

---

---

# **S**ELECTED **O**PINIONS

***TECHNICAL ADVISORY COMMITTEE***

*Volume-I*

---

---

**COMPILED BY**

**TECHNICAL DIRECTORATE**

**THE INSTITUTE OF CHARTERED  
ACCOUNTANTS OF PAKISTAN**

## Foreword

This report is a compilation of selected inquiries raised by the members, Corporate Law Authority and other agencies, and replies issued by the Technical Services Committee during 1991 and 1992, for the general guidance of the members of the Institute.

The Committee has been appointed by the Council but an opinion given or views expressed by the Committee represent the views of the members of the Committee and may not necessarily be construed as the official opinion of the Council or the Institute. The opinions are based on the interpretations of various laws and accounting principles as conceived by the Committee and could be subject to different interpretations and as such the Institute and the Committee will have no liability in connection with such opinions.

The views expressed by the Committee are based solely on the facts presented to it and are applicable only if the circumstances are not changed.

The Technical Services Committee wishes to place on record its appreciation of the considerable efforts made by Mr. Javid Hanif Zuberi, Director, Technical Services in making initial study and research, and preparing basic draft of most of the opinions issued during 1991 and 1992. I am thankful to other members of the Technical Services Committee, in extending their full cooperation in finalizing the opinions.

***Masoud Ali Naqvi, FCA***  
*Vice President, ICAP and*  
*Chairman, Technical Services Committee*

February 17, 1993

# **C O N T E N T S**

## **1. ACCOUNTING**

- 1.1 Bonus Shares-accounting treatment
- 1.2 Capital receipts from customers for providing service connections extension of mains and street light-accounting treatment
- 1.3 Contingencies
- 1.4 Equity issued to financial institutions by sponsors under an arrangement to repurchase at a higher price-accounting treatment for extra price paid by sponsors
- 1.5 Exchange differences accounting through exchange fluctuation reserve
- 1.6 Financial Statement Disclosure-Dividends declared without adequate provision for taxation
- 1.7 Financial Statement Presentation-corporate assets tax
- 1.8 Financial Statement Presentation-Enhancement in income made in the assessment with the consent of assessee
- 1.9 Financial Statement Presentation-export rebates
- 1.10 Financial Statement Presentation-provision for repairs
- 1.11 Financial Statement Presentation-net off "Advances from Customers"
- 1.12 Fixed Assets-Capitalization of capital value tax
- 1.13 Fixed Assets-Capitalization Exchange Loss
- 1.14 Fixed Assets-Charging depreciation on revalued amounts while fixed assets are reported on the basis of historical cost
- 1.15 Workers' Profit Participation Fund-Adjustment of accumulated losses
- 1.16 Workers' Profit Participation Fund-Definition of wages
- 1.17 Workers' Profit Participation Fund-interpretation of "net profit"
- 1.18 Workers' Profit Participation Fund-Profit from sale of part of undertaking

## **2. GUIDANCE FOR MEMBERS IN PRACTICE**

- 2.1 Auditors' removal before commencement of audit

- 2.2 Auditors' signature on financial statements
- 2.3 Joint Auditors-Appointment in Midstream
- 2.4 Qualification in audit report-inability to substantiate investment transactions
- 2.5 Qualification in audit report-non compliance of SRO 1131(I)/90 regarding costing records

### **3. CORPORATE LAWS**

- 3.1 Accounting period-first year's accounts
- 3.2 Circulation of accounts-requirements for listed companies
- 3.3 Compliance of requirements of the Fourth Schedule for companies listed at balance sheet date but listed before the accounts authorized for issue
- 3.4 Investment in bearer national fund bonds and bearer national investment trust units
- 3.5 Preference shares and partly paid shares (reference from CLA)
- 3.6 Pricing of shares (reference from CLA)

# **1. ACCOUNTING**

## **1.1 BONUS SHARES-ACCOUNTING TREATMENT**

**Inquiry:** What is the proper accounting treatment of bonus shares (a) by the recipient and (b) by the issuer.

**Opinion:** Bonus shares are the shares issued by a company from distributable reserves to its ordinary shareholders without consideration by way of either capitalization of its profits or utilization of share premium account.

Issue of bonus shares is prompted mainly by desire to give the recipient shareholders some separate evidence of part of their respective interests in undistributed profits without distribution of cash, which the Board of Directors deem necessary to retain in the business.

### **ACCOUNTING BY THE RECIPIENT**

Capitalization of accumulated profits by the issue of fully paid bonus shares by a company does not in fact change the networth of that company and by the same token does not add anything to the assets or income of the recipient shareholder. The correct treatment of bonus shares, therefore, in the hands of the recipient would be merely to add to the number of shares it owns without giving any monetary affect in the accounts either in terms of cost or value thereof as no accretion in fact is taking place in the hands of the recipient. However if the investments are stated at market value, monetary effect in the financial statements is necessary with regard to the bonus shares allotted.

### **ACCOUNTING BY THE ISSUER**

A bonus issue does not give rise to any change in either the company's assets or its respective shareholders' proportionate interests therein. The company issuing bonus shares shall account for such shares by transferring from Reserves to Issued Share Capital an amount equal to the par value of additional shares issued.

In the first instance, generally the profits are appropriated and transferred to Reserve for Issue of Bonus Shares. The reserve is then utilized for issue of capital on completion of necessary formalities.

## **1.2 CAPITAL RECEIPTS FROM CUSTOMERS FOR PROVIDING SERVICE CONNECTIONS EXTENSION OF MAINS AND STREET LIGHT -ACCOUNTING TREATMENT**

**Inquiry:** Contributions received from customers by a utility corporation for providing service connections extension of mains etc. have been credited to capital reserve. Would it not be better to defer them and recognize in income over current and future periods?

**Opinion:** Capital receipts for providing service connections, extensions of mains and streetlights should be recorded initially as deferred credits. The deferred credit balance should be amortized over the useful lives of the related assets.

### **1.3 CONTINGENCIES**

**Inquiry:** Section 249 of Companies Ordinance, 1984 requires that the dividend shall be paid only out of profits. However, no definition of "profit" is given in the Ordinance. It is observed that certain companies are paying dividend without maintaining reserve to accommodate liabilities and contingencies disclosed but not accrued in the balance sheet. Is such practice permissible?

**Opinion:** Liabilities should be recorded as soon as an obligation is incurred. Unrecorded liabilities may result in overstatement of net income with consequent payment of dividends out of capital.

Regarding contingencies, paragraphs 8 and 9 of IAS 10 Contingencies and Events After the Balance Sheet Date, reproduced below, deal with treatment of contingent losses.

- " 8. The amount of a contingent loss should be recognized as an expense and a liability if: -
- (a) it is probable that future events will confirm that, after taking into account any related probable recovery, an asset has been impaired or a liability incurred at the balance sheet date, and
  - (b) a reasonable estimate of the amount of the resulting loss can be made.
9. The existence of a contingent loss should be disclosed in the financial statements if either of the conditions in paragraph 8 is not met, unless the possibility of a loss is remote."

Accordingly, if a contingent loss is not provided but its existence is disclosed in accordance with paragraph 9 of IAS 10, it is entirely on the discretion of board of directors and general body whether or not to retain any profits for meeting possible losses.

### **1.4 EQUITY ISSUED TO FINANCIAL INSTITUTIONS BY SPONSORS UNDER AN ARRANGEMENT TO REPURCHASE AT A HIGHER PRICE-ACCOUNTING TREATMENT FOR EXTRA PRICE PAID BY SPONSORS**

**Inquiry:** It is observed that certain business entities issue equity to financial institutions under an agreement whereby, its sponsors shall re-purchase the same from the financial institution after the expiry of a fixed period of time on a higher price. The companies charge the extra price paid by the sponsors on transaction where economic reality clashes with its legal form and therefore, a guidance of Technical Services Committee is sought on the matter.

**Opinion:** The Committee has noted that in case the sponsors are unable to provide sufficient funds to meet their contribution to maintain debt: equity covenant, they sometimes issue equity to financial institutions with an agreement to repurchase such shares later. The difference representing the issue price and repurchase price of shares is therefore, in substance, also properly attributable to sponsors. The finance cost can only be borne by the company in case where bridge finance is organized against the fresh issue.

## **1.5 EXCHANGE DIFFERENCES ACCOUNTED THROUGH EXCHANGE FLUCTUATION RESERVE**

**Inquiry:** A number of companies use exchange fluctuation reserve account to record exchange differences. When an exchange gain arises it is directly credited to the reserve and carried forward to the next period. Exchange losses are offset against exchange fluctuation reserve. Is such practice permissible?

**Opinion:** Use of Exchange Fluctuation Reserve Account to adjust exchange differences would be inappropriate. Past rate changes are historical facts, and the users of financial statements are best served by accounting for rate changes that affect the income as those rate changes occur. Also, future changes, including accruals cannot be reliably predicted. As a result, exchange gains or loss might ultimately have to be recognized during a period in which rate changes are unrelated to recognized gain or loss.

## **1.6 FINANCIAL STATEMENT DISCLOSURE-DIVIDENDS DECLARED WITHOUT ADEQUATE PROVISION FOR TAXATION**

**Inquiry:** A listed company has not provided taxation charge under section 80D to the extent of Rs.3 million and after declaration of dividend its un-appropriated reserve is left only Rs.2.1 million. If in future the company has to incorporate the liability (which is most likely to be the case) its un-appropriated profit would be converted into a loss figure.

Opinion of the Technical Services Committee is sought as to how the matter should be disclosed in the annual report of the company?

**Opinion:** Failure of making adequate provision for taxation under section 80D would necessitate a qualification in the audit report. In such case, the directors will be required to explain in the directors' report why have they not provided for the liability. As the fact will be disclosed both in the accounts and in the auditors' report, the board of directors while recommending and the general body while approving dividend declaration would have to consider the matter.

In case the tax liability under section 80D is disputed by an entity and a stay order has been obtained from the court, the liability should be disclosed as contingent liability. In such a case if the amount of liability is significant, an emphasis of matter paragraph may be included in the audit report without qualifying the opinion

## **1.7 FINANCIAL STATEMENT PRESENTATION-CORPORATE ASSETS TAX**

**Inquiry:** How should the corporate assets tax be reflected in the financial statements?

**Opinion:** Corporate Assets Tax should be separately disclosed in the profit and loss account under the head "other charges" because:

- (a) it is a one-time levy based on the value of the fixed assets of the company and should not form part of the operating results of the company.
- (b) it is not a tax on the income of the company and is an allowable expense for tax purposes. It should therefore not be included in the taxation charge for the year.

Provision for Corporate Assets Tax should be classified as current liability in the balance sheet of the company.

## **1.8 FINANCIAL STATEMENT PRESENTATION-ENHANCEMENT IN INCOME MADE IN THE ASSESSMENT WITH THE CONSENT OF ASSESSEE**

**Inquiry:** A CBR clarification on the matter of additions made by the Department in the trading account states:

"The Board is of the view that additions made in the trading account in agreement with the assessee would not qualify to be incorporated in the books of accounts".

Clause 3 of Part I of the Fourth Schedule to the Companies Ordinance, 1984 requires that where any suppressed, concealed or unaccounted income, duty or gain has been declared, disclosed or admitted before any authority charged with the assessment or recovery of any tax, duty or gain, by or on behalf of any company the amount, nature and financial impact thereof on the company shall be disclosed along with information as to how the directors have or propose to treat the same in the financial statements of the company.

Any agreed enhancement in income, gain or revenue made by assessing authority in assessment order tantamount as admission, and therefore, falls under the ambit of Clause 3.

Technical Services Committee is requested to give its views on the matter.

**Opinion:** An enhancement in income, gain or revenue made in the assessment with the consent of assessee would be required to be disclosed in terms of clause 3 of the Part I of the Fourth Schedule to the Companies Ordinance, 1984 *irrespective of its treatment under the tax laws.*

The enhancement in assessment, which is not subsequently appealed against by the assessee, need not necessarily be construed as an admission or consent to enhancement. A company aggrieved by the assessment made by Department may decide not to make an appeal due to the formalities required which may not be worth the cost and efforts involved.



## **1.9 FINANCIAL STATEMENT PRESENTATION-EXPORT REBATES**

**Inquiry:** Some companies engaged in the business of exports, credit export rebate received by them in their trading account. What is the proper financial statement presentation of such rebates?

**Opinion:** Export rebates should be included in sales revenue in the trading account.

## **1.10 FINANCIAL STATEMENT PRESENTATION-PROVISION FOR REPAIRS**

**Inquiry:** In order to provide for a uniform charge to profit and loss account, a company has set up a provision for repairs account (i.e. the average of estimated total repairs over the life of the machinery are being debited to the profit and loss account and credited to provision account and actual amount spent on repairs is being debited to provision). Should the balance on the provision be shown as capital reserve or a deferred liability?

**Opinion:** Where a company has set up a provision for repairs of machinery crediting estimated costs to the Provision and charging actual costs to this account, balance in the provision account should be presented as a current liability. In case actual cost of repairs and maintenance in any year exceeds the balance in the provision account, the difference should be expensed.

## **1.11 FINANCIAL STATEMENT PRESENTATION-NET OFF "ADVANCES FROM CUSTOMERS"**

**Inquiry:** Advice of Technical Services Committee is sought regarding financial statement presentation of "advances received from customers" against related sales orders. Advances received from customers in the normal course of company's business against order being processed are shown as current liabilities in a company's balance sheet. The factual position is that, such advances are used to finance acquisition of raw materials and components and incurred in meeting costs relating to "supply and erection contracts-in-progress".

According to the International Accounting Standard 13 if there is an asset and liability balance appearing in respect of the same party and there exists a contractual legal right of set-off, the balance may be netted off. Taking this into consideration in our view the amount received as an "advance from customer" in accordance with a contract according to which stock has to be delivered upon completion or a contract has to be executed can be treated as part of the same contract and the same be netted off for disclosure in the accounts of the company.

**Opinion:** The proposal to show value of "supply and erection contracts in progress" net of advances from customers, is in accordance with the requirements of International Accounting Standards, provided disclosure is made in the notes to the accounts for the gross value of supply and erection contracts in progress and corresponding advances from customers.

IAS 11, Accounting for Construction Contracts provides for similar accounting treatment of advances from customers. The Standard also covers activities

relating to construction of complex pieces of equipment. The fact that advances received by the Company against orders being processed are used for meeting costs relating to supply and erection contracts in progress can be considered analogical to construction contracts where the treatment of net off advances against work in progress is allowed.

IAS 13, Presentation of Current Assets and Current Liabilities provides for offsetting a current asset against a current liability when a legal right of set-off exists. It appears that the Company would have a right to set off advances received for specific contract against costs incurred by the company for that contract. Provisions for IAS 13 would, therefore, also enable the company netting off the advances against work in progress for each specific contract.

## **1.12            FIXED ASSETS-CAPITALIZATION OF CAPITAL VALUE TAX**

**Inquiry:**            Is it permissible to capitalize capital value tax?

**Opinion:**            IAS 16, Accounting for Property, Plant and Equipment states (paragraph 15)

"The cost of an item of property, plant and equipment comprises its purchase price, including import duties and non-refundable purchase taxes, and any directly attributable costs of bringing the asset to working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price."

The capital value tax is in the nature of non-refundable purchase tax and forms part of cost of fixed assets.

## **1.13            FIXED ASSETS-CAPITALIZATION OF EXCHANGE LOSS**

**Inquiry:**            Many listed companies adjust the exchange differences against the cost of fixed assets to the extent the assets are acquired from the proceeds of loans.

IAS-21, only allows deferring of exchange difference and amortizing it over the life of long term loans (which means establishing a deferred debit or credit account) but it does not permit capitalizing exchange differences, except in the case of severe devaluation of currency affecting the liabilities on most recent acquisition of assets.

However it is argued that capitalization of exchange difference is permitted under the Fourth Schedule to the Companies Ordinance, 1984, as paragraph 2(D) of Part II states that exchange gains or losses arising on the translation of foreign currency loans out of the proceeds of which fixed assets have been acquired may be added to or as the case may be, deducted from, the carrying value of the concerned assets.

But it may be reminded that said Schedule specifies only disclosure requirements, it does not specify any accounting treatments and it appears that the above provision has been added only to allow the capitalization of exchange differences as described by the IAS.

Views of Technical Services Committee are sought on the matter.

**Opinion:** It is permissible to adjust the cost of fixed assets with the differences arising from fluctuations in exchange rates relating to loans used for acquisition of such assets.

IAS 21, Accounting for the Effects of Changes in Foreign Exchange Rates does not permit capitalizing exchange differences, except in the case of severe devaluation of currency. However, Clause 2(D) of the Fourth Schedule (Part II) to the Companies Ordinance, 1984 provides:

"Any exchange gain or loss in any year, as a consequence of fluctuations in rate of exchange, relative to the foreign currency borrowings out of the proceeds of which assets were acquired may be added to or deducted from the value of the respective assets and where such addition or deduction is made, the amount thereof under each sub-head shall be disclosed together with the depreciation policy therefor."

It should be emphasized that the Fourth Schedule of the Companies Ordinance, 1984 does not only specify disclosure requirements but also forms directives for accounting treatment in certain cases.

International Accounting Standards do not override local statutory provisions. Compliance with IAS is mandatory in so far as such Standards are not inconsistent with local regulations or standards.

**1.14                      FIXED ASSETS-CHARGING DEPRECIATION ON REVALUED AMOUNTS WHILE FIXED ASSETS ARE REPORTED ON THE BASIS OF HISTORICAL COST**

**Inquiry:** Can depreciation be charged on revalued amounts while fixed assets are carried in books at historical cost?

**Opinion:** IAS 4 Depreciation Accounting, states that "Depreciation is the allocation of the depreciable amount of an asset over its estimated useful life. "Depreciable amount has been defined in IAS 4 as "amount of a depreciable asset is its historical cost or other amount substituted for historical cost in the financial statements, less the estimated residual value."

This follows that the depreciation can be charged on revalued amount only if such amount has been substituted for cost in the financial statements.

**1.15                      WORKERS' PROFIT PARTICIPATION FUND-ADJUSTMENT OF ACCUMULATED LOSSES**

**Inquiry:** Should the past accumulated losses be adjusted in calculation of WPPF.

**Opinion:** Past accumulated losses should not be adjusted in calculating WPF as the computation of Fund is based on profits earned during the year.

**1.16                      WORKERS' PROFIT PARTICIPATION FUND-DEFINITION OF WAGES**

**Inquiry:** What type of allowances form part of "Wages" as referred to in paragraph 4(d) of the Schedule under section 2(e) of the Companies Profit (Workers Profit Participation) Act, 1968 for the purpose of distribution of WPPF.

**Opinion:** In paragraph 4(d) to the Schedule to the Companies Profit (Workers' Participation) Act, 1968, wages have been given the same meaning as in clause (vi) of Section 2 of Payment of Wages Act, 1936 but do not include any overtime or bonus.

The definition of wages per clause (vi) of Section 2 of the Payment of Wages Act, 1936 is reproduced below: -

" Wages " means all remuneration, capable of being expressed in terms of money, which would, if the terms of the contract of employment, express or implied, were fulfilled, be payable, whether conditionally upon the regular attendance, good work or conduct or other behaviour of the person employed, or otherwise, to a person employed in respect of his employment or of work done in such employment, and includes any bonus or other additional remuneration of the nature aforesaid which would be so payable and any sum payable to such person by reason of the termination of his employment, but does not include-

- (a) the value of any house-accommodation, supply of light, water, medical attendance or other amenity, or of any service excluded by general or special order of the Provincial Government.
- (b) any contribution paid by the employer to any pension fund or provident fund;
- (c) any travelling allowance or the value of any travelling concession;
- (d) any sum paid to the person employed to defray special expenses entailed on him by the nature of his employment; or
- (e) any gratuity payable on discharge."

#### **1.17 WORKERS' PROFIT PARTICIPATION FUND-INTERPRETATION OF "NET PROFIT"**

**Inquiry:** Section 87C(3) of the Companies Act, 1913 defines "net profits" as profits of the company calculated after allowing for all the usual working charges, interest on loans and advances, repairs and outgoings, depreciations, 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 of 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.

This definition has been adopted as the definition of the term "profits" used in the Companies Profits (Workers' Participation) Act, 1968.

Section 2(d) of the Companies Profits (Workers' Participation) Act, 1968 defines "profits" for calculation of Workers' Participation Fund as such of the "net profits" as defined in Section 87C(3) of the Companies Act, 1913 as are attributable in its business, trade, undertakings or other operations in Pakistan.

A question has been raised whether "Other Income" such as income received from sale of scrap, gain on disposal of fixed assets, insurance claim, commission, rent, dividends interest/profit on deposits with banks etc. be taken into account for determining "net profits" for the purpose of calculating profits on which Workers' Profits Participation Fund allocation is to be used.

ICAP is requested to examine the subject matter and favour us with its views.

**Opinion:** The Companies Profits (Workers' Participation) Act, 1968 requires companies to whom the Act applies to pay 5% of its profits to the eligible workers. Section 2(d) of the Companies Profits (Workers' Participation) Act 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."

In the opinion of the Committee, considering the definition of profit stated above, specially 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. In order to determine extraordinary or unusual items of revenues and expenses, reference may be made to International Accounting Standard 8- Unusual and Prior Period Items and Changes in Accounting Policies. This Standard defines unusual Items as: -

"Unusual items are gains or losses that derive from events or transactions that are distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly."

Hence, in the opinion of Committee, all income except unusual income should be considered in computing workers' share in the profits of the company.

#### **1.18 WORKERS' PROFIT PARTICIPATION FUND-PROFIT FROM SALE OF PART OF UNDERTAKING**

**Inquiry:** Can the amount received by a company as profit from sale of part of the undertaking of the company be considered as income for the purposes of computations of WPPF?

**Opinion:** The Companies Profits (Workers' Participation) Act, 1968 as amended from time to time, defines "profits" as such of the "net profits" of the company as are defined in Section 87C of the Companies Act, 1913 (since repealed) and which are attributable to business operations in Pakistan. There is a consensus of professional opinion that despite the repeal of the Companies Act, 1913 the

definition of "net profits" as given in Section 87C thereof will continue to be applicable since reference to it continues in the Act.

According to the definition given in Section 87(C) of the repealed Act, the term "net profits" means a sum of profit arrived at after considering all usual working charges, interest on loans and advances, repairs and outgoings and depreciation. The definition further requires adjustment of profits revealed by the accounts by deducting therefrom the following:

Bounties or subsidies received from any Government or from public body.

Profit by way of premium on shares sold

Profits on sale proceeds of forfeited shares and

Profits from the sale of the whole or part of the undertaking of the Company.

On the basis of above, the amount received by the company representing profit from the sale of the whole or part of the undertaking of the company, should not be considered as income for the purposes of computation of WPPF.

## **2. GUIDANCE FOR MEMBERS IN PRACTICE**

### **2.1 AUDITORS' REMOVAL BEFORE COMMENCEMENT OF AUDIT**

**Inquiry:** Can an auditor be removed before the commencement of audit for the year for which he was appointed / re-appointed at the company's last annual general meeting?

**Opinion:** Appointment of auditors is made at Annual General Meeting of the company and his terms of office are till the conclusion of the next Annual General Meeting. There is no provision under the Companies Ordinance, 1984 whereby an auditor can be removed before conclusion of his term.

### **2.2 AUDITORS' SIGNATURE ON FINANCIAL STATEMENTS**

**Inquiry:** Some of the practising members engaged as auditors sign the financial statements on which they express their opinion. Would it be permissible for the auditors to sign the financial statements?

**Opinion:** Auditor's responsibility is to express an opinion on financial statements in terms of relevant statutes and the recognized accounting and auditing standards.

The auditor as such issues audit report as the only document and is required to sign this report only. The financial statements are prepared by the management, and directors are primarily responsible for such statements. For the purposes of identification only, however, the auditors may initial or stamp the original set of financial statements on which they have expressed their opinion.

The auditors may sign financial statements in cases of specialized entities covered by specific statutes if required under the provision of such statutes or directive of the relevant authority.

### **2.3 JOINT AUDITORS-APPOINTMENT IN MIDSTREAM**

**Inquiry:** Can joint auditors be appointed any time during the year for which an auditor has already been appointed at the company's last annual general meeting?

**Opinion:** Joint auditors cannot be appointed in mid-stream and the existing auditors will continue as sole auditors till the next Annual General Meeting.

### **2.4 QUALIFICATION IN AUDIT REPORT-INABILITY TO SUBSTANTIATE INVESTMENT TRANSACTIONS**

**Inquiry:** Guidance of Technical Services Committee is sought in respect of purchase of shares in industrial undertaking by a limited company located in rural area covered under SRO No. 1283(I)/90 dated 13th December, 1990. The difficulty has arisen while verifying the purchase of shares. The company has purchased shares and the corresponding credit has been shown in general reserve, as the source of investment is not declared.

Advice of Technical Services Committee is sought regarding the auditor's position in signing of such balance sheet.

**Opinion:** In case the auditors are unable to satisfy themselves as to the completeness and accuracy to substantiate transactions for purchase of shares due to lack of evidence coupled with the inability to adopt alternative auditing procedures, the audit report should be qualified.

**2.5 QUALIFICATION IN AUDIT REPORT-NON COMPLIANCE OF SRO 1131(I) 90 REGARDING COSTING RECORDS**

**Inquiry:** How the non compliance of SRO 1131(I)/90 regarding maintenance of costing records of vegetable ghee and cooking oil companies be reported in audit report?

**Opinion:** In case of non-compliance of SRO 1131 the audit report should be qualified. The report should state that in the opinion of the auditors proper books of accounts as required by the Companies Ordinance, 1984, have not been kept by the Company.



### **3. CORPORATE LAWS**

#### **3.1 ACCOUNTING PERIOD-FIRST YEAR'S ACCOUNTS**

**Inquiry:** Section 233(2) of the Companies Ordinance, 1984 states:

"The period to which the accounts aforesaid relate shall not exceed twelve months except where special permission has been granted in that behalf by the registrar."

Opinion of the Technical Services Committee is sought as to whether this section is applicable for first financial year or not. If this clause is applicable for first financial year, there is a practical problem with those companies which get their incorporation just before few weeks / days of the close of their financial year and could not succeed in having business till the close of financial year. This can be explained with the help of practical example.

A company was incorporated on June 25, 1992 as a private limited company. It decided to close its financial year on June 30. Should it present:

- a) Its five days' accounts in AGM which should be held within a period of six months following the close of its financial year U/S 158(l)
- b) Its 12 months' 5 days account in AGM to be held U/S 158(1)

**Opinion:** Section 233 of the Companies Ordinance, 1984 applies both to first year's accounts and subsequent years' accounts.

In case of first year's operations, accounts may be prepared for a period covering more than twelve months. However permission of registrar is required under Section 233(2) which is ordinarily not refused.

The Committee however feels that procedure involving time and effort in obtaining registrar's permission in case of first year's accounts serves no useful purpose. Recommendation has been made to Corporate Law Authority to waive the requirements of this sub-section relating to first year's accounts of a company.

#### **3.2 CIRCULATION OF ACCOUNTS-REQUIREMENTS FOR LISTED COMPANIES**

**Inquiry:** What are the requirements of circulation of accounts in case a company is listed subsequent to the close of its accounting year.

**Opinion:** The accounts are to be circulated to shareholders along with the notice, both in case of listed and non listed companies to the shareholders who are registered as of the date of closure of share transfer book.

#### **3.3 COMPLIANCE OF REQUIREMENTS OF THE FOURTH SCHEDULE FOR COMPANIES UN-LISTED AT BALANCE SHEET DATE BUT LISTED BEFORE THE ACCOUNTS AUTHORIZED FOR ISSUE**

**Inquiry:** Section 234 of the Companies Ordinance, 1984 provides: that every balance sheet must comply with the requirements of:

- a) Fourth Schedule, in the case of listed company and
- b) Fifth Schedule, in the case of any other company.

Opinion of Technical Services Committee is sought as to whether the accounts of a company should be prepared according to the requirements of Fourth Schedule or Fifth Schedule which at the balance sheet date is unlisted, but converted into a listed company after the balance sheet date.

**Opinion:** In case where a company is unlisted at the balance sheet date, but converted into a listed company before the accounts are authorized for issue, in the opinion of the Committee, as the accounts are being released to public shareholders, it would be preferable to comply, as far as possible, with the disclosure requirements of the Fourth Schedule. Where such disclosures are not considered to be practicable, reasons thereof should be stated.

### **3.4 INVESTMENT IN BEARER NATIONAL FUND BONDS AND BEARER NATIONAL INVESTMENT TRUST UNITS**

**Inquiry:** Section 209 of the Companies Ordinance, 1984 provides:

"Investments of company to be held in its own name:

Save as otherwise provided in sub-sections (2) to (5) or any other law for the time being in force, and subject to the provisions of sub-sections (6) to (8) all investments made by a company on its own behalf shall be made and held by it in its own name."

SRO 573(I)/85 dated 6th June, 1985 dealing with Bearer National Fund Bond Rules, 1985 authorizes the bodies corporate as under:

"The Bonds may be purchased by individual and bodies corporate other than banks without limit."

On the basis of the above SRO, a public quoted Company has purchased Bearer National Fund Bonds and has been holding the same in its portfolio.

The Companies Ordinance, 1984, was made applicable on 1st January, 1985 and the Bearer National Fund Rules, 1985 become effective on 6th June, 1985. Probably therefore, the Bearer Bonds were excluded from the ambit of the Section 209(1)(a).

In view of the above stated facts Technical Services Committee is requested to confirm that National Bearer Fund Bonds and Bearer National Investment Trust Units may be purchased and held by a public quoted company without incurring an infringement of the above provision of the Companies Ordinance, 1984.

**Opinion:** The Committee noted that in accordance with the Companies Ordinance, 1984, investments made by a company on its own behalf are to be made and held by it in its own name except as otherwise provided in any other law for the time being in force.

Section 209 would be applicable to investments, which are generally required to be registered in the name of investors. In all other cases where the investment is either of a bearer nature or is not required to be registered, for validity of its title the incorporation of such investment in the books of the company would evidence the title of the company and can be construed to be held on behalf and in the name of the company.

Furthermore as pointed out by you, SRO 573 which provides for eligibility of a company to make investments in bearer National Fund Bonds or any other statutory notification which permits companies to invest in other bearer securities could also be considered as to be excluded from the scope of section 209 as stipulated by "any other law for the time being in force."

It may be noted that the opinion does not deal with the risks in terms of controls on bearer securities, which in the opinion of the Committee could be of a high concern regarding safeguard, custody and ownership from the point of view of the management and auditors.

### **3.5 PREFERENCE SHARES AND PARTLY PAID SHARES (REFERENCE FROM CLA)**

**Inquiry:** Under the repealed Companies, Act, 1913, companies were allowed to issue preference and partly paid shares but in view of the fact that there were only a few companies, which, had issued such shares, the concept was omitted in the Companies Ordinance, 1984. However, the Indian and English Company Laws contain provisions enabling companies to issue shares of different classes and also partly paid shares. Among the suggestions received from various quarters, it has been proposed that amendments in Section 90 and 91 of the Companies Ordinance be made permitting the companies to issue preference and partly paid shares. ICAP views are invited for allowing issue of preference shares and partly paid shares.

#### **OPINION: PREFERENCE SHARES**

Issue of preference shares is not desirable in view of present corporate environment of our country due to following reasons.

- i) Preference shares require guaranteed return and are therefore against the spirit of Islam
- ii) Traditionally, the public at large prefers to invest in ordinary shares. Preference shares are generally subscribed by financial institutions and insurance companies. Such institutions have the option to invest in redeemable capital.

- iii) Most of the listed companies have not been declaring dividends. Non declaration of dividends on preference shares will worsen the image of corporate sector.
- iv) Interest on debentures is a deductible expense for tax purpose while the dividends on preference shares are not. Since the cost of capital is higher if a company raises capital by issue of preference shares, few companies will resort to issue of such shares.

The Committee feels that provisions of Companies Ordinance, 1984 relating to redeemable capital need to be further relaxed to allow issue of such capital to general public and other investors with or without conversion options.

Partly paid shares:

Regarding partly paid shares the Committee feels that in certain large projects involving heavy capital investment and a fairly prolonged period of construction, full value of shares need not be called in lump sum. The Committee, therefore, recommends issue of partly paid shares.

Corporate Law Authority may consider specifying some limits based upon issued share capital, regarding eligibility for issue of partly paid shares.

### **3.6 PRICING OF SHARES (PREFERENCE FROM CLA)**

**Inquiry:** An international institution has suggested that pricing of issues (including initial public offering, disinvestment, right issue) should be left to the market place i.e., sponsors, independent underwriters and the public (investors). The emphasis should be on full disclosure approach so that an individual investor, rather than the regulators, has responsibility for evaluating the merits of an investment in a particular issuers' securities. This approach places reliance and burden of evaluating the disclosed information on the investor who as an educated investor makes a reasoned investment decision so that the aggregate of investor's decisions may be a good assessment of a company's worth.

There may not be any intervention from any government/semi government body i.e. CCI/Stock Exchanges etc.

The other view is that pricing should continue subject to regulatory control. It will be appreciated if ICAP views are furnished to this Authority.

**Opinion:** The Committee is of the view that, in the long run, the pricing of issue should be left to be determined by market forces. At the same time, our economy cannot be totally deregulated at this stage. The change has to be brought about in a phased manner. Till the time the economy is completely deregulated, the investor's protection could be enforced through various institutions like stock exchanges and underwriters. However such institutions themselves need be approximately regulated.

