
SELECTED OPINIONS

Volume VII

(July 1, 2001 to June 30, 2002)

COMPILED BY

TECHNICAL SERVICES DIRECTORATE

Of

**THE INSTITUTE OF CHARTERED
ACCOUNTANTS OF PAKISTAN**

INTRODUCTION

This report is the seventh compilation of selected opinions issued by the Technical Advisory Committee on inquiries raised by the members and other agencies during the period from July 2001 to June 2002 for the general guidance of the members of the Institute. Volume I, II, III and IV were published earlier. Volume V and VI have been put on the ICAP Website. Volume I to IV are also now available on the Website.

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.

Syed Sajid Ali
Director Technical Services

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1. ACCOUNTING

1.1 AMORTIZATION OF DISCOUNT ALLOWED ON ISSUE OF SHARE CAPITAL

Inquiry: Your attention is drawn towards the accounting treatment of discount allowed on issue of share capital, which is treated as a deferred cost and is amortized over a period of five years. It has been observed that in case shares are issued at a discount, amortization of this discount deprives shareholders of dividend for a number of years. The SEC has decided to review the accounting treatment of discount in order to enable shareholders to get some return on their investment. Your input in this regard would be highly appreciated since the new accounting treatment will be reflected in the Fourth Schedule, as amended. Kindly provide your suggestions

Opinion: Paragraph 5(B) of Part II of the Fourth Schedule to the Companies Ordinance, 1984, as reproduced below, includes discount allowed on the issue of shares in the deferred costs:

“5(B) Deferred costs shall include preliminary expenses, discount allowed on the issue of shares, if any, and expense incurred on the issue of shares including any sums paid by way of commission or brokerage on the issue of shares, to the extent not written off or adjusted and each of these items shall be stated separately.”

Further paragraph 5(C) states that the deferred costs shall be written off during a period not exceeding five years, commencing from the financial year in which the costs were incurred.

As a matter of fact the IASC Framework for the Preparation and Presentation of Financial Statements and International Accounting Standards do not have a concept of deferred costs. As deferred cost is shown as an asset in the balance sheet we will have to look up as to how an asset is defined in an IAS. According to paragraph 7 of IAS 38: -

” An asset is a resource:

- (a) controlled by an enterprise as a result of past events; and
- (b) from which future economic benefits are expected to flow to the enterprise.

If it is argued that the deferred cost is an intangible asset then the definition of intangible asset given in the same paragraph of IAS 38 also does not treat deferred cost as an intangible asset, as it is defined as:-

“ An intangible asset is an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.”

Paragraph 53 of the Framework further states that the future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the enterprise. The potential may be a productive one that is part of the operating activities of the enterprise. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.

Paragraph 49(c) of the Framework defines equity as the residual interest in the assets of the enterprise after deducting all its liabilities. Paragraph 65 explains that although equity is defined in paragraph 49 as a residual, it may be sub-classified in the balance sheet.

For example, in a corporate enterprise, funds contributed by shareholders, retained earnings, reserves representing appropriations of retained earnings and reserves representing capital maintenance adjustments may be shown separately.

Paragraph 57 (a) of IAS 38 requires expensing of start-up costs consisting of establishment costs such as legal and secretarial costs incurred in establishing a legal entity. Further SIC 17.5 requires that costs of an equity transaction are comprised of only those incremental external costs directly attributable to the equity transaction (defined in paragraphs 3 and 4), which would otherwise have been avoided. The transaction costs of an equity transaction should be accounted for as a deduction from equity, net of any related income tax benefit.

As discount on issue of share is not a payment it would not fall strictly into any of the above categories.

Furthermore concept of substance over form requires that if information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form.

The amortization of deferred cost also does not meet the criteria of expenses as defined in paragraph 70 (b) of the Framework:-

“Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.”

Accordingly it would appear that equity should be the net amount received by the enterprise. In most of the western countries the concept of par value of shares is gone. However, since we have the concept of par value in place therefore the best possible treatment could be to show the amount of discount on issue of shares as a deduction from equity and disclose it by appropriately amending paragraph 7 of the Fourth and Fifth Schedules to the Companies Ordinance, 1984.

Further the Committee was also of the opinion that as there is no concept of deferred cost / expenditure in International Accounting Standards therefore paragraph 5 of Part II of the Fourth Schedule should be amended suitably.

(June 22, 2002)

1.2 CONSOLIDATED FINANCIAL STATEMENTS

Inquiry:

We understand that the accounts of subsidiaries are required to be consolidated with the parent company in line with the requirements of IAS. The subsidiary company means where the holding company holds ownership of more than 50 % of the other company. As per the definition given in the Companies Ordinance, 1984, the subsidiary company has been defined as the Company whose direct or indirect shareholding remains with the parent Company by more than 50 %.

Our Company “A” Ltd. is holding 41 % shares of the Company “B” Ltd. and the Company “A” by virtue of agreements with the CBA and one of the creditors holds the irrevocable proxies of more than 10 %, which makes the total ownership of 51 % (i.e. direct 41 %, indirect through proxies 10 %).

The Company did not consolidate the accounts on the basis of the facts that since the direct ownership in Company “B” Ltd. is only 41%. How the majority share holding Vs minority shareholders interest will be reflected.

However, on the intervention of SECP in this regard we prepared the consolidated financial statements of these concerns for the year then ended on June 30, 2001.

But we still believe that the consolidation of financial statements is not required in our case due to the above mentioned facts keeping in view of the importance of the matter that it needs to be discussed in the technical advisory committee and the specific guidelines to be issued /clarified in this case.

Now the halfyearly accounts are becoming due to be printed. I shall be awaiting the official response from the ICAP.

Opinion: The appropriate Committee of the Institute would like to draw your attention to the following section 3 (1) (a) of the Companies Ordinance, 1984: -

3. Meaning of "subsidiary" and "holding company":

(1) For purposes of this Ordinance, a company or body corporate shall be deemed to be a subsidiary of another if -

(a) that other company or body corporate , directly , or indirectly controls, beneficially owns or holds more than fifty per cent of its voting securities or otherwise has power to elect and appoint more than fifty per cent of its directors; or

As Company "A" is holding 41 % shares of Company "B" and "A" by virtue of agreements with the CBA and one of the creditors holds the irrevocable proxies of more than 10 % which makes the total ownership of 51 % (i.e. direct 41 %, indirect through proxies 10 %). consolidated financial statements should be prepared and minority shareholding should be shown after deducting CBA and a creditor's holding.

(February 9, 2002)

1.3 FREE RESERVES

Inquiry: One of our clients raised a query on the calculation of free reserves. We want your valuable opinion on this matter. According to the definition of free reserves as given in the Companies (Issue of Capital) Rules, 1996, "free reserve" includes any amount which having been set aside out of revenue or other surpluses after adjustment of all intangible or fictitious assets.

The word used in definition is amount having been set aside out of revenue or other surpluses. Its means that the fictitious assets and intangible assets should only be deducted against the revenue or other surpluses if any set aside against that specific fictitious assets or intangible assets but not against any other profits or free reserves.

Kindly advise on the above matter.

Opinion: The Committee is of the opinion that Rule 5 and 6 of the Companies (Issue of Capital) Rules, 1996 lay down the rules for calculating free reserves for the purpose of charging premium on a right issue and issue of bonus shares and for that purpose prescribe that free reserves shall be worked out by deducting from aggregate of the reserves and surplus the amounts of all intangible and fictitious assets. The Committee is of the opinion that the interpretation you have placed on the rules is very narrow and restrictive, which does not appear to be correct.

(February 9, 2002)

1.4 IAS – 1 (REVISED 1997), DISCLOSURE OF ACCOUNTING POLICIES

Inquiry: We draw your attention to paragraph 99 of IAS-1 (Revised 1999), which refers to the accounting policies that an enterprise might consider presenting in the financial statements and captions thereof have been given.

In most of the companies, few captions, as given in the paragraph are not applicable like capitalization of borrowing cost and other expenditure, government grants etc.

We seek your clarification whether all accounting policies must nevertheless be disclosed despite the fact that some may not be applicable to the accounts presented.

Opinion: The appropriate Committee of the Institute would like to draw your attention to paragraph 99 of IAS 1 itself and paragraph 100 of the same IAS which state the litmus test for disclosing accounting policies in the financial statements:-

Paragraph 99

In deciding whether a specific accounting policy should be disclosed, management considers whether disclosure would assist users in understanding the way in which transactions and events are reflected in the reported performance and financial position.

Paragraph 100

Each enterprise considers the nature of its operations and the policies, which the user would expect to be disclosed for that type of enterprise.

There is no minimum or maximum, each enterprise has to decide within the above parameters and auditors have to report accordingly.

(December 1, 2001)

1.5 IAS – 19, EMPLOYEE BENEFITS

Inquiry: We understand from the Selected Opinions 1.7 of Volume VI that an auditor is required to express a qualified opinion, if in case, the liability under defined benefit plan is not calculated/recorded by applying actuarial valuation method (qualified actuary or otherwise).

We seek following further clarifications in this context.

- (a) If, in case, the auditor observes that the quantum of defined benefit plan liability in the overall context of the company, is not material or there is insignificant difference if worked out, either under liability method or actuarial valuation, whether the auditor must still qualify his report that the liability is not calculated on that basis.
- (b) Valuation techniques under actuarial valuation method for defined benefit plans based on certain assumptions made by the management and assessed by the auditor devolves (in view of your earlier clarification) additional responsibility/liability on the auditor which is not his field of expertise involving greater risks for the auditor as the management forecast for interest rates and market price factor may not materialize under the varying circumstances. Under the situation would it not be wise that the actuarial valuation techniques for defined benefit plans be made necessarily by the qualified actuaries.

Opinion: The appropriate Committee of the Institute would like to reproduce last paragraph of the opinion referred to by you

The auditor should assess the assumptions made by the management and if he is satisfied with them, in all **materials** respects, a **clean report should be issued**.

Further paragraph 4 of ISA-320, *Audit Materiality* states that: -

“ The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework. The assessment of what is material is a matter of professional judgement.

In the light of above the appropriate Committee is of the opinion that your enquiry at (a) does not call for any further clarification.

Regarding enquiry (b) the appropriate Committee has noted your following two concerns if an actuary is not appointed:

- (i) additional liability / responsibility on the auditors
- (ii) greater risks.

In response to (i) the Committee is of the opinion that auditors cannot be absolved from their responsibility of expressing an opinion on any area of audit if an expert is appointed for that particular area. To substantiate this the Committee would like to draw your attention towards the following paragraphs of ISA 620, *Using the Work of an Expert*: -

“2. When using the work performed by an expert, the auditor should obtain sufficient appropriate audit evidence that such work is adequate for the purpose of the audit.

12. The auditor should assess the appropriateness of the expert's work as audit evidence regarding the financial statement assertion being considered. This will involve assessment of whether the substance of the expert's findings is properly reflected in the financial statements or supports the financial statement assertions, and consideration of:

- ◆ Source data used.
- ◆ Assumptions and methods used and their consistency with prior periods.
- ◆ Results of the expert's work in the light of the auditor's overall knowledge of the business and of the results of other procedures.

As far as (ii) is concerned regarding the risk that the 'management forecast for interest rates and market price factor may not materialize under the varying circumstances', the Committee is of the opinion that risk is always there even if the actuary is appointed. You are advised to refer to the following paragraph of ISA-620 '*Using the work of an expert*'

11. The auditor should obtain sufficient appropriate audit evidence that the scope of the expert's work is adequate for the purpose of the audit. Audit evidence may be obtained through a review of the terms of reference, which are often set out in written instructions from the entity to the expert.

The above paragraph clearly reflects that while using the work of an expert an auditor can not be absolved from his responsibility of expressing an opinion on that portion or part of the financial statements.

In conclusion the Committee feels that as IAS 19 paragraph 57 does not make it mandatory to have a qualified actuary, no useful objective would be achieved by making it mandatory,

(December 1, 2001)

1.6 MERGER OF COMPANY “B” INTO COMPANY “A”

Inquiry: Kindly favour us with your opinion on the following issue.

Company ‘B’ (having year-end September 30) is being merged in Company ‘A’ under a Scheme of Amalgamation, which prescribed the cut off date for merger as October 01, 2000.

The Scheme has been approved by the shareholders of both the companies in their meetings held on December 15, 2001, and it is likely that the High Court will accord its approval of merger by January 15, 2002.

After the merger and filing of return / intimation to the Registrar of Companies under section 284 of the Companies Ordinance, 1984, Company ‘B’ will cease to exist. The effective date of merger being October 01, 2000 merged accounts will be prepared for the period from October 01, 2000 to September 30, 2001. The questions arise:

1. Who will audit the merged account, i.e. auditors of the Company ‘A’ or Company ‘B’?
2. Can auditors of Company ‘A’ audit both the accounts?
3. If audit of Company ‘B’ has already commenced and an audit report is issued before or after the announcement of Court order for merger, can auditors of Company ‘A’ use that audited accounts of Company ‘B’ for preparation of consolidated accounts and issue separate report as issued on consolidated accounts?
4. If in the Board of Directors meeting and Annual General Meeting of Company ‘A’ separate accounts of Company ‘A’ and consolidated accounts of the Company ‘A’ and ‘B’ are approved, will it meet the requirement of the Companies Ordinance, 1984?

In our view the audit of both the Companies ‘A’ and ‘B’ will be done by auditors of the Company ‘A’, being the auditors of surviving company, as the cut off date of merger is October 01, 2000 and upon granting of approval by the High Court, the Companies will be deemed to have been merged effective from October 01, 2000.

Your early response will be highly appreciated.

Opinion

The appropriate Committee of the Institute has considered your query and is of the view that the situation presented by you involves critical legal issues for which it strongly advises you to seek legal advice to fully understand implications of the situation. However, the Committee for the benefit of Members of the Institute would like to comment that:

Usually the schemes of arrangements for the merger of two entities are so designed to make adequate provision for continued smooth operations of the entities up to the date of approval by the Court and completion of other regulatory formalities after which the scheme becomes effective and binding. Till such time the entities remain separate and distinct from each other.

Generally, such schemes are based on concept of “reference date” i.e. the date on which the assets and liabilities of both the companies are valued and share swap determined and “effective date” the date on which the scheme becomes effective. However, from your query it appears that the reference date and effective dates of the merger are same which has made the situation more complex, thereby requiring a legal advice to fully understand the implications.

Till such time the scheme is not approved by the High Court, all requirements under any law for filing of documents, preparation of accounts and reports, audits, company meeting etc., will remain binding on both the companies and will have to be complied by them. Any non-compliance will attract penal actions in accordance with the related law.

In this case various hypothetical scenarios may emerge and those are discussed as follows:

Q. No.	(Scenario A) Court order not issued prior to holding of AGM by company “B”	(Scenario B) Court order issued and regulatory formalities completed prior to holding of AGM by company “B”	(Scenario C) Court order issued but regulatory formalities not completed prior to holding of AGM by company “B”
1. Who will audit the merged account, i.e. auditors of the Company ‘A’ or Company ‘B’?	The legal status of both the entities remains intact and they need to comply with the legal requirements of preparing and presenting separate audited accounts. Therefore, the financial statements of both the companies would be audited by their respective auditors.	Since the scheme has become binding and company B has ceased to exist, the auditors of company A will audit the financial statements of the merged entity.	Same as Scenario A
2. Can auditors of Company ‘A’ audit both the accounts?	Since the shareholders of company B have appointed separate auditors, the auditors of company A can not audit the financial statements of company B.	Since the scheme has become binding and company B has ceased to exist, the auditors of company A will audit the financial statements of the merged entity.	Same as Scenario A
3. If audit of Company ‘B’ has already commenced and an audit report is issued before or after the announcement of Court order for merger, can auditors of	Since the companies retain their separate legal existence, both the companies will issue separate sets of financial statements, duly audited by their respective auditors.	The financial statements of merged entity will be audited by the auditors of company A. It is their prerogative to decide whether to use the work of	Same as Scenario A

Company 'A' use that audited accounts of Company 'B' for preparation of consolidated accounts and issue separate report as issued on consolidated accounts?		<p>other auditors or not under the guidance contained in International Standards on Auditing "Using the Work of other Auditors".</p> <p>However, it is clarified that the accounts of the merged entity would that be of an entity and not consolidated accounts of two group companies. Therefore, The audit report would be issued in the form prescribed under the law for an entity.</p>	
4. If in the Board of Directors meeting and Annual General Meeting of Company 'A' separate accounts of Company 'A' and consolidated accounts of the Company 'A' and 'B' are approved, will it meet the requirement of the Companies Ordinance, 1984?	N/A	<p>As clarified above the accounts are that of a single entity and not the consolidated accounts of group companies therefore the requirement of the law would not deemed to be complied with until and unless financial statements of merged entities are approved by the board and AGM.</p>	N/A

It is also clarified that various other permutations of situation may also arise such as that up to the date the scheme becomes binding one of the company had issued its accounts and held AGM, also. The above scenario analyses is hypothetical and without any consideration of the actual situation of the case at any point in time, therefore all questions including the above will require complete information before making any decision.

Therefore, the Committee once again strongly advises that the management of company and the auditors should seek legal advice to clearly understand the implications of the scenario faced by them.

(April 19, 2002)

Inquiry:

1. Is it mandatory for private limited companies to follow IAS in presentation of financial statements?
2. Keeping in view the minimum fee charged for audit of other companies (other than public listed companies) as stated in ATR-14 (revised) whether this fee criteria is also applicable to co-operative housing societies, although housing society are not involved in trading activities, therefore, concept of turnover is not relevant.

Your early response shall be highly appreciated.

Opinion:

1. The appropriate Committee considers that by the word 'presentation' you are referring to 'preparation and presentation', because financial statements of unlisted companies are presented in accordance with the Fifth Schedule to the Companies Ordinance, 1984 wherein no material conflict exists between the Schedule and IAS. The application of IASs is generally referred to as preparation part i.e., accounting treatments for which the Ordinance does not provide any guidance, barring a few minor things.

In line with the above clarification the Committee's views on your query are as follows:-

Section 234 of the Companies Ordinance, 1984 provides that public companies, which are listed on stock exchanges, should comply with the requirements of such IASs, which are notified for compliance by SECP. Therefore, strictly in legal terms it can be argued that the IASs are not applicable to companies other than listed companies.

However, second para of Form '35A' "Format of Auditors' Report", states that "it is the responsibility of the company's management to establish and maintain a system of internal control, and prepare and present above said statements in conformity with the approved accounting standards.....". The "approved accounting standards" referred to above mean IASs notified by SECP.

Further, as a member of the Institute the auditors are duty bound to follow IASs as stated in TR-5, which says that:

"The auditor, while expressing an opinion on published financial statements, should satisfy himself that they do comply with IASs in all material respects and that in the event of any departure from or inconsistency with such standards, the auditors' report should contain suitable qualification".

Therefore it is strongly recommended that all non-listed companies should also adopt IASs, as a framework for the preparation of accounts, as otherwise the auditor may in view of the statutory format of the auditors' report and TR-5 may issue a modified opinion in case of any material non-compliance with the standards.

2. The minimum fee levels stated in ATR-14 (revised) are applicable to the audits of non-listed and listed companies. The auditor may determine the fee for audits of other entities based on the minimum hourly charge out rates for different levels of audit staff specified in the ATR.

(July 6, 2002)

Inquiry: Your input is required on following two points

1. Is it mandatory for a company to have its Cash Flow Statement, Statement of Changes in Equity and Notes to the accounts signed by its directors? Whereas the footnote of the balance sheet and profit and loss states that "the annexed notes form an integral part of these accounts". Section 241 of the Companies Ordinance, 1984 also requires only balance sheet and profit and loss to be signed by the directors.
2. It is a normal practice that some audit firms issue the accounts of a company on their own letterhead on the argument that the companies insist on this practice.

Opinion: Section 234 3(ii) says that "a statement of changes in financial position or statement of sources and application of funds shall form part of balance sheet and profit and loss account."

Further Fourth Schedule to the Companies Ordinance, 1984 in its paragraph 7 (A)(ii) states that "additions to and deductions from each item of reserves shall be shown in the balance sheet under the respective items unless they are disclosed in the profit and loss account or a statement or a report annexed thereto".

In view of the above it can be inferred that both cash flow statement and statement of changes in equity should be treated as part of balance sheet or profit and loss account and are not to be disclosed as notes to the accounts. Therefore, being merely a continuation / part of balance sheet or profit and loss these are required to be signed by directors as per section 241. As such strictly speaking, there is no specific legal requirement of signing notes to the accounts by directors.

As stated above, the preparation and presentation of financial statements is the responsibility of management and the auditor is only responsible for forming and expressing an opinion on the financial statements prepared by the management. Therefore, the practice of issuing the financial statements of a company on audit firms' letterhead should be discouraged in order to ensure that the role of auditor is not confused with that of management.

(June 22, 2002)

1.9 TAX ON RESERVES UNDER SECTION 12(9A) OF THE INCOME TAX ORDINANCE, 1979.

Inquiry: We draw your attention to the provisions of Section 12(9A) of the Income Tax Ordinance, 1979 whereby it is required that the reserves of the Company which are in excess of 50% of paid up capital will be taxed @ 10%, if a Public Company (excluding scheduled Banks or Modaraba) derives profits for any income year but does not distribute cash dividend. Reproduced below is the relevant Section:

12(9A) "Where an assessee, being a public company other than a scheduled bank or a modaraba, derives profits for any income year but does not distribute cash dividends within seven months of the end of the said income year, or distributes dividend to such an extent that its reserves, after such distribution, are in excess of fifty percent of its paid up capital, so much of its reserves as exceed fifty percent of its paid up capital shall be deemed to be the income having accrued to such company during that year:

Provided that in respect of assessment year commencing on the first day of July, 1999, the cash dividend distribution made within the following

period shall be treated as distribution for the purposes of this sub-section:

- (i) where the income year ended on a date prior to the thirtieth day of June, 1999, and the distribution is made within a period of three months reckoned from the first day of July, 1999, or
- (ii) where the income year ended on the thirtieth day of June 1999 and the distribution is made within a period of eight months reckoned from the first day of July 1999.

Explanation:

For the purposes of this sub-section, the expression “reserves” shall have the meaning as may be prescribed”.

We also draw your attention to Clause 59 of Part IV of the Second Schedule to the Income Tax Ordinance, 1979 which provides that the provisions of Section 12(9A) shall not apply to a Company listed on Stock Exchange which distributes at least 40% of the “After Tax Profits” of the relevant income year, Reproduced below is the relevant Clause:

Clause 59:

“The provisions of sub-section (9A) of section 12 shall not apply to:

- (i) a company listed on a stock exchange which distributes at least forty percent of its after tax profits of the relevant income year;
- (ii) a public company not listed on the stock exchange;
- (iii) a trust or a company in which not less than fifty percent shares are held by the Government; or
- (iv) a leasing company as defined in the Leasing Companies (Establishment and Regulation) Rules, 1996.

We shall be obliged if you please let us have your technical opinion on the following aspects of the above subject for the benefit of our Members:

- 1) Whether the term “after tax profit”, used in Clause 59 of Part IV of the Second Schedule to the Income Tax Ordinance, 1979, means profit after tax as per audited accounts of the listed company?

(Please note that accounts of the listed Company are prepared in accordance with generally accepted accounting principles and International Accounting and Audit Standards adopted by SECP in this regard)

- 2) Whether any adjustment can be made for inadmissible expenses according to the Income Tax Ordinance, in “profit after tax” to compute tax U/S 12(9A) of the Income Tax Ordinance, 1979.
- 3) If the answer to query No. 2 is yes, then can the allowable deductions as per Income Tax Ordinance, like tax depreciation or lease rentals be allowed to arrive at the figure of “after tax profit”?

We shall be highly obliged for your opinion in this regard.

Opinion: The Committee would like you to appreciate that one of the well-recognized rules of interpretation is the literal rule; it means that the language used speaks the mind of the parliament and there is no need to look somewhere else to discover the intention or meaning. A plain reading of sub-clause (I) of Clause (59) would reveal that a listed company which distributes at least forty percent of the "relevant year's" after tax profit as cash dividend would not be required to pay tax on their excess reserves. To determine what is "after tax profit" of the relevant income year, the tax liability of that year is to be computed according to the provisions of the Ordinance and the same is to be related to the profits of that year for the purposes of determining "after tax profits". It must be appreciated that there is no room to adjust the accounting profits in any manner since the term "profits" have been used as opposed to "income"

As such our para-wise replies to your queries are as follows: -

1. "After tax profit" means profit after tax as per audited accounts of the listed company.
2. No adjustment for inadmissible expenses can be made to arrive at "profit after tax"
3. Please see reply to paragraph 2 above

(September 15, 2001)

1.10 TECHNICAL RELEASE - 5

Inquiry: Reference is made to TR-5, IASC Standards – Council's Statement on Applicability. Part I) and iii) of Para 5 states the following:

- "I) to ensure that published financial statements comply with International Accounting Standards in all material respects and disclose the fact of such compliance"

My inquiry in this regards is that does this mean that after the introduction of new auditor's report which states in para 2 "it is the responsibility of the Company's management to establish and maintain a system of internal control, and prepare and present the above said statements in conformity with the approved accounting standards and the requirements of the Companies Ordinance, 1984".

Keeping these two in mind, will it be reasonable to include such a paragraph in the notes to the financial statements that said financial statements have been prepared, in all material respects, in accordance with the requirements of the Companies Ordinance, 1984 and International Accounting Standards as applicable in Pakistan.

Kindly confirm the same at your earliest.

Opinion: The appropriate Committee of the Institute has considered your query and is of the opinion that following statement is required to be included in the Notes to the Accounts of a company to comply with the requirements of TR-5: -

Basis of preparation of financial statements

These financial statements have been prepared under the historical cost convention and are in accordance with Accounting Standards issued by International Accounting Standards Committee (IASC) and interpretations issued by Standing Interpretations Committee of IASC, as applicable in Pakistan and the requirements of the Companies Ordinance, 1984.

(October 13, 2001)

1.11 TREATMENT OF DEPOSITS UNDER SECTION 226 OF THE COMPANIES ORDINANCE, 1984

Inquiry: Section 226

"No company, and no officer or agent of a company, shall receive or utilise any money received as security or deposit, except in accordance with a contract in writing; and all moneys so received shall be kept or deposited by the company or the officer or agent concerned, as the case may be, in a special account with a scheduled bank:

Provided that this section shall not apply where the money received is in the nature of an advance payment for goods to be delivered or sold to an agent, dealer or sub-agent in accordance with a contract in writing."

One of our clients has received security deposits under written contracts. Please clarify whether there is a need to put this money in a separate bank account under this section.

Opinion: The appropriate Committee of the Institute is of the opinion that the amount of security or deposit be deposited in a special account with a scheduled bank and may be utilised out of the account, only in accordance with the contract in writing.

(April 6, 2002)

1.12 TREATMENT OF SURPLUS ON REVALUATION OF ASSETS ON MERGER OF TWO COMPANIES.

Inquiry: I solicit your opinion and expert advice on whether or not a surplus on revaluation of fixed assets can become a part of revenue reserves upon merger of a company with another. Sub-section 2 of Section 235 of the Companies Ordinance, 1984 states that: -

*"Except and to the extent **actually realized on disposal** of the assets which are revalued, the surplus on revaluation of fixed assets shall not be applied to set-off or reduce any deficit or loss, whether past, current or future, or in any manner applied, adjusted or treated so as to add to the income, profit or surplus of the company, or utilized directly or indirectly by way of dividend or bonus".*

It is understood that the above sub-section refers to the revaluation surplus arising in the books of the company whose assets are revalued, however in case the company is merged with another company (having common ownership) and as a result the company ceases to exist, in such circumstances whether the same can be termed as having been **actually realized on disposal** and any excess value of the net assets of the company being merged over the paid up value of shares can be transferred to the General Reserve of the other company.

I am sure that you will also consider that the surplus on revaluation of fixed assets has not been made a part of shareholders' equity under the provisions of the Fourth Schedule and is required to be stated separately. In view thereof I solicit the committee's considered opinion whether the surplus on revaluation in the books of the company that is being merged with another company can be termed as having been actually realized on disposal and any excess value of the net assets of the company being merged over the paid up value of shares can be transferred to the General Reserve of the other company or the surplus on revaluation shall be shown as a surplus of a corresponding nature in the books of the merged company.

Opinion:

The Committee deliberated the question raised by you and observed that under the Companies Ordinance, 1984 a merger of two or more companies is essentially a process of corporate reconstruction whereby assets are neither sold nor bought by any of the companies concerned. A merger of the corporate entities entails devolution of assets and liabilities of one or more companies on the other, which may be altogether a new entity or one of the merging companies which survives with its legal and corporate existence. There is no sale, disposition, exchange or relinquishment or extinguishment of any right on the part of the companies being merged.

The Committee is of the opinion that since the net assets of the companies being merged remain intact when amalgamated, no transaction could be said to have taken place between the merging companies concerned. The primary reason that no disposal of assets occurs in the context of a merger is this absence of a transaction causing sale or exchange of assets between the companies concerned since the corporate reconstruction is merely the outcome of a scheme of arrangement duly approved by the High Court whereby by virtue of the order of the High Court, the properties of a merging company stand vested in and its liabilities ipso facto become the liabilities of amalgamated company without any transaction taking place or a consideration being paid by one company to the other.

The Committee is, therefore, of the considered opinion that the surplus on revaluation of fixed assets shall not be deemed to have been "actually realized on disposal" in the event of merger of companies undertaken under the Companies Ordinance, 1984.

(April 6, 2002)

2. AUDITING

2.1 AUDIT OF PREVIOUS YEARS

Inquiry:

An auditor had been appointed in an AGM (Form A filed with SECP) for a non-listed public limited company for the year 1999-2000. Accounts for the year 1999-2000 have not been finalized by the management and so have not been audited by the auditor so far.

The Company was enjoying tax-holiday for the period of five years up to December 1999. Income tax was due on the income of the Company for the period from January 2000 to June 2000. Extension for the delay in filing of tax return has been duly granted to the Company.

The same auditor has been re-appointed in an AGM (Form A filed with SECP) for the year 2000-2001. The audit for the year 2000-2001 has not yet been initiated and the present auditor wants to resign (perhaps due to his poor health and old age) without issuing the audit report for the years 1999-2000 and 2000-2001.

Queries:

- (a) Now in the month of September 2001, how can the Company appoint new auditor for the past year 1999-2000 and get the audit done, while for the same period the auditor had been appointed in an AGM, who could not conduct the audit.
- (b) How can the Company appoint new auditor for the year 2000-2001 and get the audit done.
- (c) Non-listed public limited companies or private limited companies having share capital in excess of Rs.500, 000 need audited accounts for taxation authorities. Since the Company was only liable to pay tax on the income earned for the period from January 2000 to June 2000, what should be the period/s of audit for this particular financial year 1999-2000? Two possibilities arise, first, audit for a single period of entire financial year 1999-2000 for SECP and a separate audit for taxation authorities for the period from January 2000 to June 2000. Second, two audits each for period of six months i.e. from July 1999 to December 1999 and January 2000 to June 2000.
- (d) Any precautionary measures that must be adopted by the new auditor before accepting the job of such nature.

Your early response shall be highly appreciated.

Opinion:

- (a) As soon as the present auditors resign, it will create a casual vacancy, which can be filled in by the directors of the company under section 252(4) of the Companies Ordinance, 1984--

‘The directors may fill any casual vacancy in the office of an auditor; but, while any such vacancy continues, the surviving or continuing, auditor or auditors, if any, may act.’
- (b) Any auditor appointed to fill casual vacancy will hold the office till the next annual general meeting. This appointment will not be 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 by directors may audit all the pending accounts.

For further clarification please refer to ATR-11 ' Appointment of auditors', Selected Opinions No.2.3 (Volume II) and 2.4 (Volume III).

- (c) A non-listed public limited company has to have its accounts audited by a chartered accountant under section 254(1)(i) of the Companies Ordinance, 1984 whereas a private company having a paid up capital of Rs.500.000 or more is covered under section 32A of the Income Tax Ordinance, 1979 which reads as--

32A. Documents certificates, etc., to be furnished by certain companies.

-

(1) Every private company as defined in the Companies Act, 1913 (VII of 1913), whose paid up capital on the last day of any income year is five hundred thousand rupees or more shall, with the return of total income for that year, furnish a copy of the balance sheet and profit and loss account for that year and an auditors' report for that year, in Form 35A of the Companies (General Provisions and Forms) Rules, 1985, prepared and signed by a person who is a Chartered Accountant within the meaning of the Chartered Accountants Ordinance, 1961 (X of 1961), or a cost and management accountant within the meaning of the Cost and Management Accountants Act, 1966 (XIV of 1966).

- (d) For any precautionary measures, the auditor should be aware of Chartered Accountants Ordinance, 1961, Chartered Accountants Byelaws, 1983 and Code of Ethics for Chartered Accountants.

(October 13, 2001)

2.2 APPOINTMENT OF INTERNAL AUDITORS AS EXTERNAL AUDITORS.

Inquiry: We are a private limited company with paid up capital of Rs.64,166,800/-. We have already engaged a firm of Chartered Accountants as our "External Auditors".

Now, we have engaged another company of Chartered Accountants as "Internal Auditors" to whom we also intend to appoint as External Auditors.

You are kindly requested to please advise us as to whether the company of Chartered Accountants engaged as Internal Auditors can also be appointed as External Auditors at the same time.

Your early response will be highly appreciated.

Opinion: According to paragraphs 6, 7 and 8 of International Standards on Auditing ISA-610 on *Considering the Work of Internal Auditing*: -

6. The role of internal auditing is determined by management, and its objectives differ from those of the external auditor who is appointed to report independently on the financial statements. The internal audit function's objectives vary according to management's requirements. The external auditor's primary concern is whether the financial statements are free of material misstatements.
7. Nevertheless some of the means of achieving their respective objectives are often similar and thus certain aspects of internal auditing may be useful in determining the nature, timing and extent of external audit procedures.

8. Internal auditing is part of the entity. Irrespective of the degree of autonomy and objectivity of internal auditing, it cannot achieve the same degree of independence as required of the external auditor when expressing an opinion on the financial statements. The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by any use made of internal auditing. All judgments relating to the audit of the financial statements are those of the external auditor.

According to paragraph 8 of Statement of Auditing Standard 500 issued by the Institute of Chartered Accountants in England and Wales

Even when the internal audit function is undertaken by a third party or the external auditors, it is part of the entity's activities. Irrespective of the degree of internal audit's autonomy and objectively it cannot achieve the same degree of independence as required of external auditors when expressing an opinion on the financial statements.

The Committee would also like to reproduce paragraphs 9.1 and 9.4 of the Code of Ethics for Chartered Accountants issued by this Institute: -

- 9.1 Chartered accountants in practice when undertaking a reporting assignment should be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity, objectivity and independence.
- 9.4 When chartered accountants in practice are or were, within the period under current review or immediately preceding an assignment: -
- a. a member of the board, an officer or employee to a company, or.
 - b. a partner of, or in the employment of, a member of the board or an officer or employee of a company,

they would be regarded as having an interest, which could detract from independence when reporting on that company.

The Companies Ordinance, 1984, the Chartered Accountants Ordinance, 1961 and the Code of Ethics do not prohibit the two appointments simultaneously or otherwise by the same firm of accountants. The Committee is, therefore, of the view that it is up to the chartered accountant to decide whether acceptance of both the positions will in any way impair his independence.

(October 13, 2001)

2.3

- (I) **APPOINTMENT OF AUDITORS**
- (II) **APPROVAL OF PRIOR YEARS ACCOUNTS BY THE DIRECTOR**

Inquiry:

We would appreciate if you kindly give your opinion on the following two issues:

1. APPOINTMENT OF AUDITORS

M/s ABC & Co. Chartered Accountants are the auditors of a Company (which is 100% subsidiary of a public company). We understand that the aforesaid firm has been dissolved, as the name of the firm is not appearing in the directory of the members and firms issued by the Institute of Chartered Accountant of Pakistan (ICAP). Moreover we

have been informed that one of the partners Mr. X of ABC & Co. is practicing in DEF & Co. Chartered Accountants whereas other partner Mr. M joined M/s. MNO & Co.

In the light of the above facts, we need opinion on the following:

- Whether the aforesaid firm has been dissolved and a casual vacancy occurred in the office of the auditors of the company; and
- Whether the present directors of the company can fill the vacancy by exercising the powers as given under section 252(4) of the Companies Ordinance, 1984.

2. APPROVAL OF PRIOR YEARS ACCOUNTS BY THE DIRECTOR

The accounts for the prior periods of the aforesaid company are pending for the audit.

Due to the change in management all the nominee directors on the board of the subsidiary company have been replaced in the financial year 2000-2001. In prior years the accounts of the company were neither approved by the directors of the company nor audited by the external auditor.

Would you please advise whether the present directors of the company who have been nominated during the period 2000-2001 could sign the accounts of the company in respect of the prior years?

Your early response in this respect will be highly appreciated.

Opinion: The following are the views of the appropriate Committee.

- (1) In case of dissolution of firm you are advised to refer to ATR-12 as the issue raised in your email has been taken care of in the same.
- (2) Companies Ordinance, 1984 is silent on this issue. But the Committee is of the opinion that the present directors may sign the accounts of previous years though they were not the directors at that time.

However the Committee would also advise you to refer your second enquiry to your legal advisor before proceeding further in the matter.

(November 3, 2001)

2.4 ATR-14 (REVISED) MINIMUM AUDIT CHARGE OUT RATES FOR AUDIT WORK BY PRACTISING MEMBERS

Inquiry: We are in receipt of ATR-14 (Revised) vide Circular letter no. CA/SEC/QC/02 dated September 19, 2001.

However, the question arises in case of minimum fees in case of joint audits where total fees is shared by more than one practising firm, where if share of both firms taken together, the minimum requirement is met, while individually it is not.

Moreover, there are several public listed companies including financial sector companies having low volumes or closed operations where the abrupt increase in fees is not justifiable.

Your immediate clarifications on the above would be highly appreciated.

Opinion: The appropriate Committee of the Institute is of the opinion that the minimum audit fee prescribed by ATR-14 means the total fee of the audit. In case of joint audit the minimum fee shall remain the same i.e. Rs.75, 000 and Rs.60, 000 for an audit of listed company

and other companies respectively if turnover is more than 20 million irrespective of the fact as to how many joint auditors share this fee.

The appropriate Committee very much appreciates the problems of financial sector companies with low volumes or closed operations but is of the opinion that the parameters of minimum fees prescribed by the Council of the Institute are the minimum which would enable a prudent auditor to carry out an audit satisfactorily according to ISAs and other requirements of relevant laws and report accordingly.

(November 3, 2001)

2.5 AUDIT OF ACCOUNTS FOR THE PERIOD FOR WHICH AUDITORS HAVE NOT BEEN RE-APPOINTED IN ANNUAL GENERAL MEETING

Inquiry: A company appoints an auditor in Annual General Meeting and auditor so appointed holds office until the conclusion of the next AGM.

We are auditors of a company having year ending on December 31. We were appointed in the year 2000 for audit of accounts for the year ending on December 31, 2000.

The company has not held Annual General Meeting of 2001 and it intends to hold both AGMs of 2001 and 2002, after obtaining directives from the competent authority giving reasons for the delay.

Now the company has asked us to audit accounts for the year ended December 31, 2001, though the Annual General Meeting for 2001 has not been held and as such the re-appointment and fixing of remuneration of auditors for the year 2001 is pending.

Please let us have your opinion in this respect.

Opinion: Under sub-section (1) of section 252 of the Ordinance, every company is required to appoint an auditor or auditors at each annual general meeting to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting.

If the AGM is not held the existing auditor will hold the office until the next AGM is held. This being the legal position the Committee is of the opinion that you can do audit of year 2001 also.

However the Committee would also advise you to refer the matter to your legal advisors before proceeding further in the matter.

(November 3, 2001)

2.6 AN ADVERTISEMENT FOR APPOINTMENT OF AUDITORS

Inquiry: We want to know what our course of action should be in answer to an advertisement for appointment of auditors. Can we say that we are a great firm and will be happy to accept the appointment and accept the appointment if offered?

Please let us have an immediate reply as this must be a routine matter for the Institute and does not merit special attention of a Committee.

Opinion: 1. Course of Action in Answer to an Advertisement for Appointment of Auditors

While replying to enquiries or tenders for audit job, you may supply information and particulars in any manner you deem fit provided it is not inconsistent with Institute's Code of Ethics for Chartered Accountants.

2. Can we say that we are a great firm and will be happy to accept the appointment and accept the appointment if offered?

The Committee would like to draw your attention to Section 7.1 of the Code of Ethics for Chartered Accountants: -

7.1 Publicity

In the marketing and promotion of themselves and their work, chartered accountants should: -

- (a) not use means which brings the profession into disrepute;
- (b) not make exaggerated claims for the services they are able to offer, the qualifications they possess, or experience they have gained; and
- (c) not denigrate the work of other accountants.

Further before accepting the appointment, if offered, the Committee would like to advise you to again go through Section 11 and Section 13 of the Code of Ethics, which provides comprehensive guidance on these two matters.

(February 9, 2002)

2.7 **ATR-14, MINIMUM HOURLY CHARGE OUT RATES FOR AUDIT WORK BY PRACTISING MEMBERS**

Inquiry: With reference to the subject ATR-14 (Revised) July 30, 2001, we seek your guidance in respect of such clients who have not approved the revision in audit fees requested by us on the basis of ATR-14

Such remuneration has however been fixed in the Annual General Meeting as per the requirement of Section 252 of the Companies Ordinance, 1984 and communicated to the Registrar as well.

We shall appreciate if Institute of Chartered Accountants of Pakistan could guide us on whether or not to accept the audit of these companies.

Opinion: When the existing auditors retire and offer themselves for reappointment, they are duty bound not to quote audit fee less than the minimum fees prescribed in ATR-14.

If the company does not agree to the proposal of the auditors, then the auditors should express their inability to take up the audit.

(June 22, 2002)

2.8 **COST AUDIT FEE**

Inquiry: Please refer to the decision of the Council of the Institute of Chartered Accountants of Pakistan (ICAP) dated 30 July 2001 (Copy enclosed) in which it has been decided that audit fee should not be less than Rs.75, 000/- for audit of a public limited company and Rs.60, 000/- for other companies having a turnover of more than Rs.20 million. Please clarify whether this decision also applies to cost audit or not.

Your early response will be highly appreciated

Opinion: The revised ATR-14 regarding minimum audit fee is not applicable to cost audits to be carried out under the Companies (Audit of Cost Accounts) Rules, 1998. However the minimum hourly rates as mentioned in the ATR should be kept in view while agreeing cost audit fee with the directors of a company under Rule 3(5) of the Rules referred to above.

(October 13, 2001)

2.9 DEFINITION OF EXISTING ACCOUNTANT

Inquiry: Please refer to the definition of “Existing Accountant” as given in Code of Ethics for Chartered Accountants dated March 1, 2000, which is reproduced below for your ready reference.

A chartered accountant in practice currently holding an audit appointment or carrying out accounting, taxation, consulting or similar professional services for client.

The above definition does not cover a “retiring auditor” under the Companies Ordinance, 1984. The legal position is that the auditor appointed immediately retires at the conclusion of the Annual General Meeting.

Accordingly, no communication is required between the receiving accountant and the retiring auditor in term of Part B-Section 13 of Code of Ethics for Chartered Accountants. If the receiving accountant (auditor) is appointed after the retirement of the existing accountant (auditor).

Since the communication is extremely important both in the interest of the retiring auditor and the receiving accountant (auditor) the definition of existing accountant (auditor) be suitably amended to include the retiring auditor who held the office immediately preceding the receiving accountant (auditor).

Opinion: The Committee deliberated the issue and would like to inform you that the conclusion that you have drawn in your letter is not correct. According to paragraph 7, Part – I of Schedule 1 referred to in Section 20A of the Chartered Accountants Ordinance, 1961 non communication even in the scenario that you have described would constitute professional misconduct. The said paragraph is reproduced below for reference: -

“accepts a position as auditor previously held by another member of the Institute without first communicating with him in writing”.

Your point of view regarding the definition of “existing accountant” has been noted for future reference.

(January 12, 2002)

2.10 LOAN AND GUARANTEE TO OR FROM CLIENTS

Inquiry: It some times happens that a partner of audit firm or the firm itself is engaged in some business dealing with a company for whom the firm is also auditor. Examples of such dealings would include:

- (a) Obtaining of vehicle(s) on lease from a leasing company.
- (b) Operating a bank account in a bank
- (c) Obtaining share brokerage services by one of the partner of the firm from a corporate brokerage house.
- (d) Buying ticket from a travel agency on credit.

These transactions may be in normal course of business and are arms length transactions:

- (a) It is lease financing by the company to audit firm or a partner of the audit firm.
- (b) There could be borrowing / loan obtained by the audit firm or a partner of the audit firm or there could be a temporary overdrawn balance in the bank account.
- (c) It may happen that in the books of the broker there is a debit balance in the name of a partner of the audit firm at some point of time.

The question is whether the above can be called "indebtedness" to the Company and hit from the provision of sub-section 3(d) of section 254 of the Companies Ordinance, 1984 which reads as under:

254 Qualification and disqualification of auditors:

- (3) None of the following persons shall be appointed as auditors of the company:
 - (d) a person who is indebted to the Company".

Kindly deliberate the above issue in an appropriate Committee of the Institute for their opinion.

I will appreciate if their decision is communicated at your earliest.

Opinion: The appropriate Committee of the Institute would like to draw your attention to following commentary on paragraph 9.3 of the Code of Ethics for Chartered Accountants: -

Neither a chartered accountant in practice nor his/her spouse or dependent child or close relatives should make a loan to a client or guarantee a client's borrowings or accept a loan from a client or have borrowings guaranteed by a client. This latter proscription does not apply to loans to or from banks or other similar financial institutions when made under normal lending procedures, terms and requirements; to home mortgages or to current or deposit accounts with banks, leasing companies and other financial institutions etc.

In the light of above, the Committee is of the view that the instances mentioned above do not fall within the purview of section 254 of the Companies Ordinance, 1984.

(November 3, 2001)

2.11 PRACTICE AS SHARE REGISTRAR.

Inquiry: Following two questions need clarification in accordance with the rules and regulations of the Institute of Chartered Accountants of Pakistan;

1. Can a member in practice or salaried employee of a Chartered Accountant in practice undertake the assignment of share registrar?
2. Is it compulsory that the name of consultancy firm must be similar with the name of practising firm?

You are requested to kindly clarify the position at your earliest.

Opinion: The Committee would like to draw your attention to following paragraph 1 of Council's Directive 5.01 relating to Engagement in Management Consulting Business that reads as under:

1. A Chartered Accountant can practice either as a Chartered Accountant or only as a Management Consultant as sole proprietor, through a partnership firm or a limited liability company. In case he opts to practice as a Chartered Accountant he can engage in all those functions, which a Chartered Accountant in practice undertakes including management consultancy after obtaining the certificate of practice as a Chartered Accountant under Bye-law 8 of C. A. Bye-laws, 1983.

In view of the above, a member in practice or a salaried employee on behalf of a member in practice can undertake the assignment of "Share Registrar".

2. No, it is not necessary that the name of the consultancy firm must be similar to name of the practising firm Comprehensive guidelines in this behalf are already available in section 4 of the Members' Handbook, Practice Administration as Chartered Accountant and are required to be followed.

(January 12, 2002)

2.12 TREATMENT OF AUDIT FEES IN THE CONSOLIDATED GROUP FINANCIAL STATEMENTS

Inquiry:

As you are aware, starting from this year, banks that have subsidiary companies are required to prepare consolidated financial statements. While preparing our bank's consolidated financial statements, I have encountered a problem in the treatment of audit fee in the group accounts. When I refer the group accounts of other banks, it was found that it was treated differently in all the financials. For example, in group accounts of "A", bank audit fee is taken as that shown in the parent company's financial statements plus the fee of subsidiary that was audited by one of the group auditors. Another example is the financials of Bank "B". In these financials, the parent company's financials were audited by joint auditors while the consolidated financials were audited by one of them.

In these financials, the audit fee that is related to the auditor that signed the group financials plus the audit fee of its subsidiary company "C" that was audited by the same auditor) was taken. While doing so, the whole amount of subsidiary's audit expenses (i.e. audit fee, out of pocket, other services fee) was taken as audit fee.

May I ask for the opinion of Technical Committee in this regard? In my own views, the audit expense in the group financials should be only the parent company's audit expense plus any fee that the auditors charged for the consolidated financials.

I will appreciate your early response in this respect.

Opinion:

Before forming an opinion, the appropriate Committee would like to re-state the issues as understood by it: -

Who should pay and show it where: -

1. Audit fee of subsidiary company.
2. Audit fee of holding company.
3. Audit fee for consolidated financial statements.

The Committee's opinion is as follows: -

1. Audit fee of subsidiary company shall be borne by the subsidiary and shown in its financial statements.

2. Audit fee of holding company shall be borne by the holding company and shown in its financial statements.
3. Audit fee for consolidated financial statements shall be borne by the holding company and shown in its financial statements.

The consolidated financial statements shall show total audit fee paid by the Group as a whole. For further guidance you may refer to Paragraph 15 of IAS 27.

(June 22, 2002)

2.13

UNDER CUTTING.

Inquiry:

Please refer to the subject captioned above. In this connection I want to get clarified that if the auditor resigns from being the auditor of the company, not because of the pressure from management of any sort, and a new auditor is appointed in its place, will the professional fees of the new auditor if less than the preceding auditor, come in the sphere of undercutting. It is pertinent to mention here that all these proceedings have occurred before the annual general meeting of the company. It may also be noted that nothing has been discussed in the Members' Handbook with respect to all this if the auditor resigns.

An early response in this regard will be highly appreciated.

Opinion:

The appropriate Committee is of the opinion that Section 11.5 of Code of Ethics for Chartered Accountants should be followed which reads as: -

“ When performing professional services for a client it may be necessary or expedient to charge a pre-arranged fee, in which event the chartered accountant in practice should estimate a fee taking into account the matters referred to in paragraph 11.2 through 11.4.

As regards quotation of fees, the Council continues to be of the opinion that chartered accountants in practice should quote fees 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.”

Further the audit fee agreed should not be less than the parameters mentioned in ATR-14 (revised) approved by Council in its meeting held on July 30, 2001

(October 13, 2001)