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

***TECHNICAL ADVISORY COMMITTEE***

*Volume-II*

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**COMPILED BY**

**TECHNICAL DIRECTORATE**

**THE INSTITUTE OF CHARTERED  
ACCOUNTANTS OF PAKISTAN**

## **INTRODUCTION**

This report is a compilation of selected inquiries raised by the members, Corporate Law Authority and other agencies, and replies issued by the Technical Advisory Committee during 1993 and 1994, for the general guidance of the members of the Institute. Opinions issued during 1991 and 1992 have been published earlier in Volume-I.

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 applied by the Committee to the facts present before it and could be subjective interpretations. Accordingly, the Institute and the Committee will have no liability in connection with such opinions.

***DIRECTOR, TECHNICAL SERVICES***

May 13, 1993

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## **1. ACCOUNTING**

### **1.1 BORROWING COSTS-CAPITALIZATION**

**Inquiry:** I wish to draw your attention towards one practical problem being faced in the capitalization of financial cost during construction period and like to have views of the Committee on the matter.

One company obtained a loan from a financial institution having markup rate of 22% per annum. On timely repayment of loan installments the applicable interest rate is 15% per annum. The grace period of the loan was three years. Within two and half years of obtaining the loan the project came into commercial production but the company failed to pay any loan installments till three years after commencement of commercial production.

At the time of commencement of commercial production financial charges @ 15% per annum (assuming timely repayment of loan) were capitalized. As project is not repaying loan in time, the applicable interest rate is 22% per annum but the capitalization was made at the rate of 15% per annum. The management wants to capitalize 7% additional for the 2-1/2 years (period during which the setting up of project was undertaken).

Keeping in view the above circumstances, please let us know that in your opinion at what rate the financial cost should have been capitalized.

**Opinion:** It would have been in order to recognize the liability initially at 22% if it was probable that the company would not be able to avail the rebate by timely repayment of loan installment. However, since the subsequent events have confirmed that the company has failed to pay loan installments in time and interest liability has crystallized at 22%, the company may capitalize additional 7% charge relating to period up to the commencement of commercial production.

### **1.2 BORROWING COSTS-MARK UP ACCRUAL WHERE A BANKER HAS MOVED A COURT FOR RECOVERY OF LOAN AND DOES NOT ADVISE AMOUNT OF MARK UP**

**Inquiry:** A banker has moved a court for recovery of loan but does not advise borrower the mark-up charges. Should mark-up be provided in such a case?

**Opinion:** In case where bank has moved a court for recovery of bank loan from a borrower, the borrower continues to have the obligation for payment of loan and mark up under the loan agreement. It would, therefore, be necessary to provide in the accounts of the borrower, the markup / penal charges in accordance with the agreement, irrespective of the fact whether or not the bank has advised the amount of mark up / penal charges.

### **1.3 DEFERRED TAXATION-APPLICABILITY OF SECTION 80C**

**Inquiry:** We understand that the deferred tax accounting does not apply to those companies whose sales are covered u/s 80 80C or 80CC of the Income Tax

Ordinance, 1979. But difficulty arises in the case of those companies, which have both sales covered u/s 80C and sales, which are not so covered. You would agree deferred tax accounting should apply to that portion of the profit, which represents non-supplies. Had the ratio between supplies and non-supplies remained the same year after year it would have been easy to account for deferred tax but since this ratio cannot be expected to be the same year after year, deferred tax cannot be calculated with accuracy.

We hope you would consider the above problem faced by the accountants and provide some guidance in the matter.

**Opinion:** In case where an entity has sales both covered under presumptive tax provisions and those, which attract normal provisions of the Income Tax Ordinance, 1979 a reasonable estimate for sales relating to non-supplies be made for future years and the deferred tax should be provided accordingly. However, if it is not practicable to develop a reasonable estimate for calculation of deferred tax liability the fact should be disclosed in the accounts stating the difficulties in quantifying.

#### **1.4 DEFERRED TAXATION-APPLICABILITY OF SECTION 80D**

**Inquiry:** One of our clients has brought forward assessed losses and the related tax saving is expected to be realized in future. Our client wishes to account for this tax benefit by creating a deferred tax asset account. However, due to the applicability of section 80D of the Income Tax Ordinance, 1979 it is difficult to ascertain the amount of tax saving relating to tax losses. Your opinion is sought in this regard.

In the absence of section 80D the calculation of tax saving resulting from tax loss carry forward would be equal to the tax effect of the amount of tax loss carry forward. Hence due to section 80D, tax saving arising from a tax loss, theoretically will be restricted to the difference between the amount of turnover tax and the tax that would have to be paid otherwise in the absence of tax loss carry forward. Had the amount of turnover tax and the tax calculated with reference to the normal rates of tax for the future years been given, the tax saving could have easily been calculated, but since these figures are unknown at the time of the issue of the accounts it poses great difficulty.

**Opinion:** Tax savings should only be considered if a reasonable estimate of the turnover for the foreseeable future can be made. Else, it would be prudent not to set up deferred tax asset for recognizing tax savings

#### **1.5 DEFERRED TAXATION-TAX LOSSES**

**Inquiry:** Normally the tax losses are assessed months or a year after the date of the balance sheet, so while ascertaining the deferred tax provision on the balance sheet date, should loss for current year be ignored or considered on estimated basis, and how this fact should be disclosed in the accounts.

**Opinion:** In order to ascertain deferred tax provision, the loss for the current year should be based on the estimated amount of loss, which is likely to be assessed by the tax authorities. The fact should be distinctly disclosed.

#### **1.6 EXCISE DUTY-ACCOUNTING TREATMENT**

**Inquiry:** In case where a manufacturer produces goods both for domestic sales and for exports, it is difficult to ascertain the amount to be provided for excise duty. In such circumstances is it permissible to exclude excise duty from cost of inventories, as it is an indirect cost?

**Opinion:** In those cases where a manufacturer produces goods both for domestic sales and for exports, provision for excise duty should be made on the basis of volume of goods estimated to be sold locally. Omission of a liability from the balance sheet is not justified only because its measurement involves use of estimates.

It is true that excise duty is an indirect tax, but on this ground only, it cannot be treated differently from other expenses. A manufacturer pays other taxes also, e.g., custom duty and other duties on imports. All taxes, other than taxes on income or sales, incurred by a manufacturer are as much an expense as salaries, rent, electricity and other operating expenses. Excise duty therefore cannot be treated on a basis different from other expenses for the purposes of allocating costs to inventories.

#### **1.7 FINANCIAL STATEMENT PRESENTATION-BANK BALANCE NOT IMMEDIATELY AVAILABLE FOR USE.**

**Inquiry:** Can the bank balance be classified as current assets in case the bank has a lien for three months, over the balances relating to long-term loan?

**Opinion:** International Accounting Standard 13, Presentation of Current Assets and Current Liabilities (paragraph 21) states: -

"Among the items included in current assets should be:

(a) Cash and bank balances available for current operations. Cash or bank balances whose use for current operations is subject to restrictions should be included as a current asset only if the duration of the restrictions is limited to the term of an obligation that has been classified as a current liability or if the restrictions lapse within one year."

In view of above, the Committee concluded that, where the bank has a lien for three months, over the balances relating to long term loan such bank balances should be shown as current assets.

#### **1.8 FINANCIAL STATEMENTS PRESENTATION-EXCHANGE DIFFERENCE ARISING ON REALIZING EXPORT DEBTORS**

**Inquiry:** Whether the exchange difference arising on realizing export debtors should be reflected in the income statement as a part of trading account item or profit / loss account items.

**Opinion:** The gain or loss due to the exchange difference should be reflected in the financial statements as a profit and loss account item but should not be considered in determining gross profit.

**1.9                    FIXED ASSETS-DEPRECIATION IN CASE OF INDUSTRIES WORKING ON SEASONAL BASIS**

**Inquiry:** In case of a sugar mill, is it permissible to adjust depreciation in order to give effect to the length of seasonal operation?

**Opinion:** The depreciable amount of an asset is allocated to each accounting period during the useful life of such asset. While estimating useful life, amongst other factors, number of hours worked, are considered. Since the hours worked are an essential ingredient in calculating depreciation, the depreciation charge need not to be adjusted further to give effect to the length of seasonal operation in an accounting period.

**1.10                  INVESTMENTS-APPLICATION OF LOWER OF COST AND MARKET POLICY**

**Inquiry:** In case the investments are held as current investments and the market value of such investments on the balance sheet date is lower than cost but subsequent to balance sheet date the market value of such investments rises above cost, whether it will be sufficient to disclose this fact in the notes to the accounts or the provision of diminution in the value of investment on the balance sheet date should be made in the accounts.

**Opinion:** Paragraph 21 of IAS-10, Contingencies and Events Occurring After the Balance Sheet Date states:

"Adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. An example is the decline in market value of investment between the balance sheet date and the date on which the financial statements are authorized for issue. The fall in market value does not normally relate to the condition of the investments at the balance sheet date, but reflects circumstances, which have occurred in the following period. However, disclosure is generally made of events in subsequent periods that represent unusual changes to the condition of assets or liabilities at the balance sheet date; for example, the destruction of a major production plant by a fire after the balance sheet date".

On the basis of the above, in case the investments are held as current investments and the market value of the such investments on the balance sheet date is lower than cost but between the balance sheet date and the date on which the accounts are authorized for issue, the market value of such investments rises above cost, the investments should be carried in the balance sheet at market value (being lower than cost). However a disclosure may be made of the market value of shares at the date on which financial statements are authorized for issue.



## 1.11 LEASES-ACCOUNTING TREATMENT OF ASSETS ACQUIRED ON FINANCE LEASE

**Inquiry:** The Company "A Limited" acquired asset on lease for three years term. The Company pays lease rental periodically, in which certain rate of mark up / profit is included in the principal amount / asset cost. The Company recorded the above transaction as follow:

Fixed Asset (on Lease)	XXXXXXX
Loan against Finance Lease	XXXXXXX

The Company claims in the Income Tax, lease rental expenses instead of depreciation on asset and mark-up expenses.

At the end of lease agreement, the title of asset is transferred to the company at a token value payment. Although at that time the life and market value of asset are much higher.

On the final payment of lease rental, leased asset account, is closed:

Accumulated Depreciation	XXXXXXX
Loss on Leased Asset	XXXXXXX
Fixed Asset (on Lease)	XXXXXXX

The loss on lease is charged to Profit & Loss Account.

### Query

a) Whether the company should record the new asset at token value and depreciate it on the basis of remaining useful life of the asset.

Or

b) The company should record the asset at market value although payment to lessor is token money and depreciation be charged to Profit & Loss Account calculated on market value of asset and remaining useful like of the asset. The difference of token money payment and market value of the asset is credited to Asset Replacement Reserve.

**Opinion:** It appears that the depreciation on fixed asset has been charged over the term of lease. If it was reasonably certain that the lessee would obtain ownership by the end of lease term, the asset should have been depreciated over its useful life in accordance with paragraph 17 of IAS 17 which states: -

"The depreciable amount of a leased asset is allocated to each accounting period during the period of expected use on a systematic basis consistent with the depreciation policy the lessee adopts for depreciable assets that are owned. If there is reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset;

otherwise the asset is depreciated over the shorter of the lease term or its useful life".

As a mistake has occurred in applying accounting policy, it is regarded as fundamental error in accordance with IAS-8 (revised).

## **1.12 LEASES-ACCOUNTING BY MODARABAS**

**Inquiry:** International Accounting Standard 17 "Accounting for Leases" specifies two types of leases viz., operating lease and finance lease. The standard further defines finance lease as a lease that transfers substantially the entire risks and rewards incident to ownership of an asset. The standard recognizes the differences between the total minimum lease payments over the lease term and the initial recorded liability as lease finance charges and requires this charge to be allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

On the contrary, Modaraba Companies and Modarabas (Floatation and Control) Ordinance, 1980 restricts the business of a Modaraba, which is opposed to the injunctions of Islam. Consequently, Modarabas cannot enter into any business, investment or other transaction, which involves the element of Riba either directly or indirectly. However, the religious board, constituted by Federal Government has approved leasing business for Modarabas. The question arises whether a finance lease, as determined in accordance with criteria set out by Standard should be classified as finance lease in accordance with requirements of Standard or operating lease in accordance with requirements of Sharia keeping in view the fact that the provisions of International Accounting Standards do not override the local regulations.

**Opinion:** IAS-17 clearly sets out criteria for classification of leases. The lease is to be classified as operating or finance lease in accordance with such criteria.

Please note that the local regulations are not contrary to IAS-17 so far as the classification of leases are concerned. The Committee is of the opinion that by classifying in the accounts a finance lease, as an operating lease does not by itself make a transaction in accordance with Sharia.

## **1.13 LEASES-ASSET ACQUIRED ON LEASE BY ONE GROUP COMPANY BUT USED BY ANOTHER COMPANY OF THE GROUP.**

**Inquiry:** What disclosures shall be required in the financial statements of both companies in case where an asset is acquired under arrangement of finance lease by company A but being used by company B?

**Opinion:** Company A cannot sub-lease its leased assets to Company "B", without adverse financial implications, since in the first place to carry on leasing business special permission is required from the Corporate Law Authority and for allocation of lease rental as an expense approval of the Central Board of Revenue is required. It is suggested that Company A can provide its leased assets, if allowed under the lease agreement, to company B simply on rental basis which transaction is of course, distinct from leasing transaction.

In case the asset is acquired on finance lease by Company A it will remain the property of Company A and depreciation is to be charged in the books of Company A even if the said asset is used by Company B on rental basis. The accounting treatment of transactions of leasing by Company A on finance or operating lease, as the case may be, and of giving an asset by Company A to Company B on rental basis will not be affected by the fact that the same asset is involved in both the transactions and, therefore, the accounting treatment would be the same as if it were two different assets.

#### **1.14            RETAINED EARNINGS-RESERVE FOR REPLACEMENT OF FIXED ASSETS**

**Inquiry:** Is an amount appropriated out of profits of the company for replacement of fixed assets a capital reserve?

**Opinion:** The Board of Directors may decide to appropriate a portion of undistributed profits for replacement of fixed assets, thereby restricting dividing payments.

The Fourth and Fifth Schedules to the Companies Ordinance, 1984 describe capital reserves as "Capital Reserves shall include capital redemption reserve, share premium account, profit prior to incorporation or any reserve not regarded free for distribution by way of dividend".

Also the Corporate Law Authority Circular No. 3/83 dated October 31, 1983 states:

"Capital reserves can broadly be categorized as:

- Statutory reserves i.e., those reserves, which by virtue of statutory provisions are not free for distribution by way of dividend.
- Specific purpose reserves i.e., those reserves, which by virtue of the decision of the directors are not regarded for the time being, free for distribution as dividend.

The retention of the second category of reserves as "Capital Reserves" is entirely dependent on the directors' decisions and the directors can resolve, whenever they wish, to transfer whole or part of such reserves to the profit and loss appropriation account or to revenue reserves. So long as the directors do not resolve so, it would be appropriate to classify both the Specific Purposes Reserves" and the "Statutory Reserves" as "Capital Reserves".

Therefore, reserve for replacement of fixed assets, is a capital reserve unless the directors decide to transfer back reserve to unappropriated profits or general reserve.

#### **1.15            REVENUE RECOGNITION-COMMISSION ON TICKETS RETURNED AFTER ACCOUNTING PERIOD**

**Inquiry:** Opinion of the Technical Services Committee is sought in respect of revenue recognition by travel agents. Normally the travel agents recognize agency

commission earned at the time of issue of air tickets to the customers. The commission on unutilized tickets subsequently returned by the customers is deducted from the gross amount of commission earned in the period in which the refund of tickets is claimed by the customers.

IATA approved travel agents are required to submit sales reports to airlines on a fortnightly basis. One of our clients submitted sales report on July 15, covering period June 15 to June 30. He adjusted commission on those tickets, which were returned by customers during July 1, and July 15, against the commission earned on tickets issued prior to June 30.

Our client pleaded that since such tickets relate to the period ended on June 30, commission on those tickets must also be set off against the income on that period.

We are of the opinion that there should be uniformity in the application of an accounting policy. Since there may still be some tickets issued prior to 30th June, in respect of which refund can be claimed after 15th July and commission on these tickets will be adjusted in the subsequent period, the commission on tickets returned between July 1 to July 15 should also be adjusted in the subsequent period.

Alternatively, a provision may be made for commission on tickets, which may be returned, after the year-end.

Advice of Technical Services Committee is sought, as to whether commission on tickets returned after June 30, which were issued prior to June 30 can be charged against income for the period ended on June 30.

**Opinion:** The commission income should be recognized on all tickets issued up to the year-end. A provision should be set up on estimated basis for the commission to be reversed relating to refunds. The provision account will be charged with actual commission attributed to refunds made in subsequent period. Alternatively, commission attributed to refunds till the date the accounts are finalized be adjusted against commission income.

#### **1.16 SALES TAX-ACCOUNTING TREATMENT**

**Inquiry:** Is accounting treatment of sales tax similar to that of prescribed by TR-19 for excise duty?

**Opinion:** No, sales tax liability arises only when there is "Sale" and as such there is no question of accrual and allocation of sales tax on goods manufactured and / or held in stock. TR-19 deals with treatment of excise duty, its accrual and allocation to cost of inventories. As discussed and explained in TR-19, excise duty is a necessary cost which must be incurred to bring the goods to the location and in the condition in which they can be sold or used in the manufacturing process.

#### **1.17 WORKERS WELFARE FUND - ON INDUSTRIES SET UP AT TAX HOLIDAY AREA**

**Inquiry:** Industrial undertaking shall pay 2% of taxable income to Workers Welfare Fund under the Workers' Welfare Fund Ordinance, 1971. Is it applicable to the industrial undertakings exempted from Income Tax, which are set-up at Holiday Area?

**Opinion:** The question whether Workers Welfare Fund under Section 4 of the Workers Welfare Fund Ordinance, 1971 is leviable should the company derive income from an industrial undertaking located in the designated tax holiday areas and thereby enjoying tax holiday concession has been referred to the High Court by the Income Tax Department. In a decision reported as (1990) 61 Tax 9 (Trib) the learned Tribunal, Karachi Bench has held that the assessing officer does not have a legislative authority to levy Workers Welfare Fund on total income of such assessee which is not assessable under the Ordinance. Since the matter is before the High Court, the Committee has refrained from giving an opinion on the question raised.

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

### **2.1 APPOINTMENT OF PRACTISING MEMBER AS COMPANY SECRETARY**

**Inquiry:** Can a practising chartered accountant act as a company secretary?

**Opinion:** Yes, the C.A Bye-laws (Bye Law-135) provides that " a chartered accountant in practice may act as secretary in his professional capacity not being a whole time salaried employee"

### **2.2 ASSOCIATION WITH DIFFERENT FIRMS**

**Inquiry:** One of our professional brothers practising at Peshawar has solicited association with our firm practising at Karachi and Lahore in the sphere of professional services as described hereunder without any monetary consideration but on the basis of bilateral facilities to be gained thereby:

1. The clients of the other professional brother located at Karachi and Lahore would be provided professional services e.g., corporate affairs and income tax matters etc., by our firm from Karachi and Lahore and vice versa, our clients located at Peshawar would be served by the other professional brother from Peshawar.
2. All official certifications of financial statements of clients of either party shall be made by respective practising firms.
3. The letterheads of either party would bear identification as under: -
  - a) On our letter head \_\_\_\_\_  
"In Association with \_\_\_\_\_  
A.B.C., Chartered Accountants of Peshawar."
  - b) On other party's letter heads \_\_\_\_\_  
"In Association with \_\_\_\_\_  
X.Y.Z., Chartered Accountants  
Karachi and Lahore."

We would, therefore, like to know before we make such an arrangement / association, whether there would be any breach of professional misconduct or whether such arrangement / association is not permissible under the bye-laws of the Institute.

**Opinion:** An audit firm may have clients at locations where it does not have its office or it is not feasible to carry out the audit by its own staff. In these circumstances the client, or the auditor in consultation with the client, may request another auditor practising at those locations to perform such professional services as necessary.

In the opinion of the Committee, such references should only be made on case to case basis. The Council's directive 4.01 provides that: -

"The Council did not have an objection to the management of a branch office of a firm of chartered accountants in another city through an arrangement with another chartered accountant having his main office in that city provided a regular partnership deed has been signed. A certified copy of the partnership deed is required to be deposited with the Institute".

The directive also states that: -

"Arrangement by a member with another member for looking after his branch office should not be allowed. Such an arrangement, if it has to take place, should be only through a regular partnership deed (under the Partnership Act), a copy of which will be filed with the Institute. Any other arrangement will not be accepted".

The Committee has therefore concluded that indication on the letterheads as "in association with ..... " is not permitted unless a partnership deed between the two firms is prepared and forwarded to the Institute.

### **2.3 AUDITOR'S APPOINTMENT AT AGM TO CARRY OUT AUDIT OF ACCOUNTS OF MORE THAN ONE FINANCIAL YEAR IF SUCH ACCOUNTS HAVE NOT YET BEEN AUDITED.**

**Inquiry:** We have been appointed statutory auditors of a private limited company for the year 1993. The audit for the year 1991 and 1992 is still pending. We have already communicated to the existing auditor in respect of the proposed appointment. We shall appreciate if you would please guide us that since we are auditors for the year 1993, can we also issue our report for the years 1991 and 1992 or not?

**Opinion:** Regarding appointment of auditors the Institute has issued ATR-11 on July 10, 1982. ATR-11 states:

"An auditor has to be appointed in an annual general meeting and he holds office till the next annual general meeting. Such appointment is not related to the accounting year of the company. In other words if more than one year's accounts of the company are in arrears for audit purposes the auditor appointed in the last annual general meeting could audit all the pending accounts till the next annual general meeting when he would cease to hold office as the auditor unless re-appointed".

In the opinion of the Committee, therefore, you may also audit the accounts for 1991 and 1992 if such accounts have not yet been audited.

### **2.4 AUDITOR'S APPOINTMENT FOR IATA REQUIREMENTS**

**Inquiry:** Does the appointment of an auditor for IATA requirements require approval or ratification by shareholders?

**Opinion:** Appointment of an auditor for IATA requirements is not a statutory appointment. It is an appointment by the directors and does not require approval or ratification by the shareholders. It will, therefore, be considered as a non-statutory audit different from what is required under the Companies Ordinance, 1984.

## **2.5 AUDITOR'S APPOINTMENT-GOVERNMENT OWNED CORPORATIONS**

**Inquiry:** Are the requirements of the Companies Ordinance, 1984, applicable to appointment / change of auditors for Government owned corporations?

**Opinion:** The provisions of Companies Ordinance, 1984 apply to the companies governed by any special enactment except in so far as such provisions are inconsistent with the provisions of such special enactments.

## **2.6 AUDITOR'S APPOINTMENT-THE AUDITOR HAS BEEN PREVIOUSLY IN THE EMPLOYMENT OF THE CLIENT.**

**Inquiry:** Mr. "A" resigned from the employment of M/s. XYZ a public limited company on July 31, 1989 and started practice as a chartered accountant. The company, at AGM held on November 30, 1992 appointed Mr. A as their auditor for the year 1992-93 (i.e. for the year ended on June 30, 1993). When Mr. A was appointed as auditor he was not at any time during the preceding three years an employee of the company. The period for which he was appointed to carry out audit (i.e. July 1, 1992 to June 30, 1993) had commenced before expiry of three years from the date of his resignation. Was he qualified to take up the audit of M/s. XYZ for the year 1992-93?

**Opinion:** Mr. A was appointed as auditor in the AGM held on November 30, 1992. He was during the preceding three years not a director, other officer or employee of the company. Therefore, Mr. A is not disqualified for being appointed as auditor of the company for the year ended June 30, 1993.

## **2.7 AUDITOR'S APPOINTMENT-WHERE A MEMBER IN PRACTICE DISCONTINUES HIS SOLE PROPRIETARY FIRM AND JOINS A PARTNERSHIP FIRM**

**Inquiry:** XYZ & Co., a firm of chartered accountants has four partners each having independent charge of different offices. Mr. A is a chartered accountant practising as sole proprietor under the name and style of "A & Co.,"

XYZ & Co., admits Mr. A as partner in its partnership with a condition that he shall change the name of his existing office in the name of XYZ & Co.

Before this arrangement the audits were accepted by Mr. A. under the name "A & Co.,"

The questions that arise are whether: -

1. Mr. A should continue to complete his previous assignments as a sole proprietor (besides being partner in XYZ & Co.) particularly in case of



limited companies, where his appointment as auditor has been made as a sole proprietor under the name "A & Co."

2. Mr. A shall complete his previous assignments under the name and style of new partnership.
3. Despite the fact that he has merged his sole proprietorship with XYZ & Co., a partnership firm and changed the name of his office, he shall complete the previous assignments as Mr. A (although the appointment was made as "A & Co." and now he is partner of XYZ & Co.)

**Opinion:** The Council's directive 4.01 provides that a member in practice intending to join a partnership may associate himself with two firms including his own sole-proprietary concern.

In the opinion of the Committee, it would be advisable that Mr. A should continue with his sole proprietary concern till he completes the existing audits. Discontinuation of audit practice of Mr. A would cause a casual vacancy to exist on the audit assignments of companies for which the audit report has not yet been issued.

## **2.8 MANAGEMENT CONSULTANCY PRACTICE-ASSOCIATING NON-MEMBER FOR RENDERING MANAGEMENT CONSULTANCY SERVICES WITH LIMITED LIABILITY.**

**Inquiry:** Can a practising chartered accountant associate himself with a non member for rendering various management services with limited liability?

**Opinion:** A practising chartered accountant can associate himself with the non-members for rendering various management services through a company with limited liability, if such non-members observe the Bye-laws and code of professional ethics of the Institute.

## **2.9 MANAGEMENT CONSULTANCY PRACTICE-DIFFERENT BUSINESS CARDS**

**Inquiry:** Part 2 of Schedule I to the C.A. Ordinance, 1961 provides that a member of the Institute engaged in management consultancy shall be deemed to be guilty of professional misconduct if he refers to associated firms of chartered accountants on his letter heads or professional cards or announcements.

If a member of ICAP is partner of a CA firm as well as director of management consultancy company does he require to have two separate business cards for the positions held by him in CA firm and management consultancy company OR is he allowed to have one business card containing all the positions he is holding in different firms?

**Opinion:** A member of the Institute engaged in management consultancy is deemed to be guilty of professional misconduct if he refers to associated firms of chartered accountants on his business cards. Accordingly, if a member is a director in management consultancy practice, he may not, on his business card of management consultancy, refer to his position in his chartered accountancy firm.

**2.10 MANAGEMENT CONSULTANCY PRACTICE-DIRECTORSHIP IN A COMPANY WITH ITS NAME DIFFERENT FROM AUDIT FIRM**

**Inquiry:** Can a practising chartered accountant become a director in a company with its name different from audit firm for rendering management consultancy services.

**Opinion:** Yes, a practising chartered accountant may be a director in a company formed for rendering management consultancy services, provided its name is either similar of the name of the audit practice or is after the name of the directors in practice.

**2.11 MANAGEMENT CONSULTANCY PRACTICE-RENDERING MANAGEMENT CONSULTANCY SERVICES TO A CLIENT INTRODUCED FOR AUDIT / ACCEPTING AUDIT OF A CLIENT INTRODUCED FOR MANAGEMENT CONSULTANCY SERVICES**

**Inquiry:** Can a chartered accountant accept the audit of a client introduced for management consultancy or can management services be rendered to a client by the company introduced for audit to the C.A. firm.

**Opinion:** A chartered accountant in practice cannot accept the audit of a client introduced for management consultancy by its auditor. He can, however render management consultancy services to a client introduced for audit.

**2.12 MANAGEMENT CONSULTANCY PRACTICE-SOLE PROPRIETORSHIP**

**Inquiry:** If a management consultancy practice is established as a sole proprietorship does it need to get approval of ICAP?

**Opinion:** Yes, a practice certificate will be required.

**2.13 MEMBERSHIP OF PRACTISING FIRM OF CHARTERED ACCOUNTANTS WITH TRADE ASSOCIATION**

**Inquiry:** Can a practising firm of chartered accountants become a member of Trade Association?

**Opinion:** There is nothing in the Chartered Accountants Ordinance, 1961 to disentitle a firm to become a member of Chamber of Commerce & Industry or other trade association.

**2.14 QUALIFICATION IN AUDITOR'S REPORT-INABILITY TO OBTAIN BANK CONFIRMATION**

**Inquiry:** At times an auditor has to face a situation where company and its bankers are involved in litigation. In such a situation where the company is not willing to forward auditors' standard request to bankers or the bankers do not reply such request, what is the option for the auditor to report on bank liability and securities held etc.

**Opinion:** Where the company is not willing to forward auditors' standard request to bankers, or the banks do not reply such requests, the auditor should not issue an unqualified opinion, as inability to obtain bank confirmation constitutes a scope limitation.

## **2.15 RENDERING SHARE REGISTRAR SERVICES**

**Inquiry:** Can a CA firm act as share Registrar for its clients?

**Opinion:** Yes.

## **2.16 STATUS OF EMPLOYEE MEMBER AS CHARTERED ACCOUNTANT**

**Inquiry:** Council's directive 4.04 states that a member employee of a practising firm is deemed to be in practice for limited purpose of training of the articulated clerks and will not deem to be in practice for other purposes and will not be granted practice certificate. While in the other directive 4.10 it is stated that a member in practice may engage in the employment of chartered accountants firm.

From the wordings of above directive I came to the following understanding:

Suppose presently I am an employee of practising chartered accountants firm. I am therefore, not eligible for applying a practice certificate. However, if I resign from the present employment and start my own practice then I can apply for practice certificate and after having obtained the required certificates I may be engaged as an employee in other practising firm even continuing my own practice.

**Opinion:** There is no contradiction between Council's Directives 4.04 and 4.10. Directive 4.04 provides that a member who is a salaried employee of a chartered accountant in practice is deemed to be in practice for the limited purpose of training of articulated clerks.

Directive 4.10 provides that a member in practice may take an employment with a practicing firms of chartered accountants. (The partners of a firm of practising chartered accountant would therefore be aware that the member employed by the firm is already in practice).

There is no ban on a member in practice intending to join a partnership firm and continue his own sole proprietary concern. For obtaining a certificate of practice, however, a release certificate from the last employer will have to be obtained.

## **2.17 USE OF LOGO BY AN AUDIT FIRM OR MANAGEMENT CONSULTANCY PRACTICE**

**Inquiry:** Can a CA firm or management consultant use a logo along with its name?

**Opinion:** Yes, a logo may be used.

## **2.18 WRITING UP BOOKS OF ACCOUNTS FOR CLIENT**

**Inquiry:** Can a chartered accountant in practice be engaged by his client to write up books of accounts?

**Opinion:** A chartered accountant in practice may be engaged by his client to write up books of accounts. However services provided by a member in practice to assist in writing up of books of accounts are advisory services. Such services should not usurp the management functions of client companies. The independence of a member in practice is not impaired by offering advisory services provided there is no involvement in responsibility assumed for management decisions. Nevertheless, the chartered accountant in practice should be careful not to go beyond the advisory function into the management sphere. A member in practice who has assisted in writing up books and preparing financial statements should perform normal audit procedures including review of internal controls and to take all normal audit steps for expressing an opinion on such statements. Also, so far as practicable separate staff should be assigned for accounting work and auditing the financial statements.

**2.19            WRITING UP BOOKS OF ACCOUNTS OF AN ENTITY WHERE ANOTHER FIRM OF CHARTERED ACCOUNTANTS HAS BEEN APPOINTED AS AUDITOR**

**Inquiry:** A company has existing statutory auditors. We have been appointed special auditors of said private limited company. We have been asked to prepare accounts from books of accounts as of different dates.

We have communicated to existing statutory auditors of our appointment as special auditors. We shall be obliged if you please let us know whether we can issue accounts as special auditors.

**Opinion:** If a firm of chartered accountants is specifically assigned the job of preparing accounts from books of accounts, it may prepare such accounts as a special assignment even if any other firm of chartered accountants has been appointed as statutory auditors.

### **3. CORPORATE LAWS**

#### **3.1 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 issuance 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.

### **3.2 PRICING OF SHARES (REFERENCE FROM CLA)**

**Inquiry:** An international institution has suggested that pricing of issues (including initial public offering, dis-investment, 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, have 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 appropriately regulated.

### **3.3 SCRIP DIVIDEND (REFERENCE FROM CLA)**

**Inquiry:** We shall be grateful if the Institute of Chartered Accountants of Pakistan may please furnish its considered views on the issue of introducing a scrip dividend scheme.

**Opinion:** Whereas it is recognized that scrip dividend is a practice, which is followed in a number of countries and should also be permissible in Pakistan, its implementations would require an evaluation of the stage of development of capital market and shareholders culture in general with a view to assess its acceptability and fairness in all respects. Furthermore, the Companies Ordinance, 1984 only provides for the right issue as a mode for issue of further capital. The only departure is in respect of capitalization of profits by issue of bonus shares, which is covered under the Capital Issues (Exemption) Ordinance, 1967.

Right issue contemplates issue of shares either at par, premium or discount strictly in proportion to the entitlement determined on the basis of the shareholdings in the company resulting in a pre-emptive right. Bonus issue on the other hand, represents capitalization of profits. Such shares are issued at par and distributed in lieu of dividend. The entitlement is again determined on the basis of shareholdings in the company.

Scrip dividend would be a combination of right issue and distribution of cash dividend with certain specific characteristics, which can be summarized as follows:

1. The shareholders are given an option to either receive cash dividend, which would be a declared percentage in relation to face value of shares or fully paid shares of the company.
2. The number of shares to be issued as scrip dividend are determined on the basis of specified criteria so as to ensure that immediate monetary benefit accruing to the shareholder in case of exercise of either option should be almost identical.
3. The amount of further capital issued in case of scrip dividend would remain flexible depending upon the exercise of the option rather than a fixed amount in case of right issue or bonus shares.

The scrip dividend plan therefore results in the following:

1. The option of receiving dividend either in cash or shares vests with individual shareholders rather than with the company.
2. There are no enabling provisions in the Companies Ordinance, 1984, which would cater for the scrip dividend plan. Consequently there would be a need to amend Capital Issues (Exemption) Order, so as to provide for enabling power in this respect.
3. The Controller of Capital Issue should also issue a guideline for determining of the value of such shares and provide for circumstances in which the company should be allowed to use scrip dividend alternative.
4. The requirements of maintenance of free reserve as applicable in case of issue of bonus shares should also be considered in case of scrip dividends.

In view of the above, the Committee concluded that it would be appropriate to allow the scrip dividend alternative to the companies after considering the aspects discussed above. Furthermore, in view of the developments of the capital markets all over the world, the Committee recommends the Authority to also explore the possibility of the issue of treasury stocks, which would complement the scrip dividend alternative. These two vehicles would enable the companies to raise funds and reduce the capital when required.

