

# ACCA Pakistan technical e-newsletter



**ACCA Pakistan**  
technical e-newsletter  
ISSUE 7, Oct - Nov 2008

# From the editorial desk

'Bliss was it in that dawn to be alive,

But to be young was very heaven!'

(From *The Prelude*, William Wordsworth, on the French Revolution)

A fundamental principle of the 21<sup>st</sup> Century is that things change. As we prepare to bid farewell to 2008, much has changed in this one year. Nationally, we have a new government, economic growth has slowed, inflation is increasing, poverty figures are becoming alarming, but while the US and the European banking sector struggles for survival, the banking sector of Pakistan has remained resilient. Industrial growth has remained sluggish and the general mood in the country is of pessimism, but there are signs of change in the next year. The IMF has agreed to give us a loan. We may have reservations about the loan but let us hope that this loan brings sustained growth and development to Pakistan. The friends of Pakistan are willing to invest in Pakistan. The rupee has started recovering against the dollar. I recently visited Shaukat Khannum Memorial Hospital (SKMTH) to inquire about the health of a relative. I felt proud to be a Pakistani. The hospital is a tribute to us the nation. It shows how when we Pakistanis believe in the sincerity of a cause, we can come together to overcome any obstacle, the impossible destination then becomes our destiny. There are many other stories of

national pride.

Internationally, the credit crunch has been the main news of the year. The American nation has voted for change. Barack Obama has been elected as the next President of America. As think tanks dissect the reasons for the credit crunch, calls for changes to accounting standards, greater transparency in reporting and corporate governance have been hitting the headlines. From the G20 summit to national politicians to economists to the common man, everyone is commenting critically on accounting standards, the fair valuation model, the going concern concept and convergence with IFRS. Analysts and commentators are assessing the utility of annual reports to their users, and wondering why a plethora of standards could not prevent institutional collapses. We in Pakistan also need to assess the financial reporting implications of the credit crunch. Through discussions arise ideas, thoughts and vision, which when implemented initiate change.

As pressure mounts for more transparency of financial reporting standards, a question being asked is whether, in the pursuit of the implementation of standards,

principles were sacrificed. In this issue we introduce the discussion theme 'From principles to standards: have accounting and auditing changed for better or worse?' At ACCA we lead discussion and thus encourage you all to send us your opinions on this theme.

In this newsletter we have included a section called 'Ponder Time'. The section intends to encourage you to ponder a question and send your feedback to *ACCA Pakistan*. In the current issue we raise the question 'Are annual reports dead or alive?' As the poverty figure in Pakistan rises, the importance of microfinance as a means of poverty alleviation and of creating an equitable Pakistan has increased. In this issue, we comment on the possibility that greater access to microfinance will result in a more equitable Pakistan.

As this is the last issue of this year's *ACCA Pakistan* technical e-newsletter, on behalf of *ACCA Pakistan* we wish you all a very happy new year as well as Happy Eid.

## **Enjoy the Eid.**

Keep in touch by e-mailing us your dreams, your aspirations, your hopes for the technical e-newsletter.

Allah Hafiz

# Contents

## **Discuss**

**From Principles to Standards: have accounting and auditing changed for better or worse?**

---

4

## **Accounting and Auditing Standards Update**

---

5

## **Ponder time:**

**Annual reports: Dead or alive?**

---

6

## **Sneak Peak**

**Microfinance in Pakistan: striving towards an equitable Pakistan**

---

8

## **Making Contact**

---

The editorial desk can be contacted at  
[technical@acca.org.pk](mailto:technical@acca.org.pk)

# Discuss

## From Principles to Standards: have accounting and auditing changed for better or worse?

It is easy to fall into the trap of answering this question from the perspective of the accountant or auditor in public practice, engaging with the world of publicly listed, quoted, limited liability corporations. Yet before we move into this relatively small part of the global economy we should not forget the perspective of the accountant working in the many large and small businesses that are not public or listed or quoted but which constitute the powerhouse of all economies.

Among these firms, the perspective is actually pretty good. Certainly, over the last two decades, the advance in ICT, combined with highly competent accountants who engage and align themselves with the businesses they serve, has led to a vibrant profession that provides accurate, relevant financial information to the managers and owners of those businesses. Building robust multi-currency international accounting systems has enabled business management to pose more sophisticated questions of the data they are confronted with, thereby allowing them to divide their markets into segments and drive their businesses forward. With many ways of mining data, questions can be asked about the product and service life cycles, allowing swifter responses to changing customer and client needs, and more effective exploitation of the intellectual capital within the organisation, well as better management of the vital functions of controlling cash flow and generating increasing value. In so doing, the accountant in business in many jurisdictions has the number-two role in the business corporation, and is a trusted ally of the managing director or chief executive. Of course, it would be

complacent to assume this situation will last indefinitely, and the accountant in business must constantly work at his/her art to justify this cherished position. But 'principles', 'standards', and to a lesser extent 'auditing' drive us to consider the state of things from the perspective of the many stakeholders in the publicly listed, quoted, limited liability corporations. It may be worth reminding ourselves of who some of those stakeholders are:

- individual shareholders
- investment funds
- sovereign wealth funds
- the board of directors and, increasingly, the chief executive officer as a separate role
- employees
- pensioners
- customers and clients
- creditors and suppliers
- credit rating agencies and analysts
- national and local governments
- tax authorities
- NGOs
- account preparers
- statutory auditors, and
- non-statutory auditors and assurers

This is a vastly diverse and fragmented list. The relative influence of these parties will wax and wane over time and between jurisdictions. For example, with the recent extraordinary events in the US and UK investment and retail banking and insurance markets we can expect to see a backlash of regulation and a reassertion of the power of national government. Shareholder activists are likely to be very

robust in their dealings with boards of directors, and particularly with the chief executive roles. This should remind us that accounting and auditing do not develop within a vacuum. At all times, our profession needs to pay attention to the fundamental economic shifts that dictate how and why we account for transactions. An increasing complaint directed at the international accounting and auditing standard setters is that standards have become both overly complex and divorced from fundamental economic trends. In the light of the collapse of large sections of the derivatives markets over the last 15 months, for example, we need to ask whether there was ever a 'market' there at all, or whether we were simply watching a grotesque combination of massive computing power and serious intellectual horsepower to create a folly, a castle built on sand. We will find out in time. The brief asks us to consider 'principles' and 'standards'. Do we have a clearly defined set of principles that guide our professional development? Certainly we began with the four fundamental accounting concepts, and possibly the fifth, of materiality. In certain jurisdictions the principle of 'true and fair' has been incorporated into law. Nonetheless, there are many terms we commonly use that do not come from a conceptual framework and are therefore open to wide interpretation the dichotomy between 'rules-based' and 'principles-based' regulations is one example; the notion of 'fair value' is another. This should be of some concern to us, since our essential principles should be informing our standards. This suggests that the International Accounting Standards Board's

project to revisit the conceptual framework is timely, relevant and necessary. The notion of progressing from principles to standards is to alert us to the way in which that road has been travelled to date within the IFRS and IAS standard-setting process. No one would question the need for international accounting and auditing standards. There are now many corporations large and small that work internationally in terms of their supply chains, their delivery to customers and clients and, perhaps most importantly, in where they derive their capital. For those who provide the capital it is imperative that financial statements are transparent (an easy word to use; harder to

demonstrate in practice) and comparable in order that the capital allocation decision can be made in a rational manner. But what of the way international accounting and auditing standards have evolved from principles?

The International Accounting Standards Board can rightly lay some claim to success in the acceptance of IFRS in over 200 jurisdictions. And a notable advance is, of course, the agreement of the US SEC both to accept convergence with IFRS and to allow that those US corporations that adopt IFRS need not reconcile their financial statements with US GAAP. But, as referred to above, there are increasing concerns about the complexity of the

standards themselves. And, more fundamentally, there are concerns about the governance of the IASB and therefore its legitimacy to act as an international standards setter as witnessed by the IASB's foundation's recent consultation on the constitution and size of the IASB. Similar concerns about governance and overly complex standards have focused on IFAC, the international auditing standard setter.

Perhaps we should be asking ourselves what we mean when we speak of changing an accounting and auditing function for the better. What would be the key attributes of an improved system?

# Auditing and Accounting Standards Update

## Exposure draft of Additional Exemptions for First-time Adopters: Amendments to IFRS

1  
The IASB (International Accounting Standards Board) has issued an exposure draft containing additional exemptions for first-time adopters of IFRS. IASB has also asked for stakeholders' comments on the exposure draft; the last date for submission of comments is 23 January 2009.

To view the exposure draft, please visit:  
[ED of Additional Exemptions for First Time Adopters: Amendments to IFRS 1](#)

## Amendments to IAS 39 Financial Instruments: Recognition and Measurement

The IASB has issued amendments to IAS 39 that allow an entity to reclassify some non-derivative financial assets out of the held-for-trading category and loans and receivables out of the held-for-trading or available-for-sale categories.

For further details, please visit:  
[Amendments to IAS 39 Financial Instruments: Recognition and Measurement](#)

## IASB issues Fair Value Guidance

IASB has issued guidance on the measurement of fair value when the markets are inactive. The report looks at the fair value disclosures in such a situation. For further details, please visit:  
[IASB Guidance](#)

# Ponder time: Annual reports: Dead or alive?

*'We commit to implementing policies consistent with the following common principles for reform:*

*\* Strengthening Transparency and Accountability: We will strengthen financial market transparency, including by enhancing required disclosure on complex financial products and ensuring complete and accurate disclosure by firms of their financial conditions. Incentives should be aligned to avoid excessive risk-taking.*

*\* Enhancing Sound Regulation: We pledge to strengthen our regulatory regimes, prudential oversight, and risk management, and ensure that all financial markets, products and participants are regulated or subject to oversight, as appropriate to their circumstances. We will exercise strong oversight over credit rating agencies, consistent with the agreed and strengthened international code of conduct. We will also make regulatory regimes more effective over the economic cycle, while ensuring that regulation is efficient, does not stifle innovation, and encourages expanded trade in financial products and services. We commit to transparent assessments of our national regulatory systems.'* (Extract from the declaration of the G20 summit on Financial Markets and the World Economy, 15 November 2008)

As I read the declaration of the G20 summit on financial markets and the world economy, I thought to myself that we live in interesting times. Once again, the accounting world stands at a crossroads. Revolutionary changes are in the air and for young people, it is time to read, think, wonder, analyse and then be the change leaders.

The G20 leaders aspire to strengthening transparency and accountability and enhancing sound regulation. The French President, Nicolas Sarkozy, wants to reform the fair valuation model, which in his opinion has aggravated the credit crisis. American President Bush wants improvement in accounting rules so that investors can make informed decisions. The European Commission has expressed concerns about the fair valuation model, asking the International Accounting Standards Board (IASB) to amend or issue guidance on IAS 39.

*Annual reports do contain relevant information for decision making. However, the absence of an oversight board to verify the correctness of the whole system and for keeping a check on the same is lacking in Pakistan. (Vice President of a large local listed bank)*

The Financial Institutions Bailout Bill, approved by the United States House of

Representatives, urged for a study on mark-to-market accounting. It had two sections relating to fair value measurement.

While politicians want radical changes to accounting rules, accounting standard

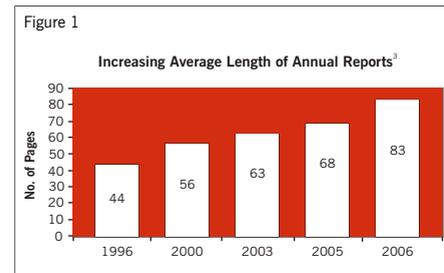
*Revenue, expenses and EPS are the major information avenues for an average decision maker. Annual reports contain this information, but sometimes absence of information about a material one-off source of revenue misleads the users into making wrong investment decisions. (An accountant of a local listed company)*

setters caution restraint. Even though the IASB has issued educational guidance on the application of fair value measurement when markets become inactive<sup>1</sup> and an exposure draft of proposed amendments to IFRS 7 Financial Instruments: Disclosures<sup>2</sup>, accountants are warning against a 'knee-jerk' reaction to the crisis. IASB is organising a series of roundtables and has initiated a study into the credit crunch crisis so as to take into account the perspective of the users and preparers of annual reports on the changes (if any) that need to be made to accounting rules and annual reports.

The annual report the document that has

weathered many previous crises, once again faces a new crisis. A question being asked is 'are annual reports in their present form useful to their users, namely investors, in making decisions?' This is not the first time that this question has been asked and nor will it be the last time. Academic researchers have produced voluminous research in an attempt to pass a final verdict on the usefulness of annual reports. The research to date has remained inconclusive.

As researchers have tried to find an answer to the question of the relevance of annual reports, preparers have continued to produce them. Standard setters, policy makers, preparers and users have continued to suggest and implement innovations in annual reports. Owing to these innovations, the annual report of today is a voluminous document as shown in figure 1.



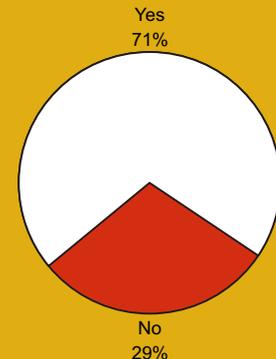
<sup>1</sup>[http://www.iasb.org/NR/rdonlyres/F3AFDA4D-6605-42CE-858F-23BBB9044355/0/IASB\\_Staff\\_Summary\\_October\\_2008.pdf](http://www.iasb.org/NR/rdonlyres/F3AFDA4D-6605-42CE-858F-23BBB9044355/0/IASB_Staff_Summary_October_2008.pdf)

<sup>2</sup><http://www.iasplus.com/pressrel/0810ifrs7ed.pdf>

<sup>3</sup>Reasons to write, A Survey by Deloitte & Touche

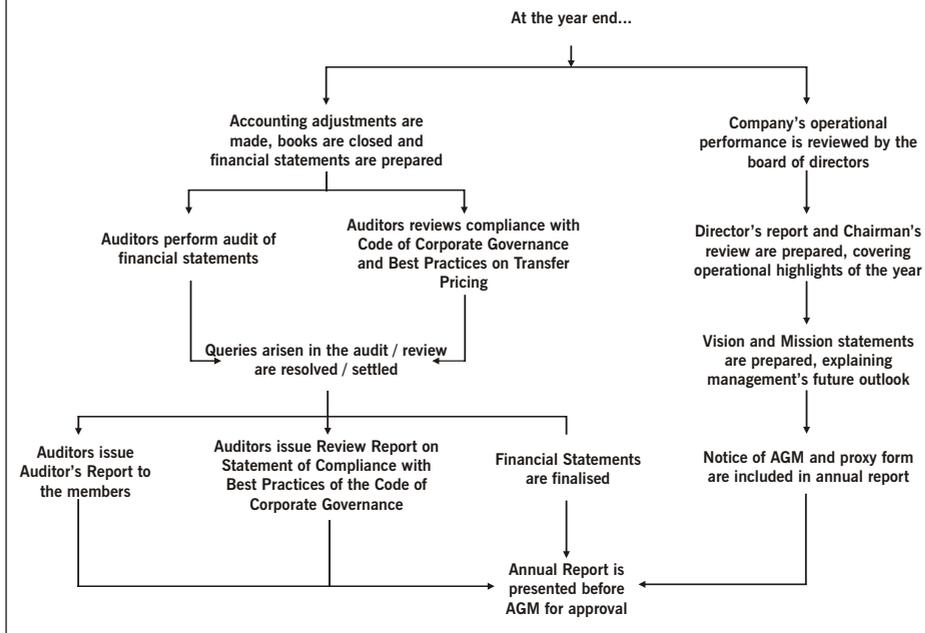
# Quick poll on the usefulness of annual reports

Annual reports are published each year by listed companies with the aim of presenting their operational results and financial positions. But do these reports provide useful and relevant information to the stakeholders? We did a quick poll of 50 accountants to find out how accountants perceive the annual reports. As outlined in Figure a majority of respondents (71%) stated that annual reports published by listed companies contain relevant, reliable and useful information for making informed decisions.



Nonetheless, these responses contained some reservations, which included the lack of an oversight board in Pakistan, the need to establish remuneration committees, and the inconsistencies between the information and disclosures in the annual reports of different companies. Twenty-nine per cent of respondents were not in favour of relying on annual reports for making investment decisions and strongly recommended inclusion of additional disclosures and analysis of financial and non-financial information.

**Figure 2:**  
How is an annual report prepared?



*Annual reports usually do not go into details about their future course of actions for achieving their ultimate mission/vision. Directors' reports should also include financial analysis of different business segments and comparative industry information'. (An academic)*

Every problem in the last decade, whether the Enron or tiger economies crises of the late 1990s or the rising importance of 'triple bottom line' reporting, has raised questions about the relevance of annual reports. The preparers and the standard setters have responded not by abandoning annual reports but by initiating changes to that have resulted in the transformation of the annual report from a document of few pages to a document of numerous pages. As the world today brainstorms the causes of the credit crunch and calls for changes

in accounting rules, designers and preparers of annual reports can hear the bells of change. It is the resilience of the annual report to change that keeps it alive. One only hopes that any change results in increased usefulness of annual reports for decision making, rather than creating an information overload.

*I think disclosures about legal disputes and their financial implications are usually ignored in the annual financial statements. This creates a wrong image for a prospective investor as regards the financial viability of a company. (An accountant of a local private company)*

# Sneak Peak

## Microfinance in Pakistan: striving towards an equitable Pakistan

Five years ago, Naheed's life was in disarray. Her husband, a tailor by profession, had sustained spinal cord injuries in a road accident. He was physically incapacitated and could no longer earn a living. Naheed thus had four young children and a husband to take care of. Today Naheed owns a profitable business. A few years ago, Ali Sher Sheikh lived a hand to mouth life. He did not have the finances to carry out his livestock business as well as provide for his family. Today he has a successful livestock business and his family is well provided for. Masoom Ali Shah, a craftsman by profession and a father of seven children, had a small business in Muzaffarabad. The devastating earthquake that hit Pakistan on 8 October 2005 ruined his home and business. He and his family faced a life that threatened financial hardships. Today he has been able to re-establish his business and his family leads a comfortable life. The transformation in the lives of Naheed, Ali Sheer and Masoom was possible because of access to microfinance loans.

In a country where, according to different estimates, 23% to 25% of people live below the national poverty line, access to microfinance has been outlined in recent major studies<sup>4</sup> as instrumental in poverty alleviation. The majority of Pakistan's population live in rural areas where employment opportunities are scarce and the literacy rate is low. For a large segment of the population the source of income has historically been farming. Increasing inflation has, however, resulted in financial constraints as many find it difficult to purchase seeds, fertiliser and fodder, or to pay electricity bills. The fishermen of semi-urban areas of Sindh (a province of Pakistan) are today in danger of losing their livelihood. For many of them it is

financially impossible to buy fishing boats or nets. Womenfolk in rural and semi-urban areas have traditionally supplemented the family income by making dresses, doing embroidery or making handicrafts but, as poverty has increased, both finding clients in these areas and purchasing the raw materials have become arduous. Access to finance may result in the elimination of their financial hardships and the survival of their existing sources of income, but the challenge is sourcing the finance. Commercial banks will not provide these people with finance, as it is not commercially viable for them and it is not even their objective.

'There is a realization today that collectively the billions of poor and low-income households have immense entrepreneurial capability and buying power. They represent a most exciting and fastest growing new market. The name of the game is about creating an inclusive society and a taxation system that promotes inclusion and equity while striving towards a more equitable Pakistan.' Mr. Ghalib Nishtar, President Khushhali Bank Pakistan (Pakistan's leading microfinance institution) speaking at the *ACCA Pakistan* Pre-Budget Seminar.

Microfinance institutions offering small loans on easy terms and conditions can bring about a revolutionary change in the lives of millions of these individuals. In Pakistan a number of microfinance institutions and banks are striving to provide access to microfinance to millions of under-privileged Pakistanis.

An example of such an institution is Kashf Foundation one of Pakistan's leading microfinance institutions, providing financial services to women from low-

income households. What began as an action research programme in 1996, currently has estimated 170 branches, 302,312 clients with outstanding loans of Rs.2.97 billion. Kashf follows the Grameen model, lending to groups of 1525 women without collateral or guarantee, relying only on social collateral. Kashf has made a significant impact in terms of increasing its clients' daily income. Mature clients enjoy incomes 51% higher than the Foundation's new clients, indicating success in poverty alleviation.

Despite significant growth in the past five years, the microfinance services in Pakistan, as compared with other countries such as Bangladesh, are still in their early stages of development. It is estimated that microfinance services have reached out to only one million clients while approximately 5.6 million households are in urgent need of these services. In the years to come, microfinance institutions will have to increase their outreach to provide the opportunity of financial survival to millions of extremely talented but underprivileged Pakistanis. According to estimates, by 2010 the number of microfinance clients is expected to increase to three million, provided that microfinance institutions invest in human resources and information technology, are able to sustain growth and increase their outreach to areas as yet unexplored.

As microfinance grows in Pakistan, opportunities may arise for accountants to provide advice to micro-entrepreneurs about maintaining reliable and accurate accounting records as well as making business plans. It may be early days but it is possible that in days to come accountants may assume a new role that of an enabler enabling micro-entrepreneurs to plan for a sustainable future and poverty-free world.

<sup>4</sup>E.g. *Pakistan, Promoting Rural Growth and Poverty Reduction*, World Bank, March 2007

**TECH-TEN-007**

**ACCA Pakistan** 61 C Main Gulberg Lahore 54660 Pakistan / +92 (0)42 111 22 22 75 / <http://pakistan.accaglobal.com>  
An Association established under section 42 of the Companies Ordinance 1984