



Selected Opinions Volume XVIII

From July 1, 2012 to June 30, 2013

Compiled by Technical Services Directorate
The Institute of Chartered Accountants of Pakistan

INTRODUCTION

This report is the eighteenth compilation of selected opinions issued by the Technical Advisory Committee on inquiries raised by the members and other agencies during the period from **July 2012 to June 2013** for the general guidance of the members of the Institute.

The opinions contained in this compilation are of the competent Committees constituted by the Council of the Institute and are of operational nature and not on issues on which relevant laws and rules are not explicit. These “Selected Opinions” are not a compendium of “legal advice”.

The opinions issued by the Committees to the members’ queries are dated. Since an opinion is arrived at on the basis of the facts and circumstances of each individual query, it may change if the facts and the circumstances change. An opinion may also change due to subsequent developments in law, pronouncements made by the Institute and other relevant changes. The Institute and the Committees will have no liability in connection with such opinion.

In every case the members have to take their own decisions in the light of facts and circumstances in accordance with related laws and rules etc., applicable to the issue under decision at that point in time.

Haroon Tabraze
Director Technical Services

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1.1 EXEMPTION FROM DISCLOSURE REQUIREMENTS OF IAS-12 INCOME TAXES

Enquiry: A request has been received from a Company to a Commission for exemption/ waiver to Company for complying with the provision of IAS-12. The Company has stated that said waiver is requested till its taxable depreciation losses are not fully adjusted against the profits generated. The Company has unabsorbed depreciation loss owing to capitalization in the years 2007-09 and in 2010-11. However the Company expects to pay only minimum tax on turnover and does not normal foresee tax liability to arise in future as the forecasted profits and budgeted capital expenditure are not expected to fully absorb the depreciation loss. As the Company requires building reserves for redemption of preference shares, the aforesaid provisioning is directly affecting its reserves. The Company therefore has requested exemption from disclosure requirements of deferred tax liability as per IAS-12 for as long as its depreciation losses are not fully adjusted against profits generated and the Company has to pay minimum tax only.

With respect to preference shares of the Company, it may be noted that 300 million 13% non-voting cumulative redeemable preference shares of Rs. 10 each, as right shares were issued by the Company in 2009. The main features of said preference shares are summarized below:

- a. **Issue size:** Up to PKR 3,100,000,000/-
- b. **Proportion:** 4.25 Preference shares for every 1 ordinary share held
- c. **Dividend:** Coupon Rate: 13% p.a. on cumulative basis.
- d. **Preferential cumulative dividends:**
 - Annual dividends payable when and if dividend declared by the Company but shall be paid on cumulative basis prior to any dividend or other distribution payable to ordinary shareholders.
 - Annual dividends payable on accumulated @ 13% per annum on the face value of the preference shares.
- e. **Company's redemption option:** The Company shall have the option to redeem the share in full or in part, within ninety days of the end of the completion of any quarter, commencing from the expiry of third anniversary of the issue ("Redemption Period") by giving at least thirty day's notice. A minimum of 1/ 10th portion of the total issue size of the preference shares may be redeemed by the Company during any redemption period. The redemption will be at the option of the Company and subject to availability of funds and compliance with the provisions of Section 85 of the Ordinance.
- f. **Utilization:** Proceeds from issuance of preference shares shall be utilized for Company's operations including reduction in its debt obligations and to comply with the terms of the lenders of the Company.

You are requested to provide your comments in light of requirements of IFRS whether, keeping in view the structure as defined by Company, deferred tax liability can be regarded as a mere notional entry however substantially affecting the general reserves. Moreover, you are requested to ascertain if exemption given to the Company from the

disclosure requirements of deferred tax liability under IAS-12 shall affect the true and fair view of the financial statements.

Opinion:

The Committee would like to emphasize that compliance with accounting standards and local laws result in a true and fair view of financial statements. Disagreement with a particular standard or omitting a requirement due to exemptions received from the regulator does not, on its own, provide grounds from departing from the principles of 'true and fair view'. Almost all true and fair view overrides are due to provisions of law, including exemptions given by the Regulator.

The Committee would like to draw attention to the following paragraph of IAS 12 'Income Taxes':

- 15 A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:
- (a) the initial recognition of goodwill; or
 - (b) the initial recognition of an asset or liability in a transaction which:
 - (i) is not a business combination; and
 - (ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

The above paragraph requires that all taxable temporary differences (except as stated in (a) and (b) above) should be considered while calculating deferred tax liabilities.

The Committee is of the view that recognition of deferred tax liability is mandatory irrespective of timing of reversal. Non-recognition of deferred tax liability would not only overstate the profits but also understate liabilities and it is not prudent to not recognize one liability to provide for recognition of another liability. The Committee is also of the view that movement in net deferred tax liability and the charge of deferred tax in the profit and loss account is not a notional entry. In fact, it is arising (and will arise in future) as a result of changes in tax bases and accounting bases of assets and liabilities.

However, the Regulator has the powers to provide exemption under the local law. In case such exemption is granted, the accounting standards require certain disclosures, as described in the following paragraphs of IAS 1 'Presentation of Financial Statements':

- 19 In the extremely rare circumstances in which management concludes that compliance with a requirement in an IFRS would be so misleading that it would conflict with the objective of financial statements set out in the Framework, the entity shall depart from that requirement in the manner set out in paragraph 20 if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.
- 20 When an entity departs from a requirement of an IFRS in accordance with paragraph 19, it shall disclose:
- a) that management has concluded that the financial statements present fairly the entity's financial position, financial performance and cash flows;
 - b) that it has complied with applicable IFRSs, except that it has departed from a particular requirement to achieve a fair presentation;
 - c) the title of the IFRS from which the entity has departed, the nature of the departure, including the treatment that the IFRS would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in the Framework, and the treatment adopted; and

- d) for each period presented, the financial effect of the departure on each item in the financial statements that would have been reported in complying with the requirement.

Based on the facts provided, the Committee strongly believes that not accounting for the deferred tax liability may provide misleading information regarding profits of the company, and hence, does not support exemptions from the provisions of IAS 12.

(Nov 28, 2012)

1.2. OPINION ON ACCOUNTING FOR EXCHANGE OF MEMBERSHIP CARD WITH SHARES AND TRADING RIGHT ENTITLEMENT CERTIFICATE ON DEMUTUALIZATION OF THE STOCK EXCHANGES

1. The following guidance paper has been prepared in response to various queries received by the Technical Advisory Committee (TAC) from the members of stock exchanges in relation to accounting for exchange of membership cards with shares and Trading Right Entitlement Certificate on Demutualization of Stock Exchanges.

Background:

2. Before demutualization, the three stock exchanges of Pakistan were functioning as Guarantee Limited Companies, wherein ownership and trading rights were conferred to members through a membership card. Pursuant to the promulgation of the Stock Exchanges (Corporatisation, Demutualisation and Integration) Act, 2012 [the 2012 Act] on 9 May 2012, the ownership in a stock exchange has been segregated from the right to trade on the exchange. Therefore, the membership card has now been replaced by:
 - a) Shares in the exchange; and
 - b) Trading Right Entitlement Certificates (TREC)
3. Each membership card holder is entitled to 4,007,383 shares, along with a TREC. 60% of the entitlement of each member's shares would be blocked in a separate account held with CDC. The blocked shares would be sold to strategic investors and general public at a future date, at a price which remains to be finalised. The remaining shares (40% of the total entitlement) are now available to each member, with no condition on their future sale.
4. Each member has also received a TREC. This initial TREC may be sold or transferred once, by the member. However, once sold or transferred, it would take the form of a 'licence' and would not be saleable / transferrable again. Under the 2012 Act, a stock exchange may issue new TRECs. Till the year 2019, new issues of TRECs would be restricted at a specified number, however, the restriction on the number of issues would end after the year 2019. These new issues would be in the form of a 'licence', without any possibility of a sale or transfer.

Enquiry:

5. The issue arising out of this transaction is how to account for the shares and TREC in exchange of the value at which the membership card is carried on the balance sheet of a member of the stock exchange.

Opinion:

6. The transaction is in the nature of exchange of an intangible asset (membership card) with a financial asset (shares) together with an intangible asset (TREC). Shares and TRECs are separate assets and mutually exclusive to each other.

7. The Committee referred to Paragraph 12 of IAS 18, which states that when goods are exchanged or swapped with goods of a similar nature and value, the exchange is not regarded as a transaction which generates revenue.
8. The Committee concluded that nature and value of the asset given up (membership card) is similar to the nature and value of the asset acquired (Shares and TREC). Therefore, exchange of assets will not result in any gain or loss. Further, it can be argued that derecognition of the membership card has not occurred because the rights of the cardholder were not lost at any point during the exchange.
9. The Committee also referred to paragraph 45 of IAS 38, which inter alia states that when the fair value of neither the asset received nor the asset given up can be reliably measured, the cost of the asset received should be measured at the carrying amount of the asset given up, and no gain or loss shall arise on the exchange. This further corroborates the discussion referred to in paragraph 7 and 8 above.
10. To reach the conclusion referred in paragraph 8 and 9 above, the Committee noted that the documented selling prices available for the membership card, in the pre-demutualization days, are those whereby the exchange had auctioned off the membership card of defaulting members. All other transactions were private, for which verifiable data is not available. The Committee observed that the prices at which cards were auctioned by the exchange may represent "Forced Sale Prices" in a "Sale in Distress" and may not reflect the fair values of these cards.
11. The Committee also noted that the active market is not available for shares received by the membership card holder. An attempt to arrive at the fair value by using an appropriate valuation technique may be possible, if data from observable markets is available. However, it would be difficult to arrive at the fair value of TRECs received by the membership card holders, as active market is not available for these rights and similar rights may be issued by the exchange in future (in the form of 'license') which would introduce significant subjectivity and variability in the range of fair value estimates.
12. In the absence of reliable fair values of shares and TRECs, the allocation of the carrying value of a membership card between the assets (Shares and TREC) may be made using a basis which is considered reasonable by the management and is also acceptable to the auditors.
13. However, if the management believes it can allocate the cost on the basis of the fair values of the respective assets, and the determination of which is acceptable to the auditors then it would be a preferable basis of allocation of cost.
14. The shares should be classified as 'Available for Sale' and the effect of any subsequent measurement of their fair value should be recognized in accordance with the requirements of the IAS 39. Further, the TREC issued to the original membership cardholder should be separately identified as an intangible asset under the requirements of IAS 38.
15. Any subsequent measurement of the shares and / or TREC would only be possible when their reliable fair values can be measured. This would most likely happen when the blocked shares are sold to a strategic investor or to the general public through an IPO and an active market develops for the TREC.
16. As the rooms occupied by a member in the stock exchange are separate assets therefore these should be accounted for separately.

(February 25, 2013)

1.3 RECOGNITION OF INTEREST ON DEFENCE SAVING CERTIFICATE HELD BY AN EMPLOYEE'S PROVIDENT FUND

Enquiry: We would like to draw attention and seek advice of the technical committee of the Institute towards the treatment of held to maturity investments which are to be recorded at amortised costs using the effective interest rate method. Here we are specifically referring to the investment made in Defence Saving Certificates (DSC) which is issued and regulated by National Savings, Ministry of Finance, Pakistan.

Issue no. 1

The authority provides a schedule of interest accruing every year along with an effective interest rate. The amount of interest accruing in the year of maturity (10th year) as per the said schedule agrees to the calculations made using the effective interest rate, however, the same mode of calculation gives different results to what is provided in the schedule when calculating the accrued interest for any time between 1st to 9th year subsequent to the certificate is purchased. This leads to drastic variations between the calculation made by applying effective interest method and the amount of interest that appears in the schedule issued by the regulator, thus calculations by former results to figures which are not claimable by the holder and the entity does not hold a contractual right to receive cash against them. Hence, if we continue to accrue interest as per effective rate of interest then we record an asset:

- a) At a value which is greater than its fair market value;
- b) At a value against which the entity does not hold a contractual right to receive cash / benefits as the same are limited to what is calculated in the schedule provided by the issuer.

Issue no. 2

Another issue arises when it comes on to the distribution of funds to members' account based on the effective interest method. The attached case study highlights the fact that although the concept behind recording an investment held to maturity at amortised cost using effective interest method is to evenly spread the related returns over the life of the asset however, in this very particular case (DSC) where investment is held by a trust for the benefit of employees the purpose seems to be over ruled. Member retiring at any time between 1st and 10th (last) year subsequent to the investment is made not only receive different returns over the said investment but also the excess benefit enjoyed by one retiring member is actually the cost of those who remain employed as the profit credited to retiring members' account are actually not received from the certificate issuer.

A detailed case study is prepared and attached to this covering letter to further highlight the grey areas of the calculations made using effective interest method in the above context.

Query

In context of the above we would like to know:

- a) Whether the interest accruing on Defence Saving Certificates (DSC) should be recorded in the books of accounts as per schedule provided by National Savings, Ministry of Finance, Pakistan.

OR

- b) Alternatively we record interest in the books of accounts using effective interest method and withhold distribution to members' account by the differential amount arising from the two modes of calculations i.e. Effective interest method and the schedule provided by National Savings, Ministry of Finance, Pakistan.

We look forward towards your guidance in the above matter and would appreciate if you could reply to our queries at earliest.

Opinion: Your attention is drawn to the ICAP Selected Opinion No. 1.16 of Volume No. VIII on "Recognition of interest on Defence Saving Certificates held by an Employee Provident Fund" which responds to your concerns:

'The definition paragraph 10 of IAS 39 explains the calculation of amortization to be used as the effective interest method. It is the rate that exactly discounts the expected stream of future cash payments through maturity, or the next market-based re-pricing date to the current net carrying amount of the financial asset or financial liability. That computation should include all fees and points paid or received between parties to the contract. The effective interest rate is sometimes termed the "level yield" to maturity or to the next re-pricing date and is the internal rate of return (IRR) of the financial asset or financial liability for that period.

In view of the above discussions, the Committee is of the opinion that if the Defence Saving Certificates satisfy the criteria mentioned then these investments should be measured at amortized cost by applying effective interest rate method.' (IAS 39, Volume 2003)

With regard to your alternative option, the Committee considered your concerns and is of the view that withholding of differential amount arising between the effective interest method and the schedule provided by the National Savings, Ministry of Finance, Pakistan in the member's account would not be appropriate and may be tantamount to denying the members leaving the fund earlier their due share of income.

(May 28, 2013)

1.4 REQUEST FROM A COMPANY FOR EXEMPTION FROM APPLICATION OF IAS-2

Enquiry: The Commission has been approached by a Company requesting exemption from the application of International Accounting Standard (IAS- 2) "Inventories" in the financial statements for the year to be ended on June 30, 2013 and onwards.

Extracts of the information received from the Company's consultant is as follows:

"On behalf of our above client "XYZ" we would like to inform you that XYZ was Setup in 1957, and acted as a public sector trade house for exporting of agriculture and consumer goods and import of essential commodities under the specific directives of the Government.

XYZ is a wholly owned Company of Government of Pakistan and its all above activities are carried out in accordance with the directions of Government.

By virtue of SRO 23 (1)/ 2012 dated January 16, 2012, XYZ has become a significant economic entity and, therefore, the application of IFRS as applicable to listed companies is applicable to XYZ.

XYZ capitalized its financial charges in the carrying cost of inventories purchased which draw the attention of their external auditor who objected such treatment in contravention of IAS 2, which prohibit capitalization of borrowing cost in the value of inventory.

Quote From Auditors' Report:

The mark up on overdraft amounting to PKR XXX million is included in cost of sales instead of financial cost and the gross profit is reduced by the same amount.

Un Quote:

Quote From IAS 2 - Measurement of Inventories:

10. The cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Other costs:

15. Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include non-production overheads or the costs of designing products for specific customers in the cost of inventories.

16. Examples of costs excluded from the cost of inventories and recognized as expenses in the period in which they are incurred are:

- a. abnormal amounts of wasted materials, labour or other production costs;
- b. storage costs, unless those costs are necessary in the production process before a further production stage;
- c. administrative overheads that do not contribute to bringing inventories to their present location and
- d. selling costs.

17. IAS-23 'Borrowing Costs' identifies limited circumstances where borrowing costs are included in the cost of inventories.

Un Quote:

This treatment of capitalization is justifiable in the case of XYZ as it sell and purchase on behalf of the Government, and resultantly claims subsidy on the differential amount of this activity. In order to calculate the subsidy from the differential amount of sell/purchase it is essential to calculate the cost of financing XYZ pays to the financial institution in order to comply with the directions of Government.

It is imperative for the XYZ to make the financial charges part of the inventory in order to claim correct value of subsidy calculated from the Government.

We, therefore, request you to kindly allow exemption from the applicability of IAS 2 in case of XYZ to extent of capitalization of financial charges to carrying cost of inventories by virtue of the powers of the Commission."

As the Company is requiring permanent exemption in the matter and is acting as the agent of the Government, the Commission requests your comments in the matter before arriving at any final decision.

Opinion: The Committee would like to draw attention to the following paragraphs of IAS 23 'Borrowing Costs': (underline is ours)

5. "A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale."
7. "Depending on the circumstances, any of the following may be qualifying assets:
 - a. inventories
 - b. manufacturing plants
 - c. power generation facilities
 - d. intangible assets
 - e. investment properties.

Financial assets, and inventories that are manufactured, or otherwise produced, over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired are not qualifying assets."

It is clear from the above reading that the Company is engaged in the trading of commodities ready for intended use or sale when acquired, which do not come under the definition of qualifying asset. The Committee is of the view that the inclusion of financial charges in the cost of inventory may conflict with the matching principle, and would not only understate the gross profit but also overstate inventory cost; resultantly increasing the amount of subsidy claimed by the Company. The Committee strongly believes, on the facts illustrated in the enquiry, that such a treatment is not justified and may mislead the user.

However, the Committee reiterates that the final decision to provide exemption lies with the regulator, whatever may be the reason for such an exemption. The Committee would like to draw attention that where such an exemption is granted, additional disclosures are required, as described in the following paragraphs of IAS 1 'Presentation of Financial Statements':

- "19 In the extremely rare circumstances in which management concludes that compliance with a requirement in an IFRS would be so misleading that it would conflict with the objective of financial statements set out in the Framework, the entity shall depart from that requirement in the manner set out in paragraph 20 if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure."
- "20 When an entity departs from a requirement of an IFRS in accordance with paragraph 19, it shall disclose:
 - a) that management has concluded that the financial statements present fairly the entity's financial position, financial performance and cash flows;
 - b) that it has complied with applicable IFRSs, except that it has departed from a particular requirement to achieve a fair presentation;
 - c) the title of the IFRS from which the entity has departed, the nature of the departure, including the treatment that the IFRS would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in the Framework, and the treatment adopted; and

for each period presented, the financial effect of the departure on each item in the financial statements that would have been reported in complying with the requirement.”

(May 28, 2013)

1.5 CLARIFICATION REGARDING WWF AND WPPF

Enquiry: ABC Limited is an Independent Power Producer (IPP) engaged in business of generation and selling of electricity to National Transmission & Despatch Company (NTDC). As per its tariff determined by NEPRA (the Regulator), WWF and WPPF is recovered from NTED after payment.

Before the Commercial Operations, ABC Limited capitalized its exchange gain/(loss) for the year ended June 30, 2009 and there was loss in the Financial Statements to the extent of Administration cost. In the next year to comply with IAS 21, the Company changed its accounting policy and charged exchange gain/(loss) to profit and loss account and restated its accounts for the year ended June 30, 2009 as per IAS 8, as a result, loss for the year 2009 converted into profit.

Company paid WWF and WPPF on the restated profit and invoiced the same amount to NTDC for recovery as per Power Purchase agreement and Tariff determined by NEPRA. NTDC wrote a letter to ABC Limited to seek clarification from ICAP that in case Company again changes its accounting policy, it may get some benefit from the concerned authority too after getting its reimbursement from NTDC also.

Please provide us the clarification on the following queries:

1. Whether a Company is liable to pay WWF and WPPF pertaining to previous year in case of restatement of financial statements due to change in accounting policy?
2. After getting reimbursement of WPPF and WWF from NTDC, can Company get benefit from Ministry of Human Resource and FBR in future by again adopting the previous accounting policy?

Opinion: The Committee would like to give its opinion only on the accounting aspects of the issue. The Committee would like to draw your attention towards section 2(d) of the Companies Profits (Workers' Participation) Act which defines profits as:

"Profits in relation to a company means such of the net profits as defined in Section 87C of the Companies Act, 1913 as are attributable in its business, trade undertakings or other operations in Pakistan."

Section 87C(3) of the Companies Act 1913 (the Repealed Act) defines **Net Profits'** as under:

"For the purposes of this section 'net profits' means the profits of the company calculated after allowing for all the usual working charges, interest on loans and advances, repairs and outgoing, depreciation, bounties or subsidies received from any Government or from a public body, profits by way of premium on shares sold, profits on sale proceeds of forfeited shares, or profits from the sale of the whole or part of the undertaking of the company but without any deduction in respect of income-tax or super-tax, or any other tax or duty on income or revenue or for expenditure by way of interest on debentures or otherwise on capital account or on account of any sum which may be set aside in each year out of the profits for reserve or any other special fund."

In the opinion of the Committee, considering the definition of profit stated above, especially the underlined portion, it appears that only profits from the ordinary activities of the company should be considered in computing the share of the workers. The Committee is of the view that the Company would be liable to pay WWF and WPPF for previous year in case of restatement of financial statements due to change in accounting policy as it is relevant to the business operations of the company and the same should be construed as part of the profits of the company for all intents and purposes.

With regard to your second query, the Committee would like to your attention to the following paragraph of IAS-8 'Accounting Policies, Changes in Accounting Estimates and Errors':

- 14 An entity shall change an accounting policy only if the change:
- (a) is required by an IFRS; or
 - (b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

From the above, it is clear that change in accounting policy may only make to obtain reliable and relevant information. A Company must not change its accounting policy merely to get monetary benefit from any other entities.

(May 28, 2013)

2.1 CERTAIN CLARIFICATIONS REGARDING ATR – 17 (REVISED 2012)

Enquiry: Your attention is drawn towards the ATR – 17 (Revised 2012) and request you to advise which audit report should be issued in the following cases:

1. In two NGOs the following scenario arises :-

The **first NGO** is covered under paragraph (b) (i) and receipts and disbursements account is prepared whereby both receipts and disbursements are on cash basis. However advances to employees for expenses and against salaries are recorded as advances. Further, fixed assets purchased are also capitalized as assets. The receipts and disbursements statement is prepared on the following format:

Receipts – donations	-----
- Misc. receipts	XXXXXXX
Total Receipts	XXXXXXXX
Less: Disbursements (other than advances & assets purchased)	<u>XXXXXXXX</u>
Excess of receipts over disbursements for the year	XXXXXX
Add: opening balance	XX
Closing balance	<u>XXXXXXXX</u>
	=====
<i>Represented by:</i>	
Cash & Bank Balance	
Advance to Staff	
Fixed assets	<u>XXXXXX</u>
	=====

In case of **second NGO** (having same accounting treatment as for first mentioned NGO) receipts and disbursement statement is prepared as mentioned above and the lower part 'represented by' is not prepared. Further, a separate balance sheet is prepared where closing balance is kept on 'capital and liabilities' side and assets on the other side.

Question 1: You are requested to advise which audit reports should be issued for above two NGOs. Apparently, ATR- 17 (revised – 2012) do not address such situations?

A **third NGO** is covered under paragraph (b) (iii) of the ATR - 17. In this NGO fixed assets and non- expandable items purchased are charged to expenditure under donor's requirements whereas as all other assets and liabilities are recognized in the balance sheet.

Question 2: You are requested to advise which audit report should be issued under ATR – 17 (revised – 2012) for third NGO?

2. Additionally I wish to draw your attention towards specimen audit report covered under paragraph (b) (iii) of the said ATR wherein it is mentioned that "We have audited

the annexed balance sheet of the As at and the related income and expenditure account..... “

The specimen audit report does not suggest an opinion on the balance sheet. In the opinion paragraph it is stated” In our opinion the financial statements present fairly, in all material respects, **the cash receipts and expenditure.....”**

Question 3: Please advise whether one can refrain from giving an opinion on any components of financial statements after mentioning that he has audited that component?

Question 4: Further, would it be appropriate to call the “receipts and expenditure and balance sheet” (having all assets and liabilities except for fixed assets) as “financial Statements” of the third NGO mentioned in paragraph 1 of this query?

Opinion: The Committee would like to emphasize that financial statements may be prepared in accordance with any other comprehensive basis of accounting (or accounting framework), apart from three examples illustrated in para (b) of ATR-17. The basis of accounting should be adequately disclosed in the note for the basis of preparation of financial statements.

The Committee examined your enquiry and is of the opinion that:

Question 1

The audit report formats provided in ATR-17 are for guidance purposes. In cases where a reporting framework other than those illustrated in ATR-17, is used, or specific donor requirements exist, the prescribed formats of ATR-17 may be amended by the practitioners accordingly.

Question 2

The auditor should exercise his professional judgment to decide the auditor's report format to be issued under ATR -17. The reporting format may be amended in accordance with the basis of preparation used.

Question 3

The audit report covered under paragraph (b) (iii) of ATR-17 states that “financial statements include balance sheet and the related income and expenditure account and cash flow statement together with the notes”. Therefore, it is not necessary to mention each component of financial statements separately in the opinion paragraph.

Further, the auditor cannot refrain from giving an audit opinion on any component of financial statements, after mentioning the fact that he has audited that component.

Question 4

The Committee would like to refer the definition of Financial Statements as defined in Glossary of Terms in International Standards on Auditing (ISA):

A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term “financial statements” ordinarily

refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but it can also refer to a single financial statement.

Based on above, the Committee is of the view that the receipts and expenditure account and balance sheet together may be called 'Financial Statements'.

(Nov 06, 2012)

2.2 AUDIT REPORT ON CONSOLIDATED FINANCIAL STATEMENTS AFTER CHANGE OF AUDITORS

Enquiry: We were the auditor of a parent company for the year 10-11. We signed our audit report on the separate financial statements for the year ended 30 June 2011. We completed our work on the consolidated Financial Statements (FS) of the company for the year ended 30 June 2007, 2008 and 2009 and send draft to client. After about four months they changed the auditors. Now, since we are not the auditors of the company, but the company has contacted us to issue audit report on the consolidated FS. Can we do so and at what date?

Opinion: The Committee would like to draw your attention to section 252(1) of the Companies Ordinance, 1984:

"Every company shall at each annual general meeting appoint an auditor or auditors' to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting".

The Committee is of the view that if consolidated financial statements have not been approved in the AGM, then the previous auditor cannot express an opinion on them, although he may have completed the necessary field work.

(Nov 06, 2012)

2.3 TECHNICAL OPINION ON PUBLIC SECTOR BIDDING

Enquiry: With respect to above mentioned subject, we need technical opinion of ICAP on following issues:-

1. Whether ATR-14 of ICAP Section 240.1 and 240.2 of ICAP Code of Ethics (Revised) applies in case of bidding, by Chartered Accountant Firms, in public sector organizations.

2. Our firm submitted technical and financial proposal, against advertisement in newspaper, for external audit of a public sector organization (hereinafter called the "Organization"). We required, in written, copy of latest audited financial statements from the concerned official of the organization. The organization's official neither provided us financial statements nor replied to our letter. Keeping in view not losing the opportunity, we submitted our bid on the submission date and consequently, our firm won the bid being the lowest among all the bidders.

During our meeting the organization's officials to start the assignment, we obtained the latest audited financial statements and found that our quoted audit fee is less than the retiring auditor's fee. We conveyed, in written, to the organization's official, that we are unable to accept the assignment as per requirement of ATR-14 of ICAP and Section 240.1 and 240.2 of ICAP Code of Ethics (Revised). The Organization's official replied, in

written, that our aforesaid letter is irrelevant and we have to accept the engagement on the audit fee quoted in our bid otherwise they would seek legal remedy.

Opinion: The Code of Ethics for Chartered Accountants (the Code) and the Technical Releases issued by the Institute is applicable on all members of the Institute. We would like to refer the following paragraphs of the Code, for your guidance, which are self-explanatory:

Preface of the Code “The Code applies to all members, students, affiliates, employees of member firms and, where applicable, member firms, in all of their professional and business activities, whether remunerated or voluntary.”

Section 240.1 When entering into negotiations regarding professional services, a chartered accountant in practice may quote whatever fee deemed to be appropriate commensurate with the nature and service to be rendered. However, in such cases, chartered accountants in practice should be careful not to quote fee lower than that charged by the chartered accountants in practice previously carrying out the audit unless scope and quantum of work materially differs from the scope and quantum of work carried out by the previous auditor, as it could then be regarded as undercutting.

Section 240.2 Chartered accountants in practice shall comply with ATR-14, Minimum Hourly Charge out Rates and Minimum Fee for Audit Engagements.

Keeping in view of the above requirements, it is suggested that at the time of participating in the tender for public sector audit, you may include a proviso that proposed audit fee (if agreed) would not be less than the audit fee of the retiring auditor as required by ICAP Code of Ethics and ATR 14.

(March 13, 2013)

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