA deals with the auditors' responsibility relating to subsequent events in an audit of financial statements.

For further details please visit:
[ifac website: ISA 560](#)

IFAC releases guidance for professional accountants in business

As part of its programme to develop guidance to support professional accountants in business in delivering long-term value to their organisations, the Professional Accountants in Business (PAIB) Committee has released new guidance entitled 'Project Appraisal Using Discounted Cash Flow'.

For further details please visit:
[ifac website: guidance for professional accountants](#)

Finance Act 2008

Reflections

An officer at FBR

We have brought directional changes in this budget, such as by linking tax limits with indexation and introducing progressive tax rates. The much-talked-about investment tax scheme is to legalise the common practice of bringing funds to this country through 'hundi'. We have weeded out anomalies at the import stage by introducing uniform tax rates.

SME owner

I think the increase in sales tax rate from 15% to 16% is going to cause a very negative impact on the economy as a whole. It will lead to an increase in prices of almost all commodities and will increase inflation. Similarly, the collection of import duty as withholding tax will cause cash flow problems for importers. The positives coming out of the Finance Act 2008 (FA 2008) are the abolishment of the minimum tax for companies and the introduction of progressive tax rates for the SMEs.

Controller of Accounts in Multinational Company

FA 2008 has increased sales tax from 15% to 21% on telecom services, which will increase the cost of running a business, as most of the telecom services are using outside production facilities and their input tax cannot be claimed for refund.

Importer

If only the sales tax rates [were to] be uniform, I could save a lot on my admin cost.

An office clerk

Increase in the salary exemption limit is

good, but I still feel that considering the recent inflation rate the exemption limit should have been doubled.

Finance Executive in a Multinational Company

Marginal tax relief came as a pleasant surprise [but] other than that budget was all bad news especially for the middle class.

Chief Financial Officer in a Multinational Company

Expanding the scope of the dividend to include foreign branches and the change in the thin capitalisation rule can make Pakistan less attractive to foreign investors.

Partner at a Big Four Auditing Firm

There are a few favourable changes introduced through the FA 2008, of which the most notable are:

- *revision in the taxation of rental income, through which exemption of rental income of Rs150,000 and reduced tax rates have been introduced for individuals; further, progressive tax rates have been introduced for varying levels of rental income*
- *90% First Year Allowance (FYA) for assets in specified undeveloped areas*
- *the treatment of expropriation of branch profits as dividends. This will bring uniformity with a subsidiary of a foreign company expropriating its after-tax profits.*

However, the increase in the sales tax rate will cause a boost in inflation. Another area where FBR needs to revise its strategy is that it is aiming to collect 60% of the tax revenue through indirect taxes and 40% through direct taxes. Direct taxes are income based and the approach should be to collect tax revenue from this sector.

Did You Know?

- If your monthly salary is no more than Rs15,000 there will be no tax deduction from your salary.
- If you are a woman and your salary is no more than Rs20,000 there will be no tax deduction from your salary.
- Before the introduction of Marginal Tax Relief the tax on your salary could have increased up to Rs84,000 whenever you cross the salary slab by only Re 1!
- You will now be taxed on the amount of provident fund contribution made by your employer that exceeds Rs100,000 per annum or 10% of your annual salary.
- A company will remain a small company even if its turnover exceeds Rs250 million per annum².
- A business can now pay salaries of up to Rs15,000 in cash.
- A business can now enjoy a First Year Allowance (FYA) of 90% on the cost of plant, machinery and equipment (PME) if all of the following conditions are met:
 - it is not previously used in Pakistan
 - it is installed by an industrial undertaking
 - the industrial undertaking is in specified rural and underdeveloped areas
 - the industrial undertaking is owned and managed by a company
 - PME is put to use after 1 July 2008.
- The minimum tax, previously paid even by loss-making entities, is now abolished.
- If you are an individual and your annual rental income does not exceed Rs150,000, there is no tax liability.

² Small company defined in section 2 sub section 59A, Income Tax Ordinance 2001.

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