

II. Accounting and Auditing in Pakistan

This chapter presents an overview of accounting and auditing arrangements in Pakistan. It provides context for the following chapters on professional infrastructure, accounting and auditing standards, accounting and auditing training, and government budgeting and accounting arrangements. The chapter comprises ten sections, in two parts, as follows:

Part One: Accounting

- 1 – Introduction
- 2 – Public Sector Accounting
- 3 – Private Sector Accounting
- 4 – Financial Reporting Requirements
- 5 – Private Sector Reporting

Part Two: Auditing

- 6 – Introduction
- 7 – Auditor-General
- 8 – Public Accounts Committee
- 9 – Private Sector Auditing
- 10 – International Accounting and Auditing Firms

Part One. Accounting

1. Introduction

This chapter details the current and proposed Public Sector accounting procedures. Under the Project for Improvement to Financial Reporting and Auditing (PIFRA), it is recommended that a modified cash basis be used for the accounts and it recommends a move to full accrual at the appropriate time. Public Sector Guidelines for Accounting Standards have been taken into consideration when framing the Government Accounting model. Listed Companies are required to comply with International Accounting Standards (IAS) in accordance with the requirements of the Companies Ordinance 1984.

2. Public Sector Accounting

Accounting Basis and Procedures

In accordance with paragraph 10 of the Pakistan (Audit & Accounts) Order, 1973, the Auditor-General is required to submit to the President a General Financial Statement incorporating a summary of the accounts of the Federation and the Provinces annually. The Government accounts are kept in two parts: (i) Consolidated Fund, and (ii) Public Accounts.

All revenues received, all loans raised, all monies received in repayment of any loan and payments, form part of the Consolidated Fund of the Government. The receipts and payments in respect of which the Government incurs a liability to repay the money received or has a claim to recover the amounts paid form part of Public Accounts.

The Government accounts are maintained on a Cash basis. The accounts of the Consolidated Fund are kept on single entry system and closed off to "Government".

Under agreements made by the Federal and each Provincial Government with the State Bank of Pakistan the treasury business of each Government is conducted by the State Bank. The Federal and Provincial Governments keep their own separate balance and separate account with the State Bank.

Project for Improvement to Financial Reporting and Auditing

The current accounting parameters for the Consolidated Fund and Public Account are maintained under PIFRA in accordance with the requirements of the Constitution. Under PIFRA, it is intended to introduce a Modified Cash basis system.

The system will record transactions on a cash basis but will also take into account commitments, acquisitions of fixed assets and incurrence of liabilities during an accounting period. The system will facilitate the transfer to a full accrual basis of accounting when appropriate. Some accounting theorists would argue that the system recommended tends more towards modified accrual than modified cash.

3. Private Sector Accounting

The Companies Ordinance, 1984

Section 230 of the Companies Ordinance, 1984 requires the following books of account to be kept with respect to: (i) Receipts and payments; (ii) Sales and purchases; and (iii) Assets and liabilities.

In the case of a company engaged in production, processing, manufacturing or mining activities, all particulars relating to utilization of material or labor or to other inputs or items of cost as may be prescribed, if such class of companies is required by the Securities and Exchange Commission (SEC) of Pakistan by a general or special order to include such particulars in the books of account.

Section 233 requires the directors of every company to submit a balance sheet and profit and loss account to the annual general meeting of the company within 18 months of incorporation and every year thereafter. These accounts are required to be audited and the auditors report attached to the financial statements. Twenty-one days before the annual general meeting, the accounts, auditors report and directors' report will be sent to every member of the company and, in the case of a listed company these accounts and reports will be sent to the SEC, the Stock Exchange and the Companies Registrar.

Section 234 requires that every balance sheet of a company will give a true and fair view of the state of affairs of the company as at the end of its financial year, and every profit and loss account will give a true and fair view of the profit and loss of the company for the financial year.

In the case of a listed company, the accounts are required to be compiled in accordance with the Fourth Schedule to the Companies Ordinance, 1984. The major disclosure features are as follows:

- All material information necessary to make the financial statements clear and understandable.
- If a fundamental accounting assumption, namely, going concern, consistency and accrual is not followed in preparation of financial statements, that fact together with the reasons therefore.
- Significant accounting policies preferably in one place.
- Change in an accounting policy that has a material effect in the current year or may have a material effect in the subsequent years together with reasons for the change and the financial effect of the change, if material.
- The basis of conversion or translation into rupees of assets and liabilities in foreign currencies and the accounting policy followed in respect of exchange gains or losses.
- Particulars of any charge on the assets of the company to secure the liabilities of any other person including, where practicable, the amount so secured.
- The general nature of any credit facilities available to the company under any contract, other than trade credit available in the ordinary

course of business, and not availed of at the date of the balance sheet.

Schedule Four also outlines comprehensive details of the requirements of the Balance Sheet including matters relating to Fixed Assets, Long-Term Investments, Long-Term Loans and Advances, Current Assets, Share Capital and Reserves, Surplus on Revaluation of Fixed Assets, Redeemable Capital, Debentures and Long-Term Loans, Lease Financing, Deferred Liabilities, Long-Term Deposits, Current Liabilities and Contingencies and Commitments. Comprehensive details of the requirements of Profit and Loss Accounts are also included.

In the case of unlisted companies, the accounts are required to be compiled in accordance with the Fifth Schedule to the Companies Ordinance, 1984. The main disclosure features are as follows:

- All material information necessary to make the financial statements clear and understandable.
- If a fundamental accounting assumption, namely, going concern, consistency and accrual is not followed in preparation of financial statements, that fact together with the reasons therefore.
- Change in an accounting policy that has a material effect in the current year or may have a material effect in the subsequent years together with reasons for the change and the financial effect of the change if material.
- The basis of conversion or translation into rupees of assets and liabilities in foreign currencies.

Schedule Five also gives comprehensive details of the requirements of Balance Sheets and Profit and Loss Accounts. Section 234 subsection (3) states that in the case of a listed company:

- International Accounting Standards and other standards will be followed in regard to the accounts and preparation of the balance sheet and profit and loss account as are notified for the purpose in the Official Gazette by the SEC;
- A statement of changes in financial position or statement of sources and application of funds (Cash Flow Statement) will form part of the balance sheet and profit and loss account; and
- Accounting policies will be stated and, where there is any change in such policies, the auditor will report whether he agrees with the change.

The Securities and Exchange Commission (SEC) of Pakistan issues special Regulatory Orders (SROs) that prescribe the mandatory application of (IAS) to listed companies and their subsidiaries. Each

SRO is issued under the authority of sub-section (3) of Section 234 of the Companies Ordinance 1984. Unlisted companies other than subsidiaries of listed companies have no mandatory direction to comply with IAS. However, in general practice these companies do follow IAS normally because of advice received from Institute of Chartered Accountants of Pakistan (ICAP) members who are responsible for the compilation or audit of the accounts.

Other relevant sections of the Companies Ordinance 1984 include Section 258 which allows the Federal Government to direct that a cost audit⁴ be carried out on a company, Section 505 which empowers the Government to alter regulations and Section 506 which permits the Government to make rules and impose fines for hindrance and obstruction of the audit of the company.

Cost audits have been mandated by the Government for listed companies involved in cement, sugar and edible oil products and processing. These companies and other companies which may require to have a cost audit applied, are required to prepare the following:

- A statement of production capacity of the plant, in terms of machine hours and production units, the actual utilization of the capacity and reasons for the difference between the two; and
- A statement of stock-in-trade of the company as at the end of the financial year in terms of quantity and cost distinguishing between:
 - Stock of raw material and components;
 - Stock of work in process;
 - Stock of finished products; and
 - Other stocks.

The above statements are required to be signed by the Chief Executive and Chief Accountant of the company. The Cost Auditor is required to finalize his report within 60 days of his appointment and submit this to the SEC. The company is required to submit an explanation on any qualification or reservation contained in the report to the SEC within 30 days.

Banks and insurance companies are exempted from these arrangements and their accounting and financial reporting procedures are covered by separate enabling legislation.

⁴ In the case of a company engaged in production, processing, manufacturing or mining activities, such particulars relating to utilization of material or labor or to other inputs or items of costs as may be prescribed, if such class of companies is required by the Authority by a general or specific order to include such particulars in the books of account – Section 230(e), *Companies Ordinance 1984*.

4. Financial Reporting Requirements

Introduction

This part outlines the major financial reports required to be submitted by the Public Sector and future reports recommended by PIFRA. The private sector financial reporting procedure and requirements are contained in schedules 4 and 5 of the Companies Ordinance 1984 and regulated by the SEC.

The Constitution of the Islamic Republic of Pakistan

Article 80 of the Constitution gives details of the requirements of the Annual Budget Statement and Article 171 refers to the reports required by the Auditor-General relating to the accounts of the Federation and the Provinces.

Public Sector Reports

The Public Sector major financial reports for the Federal and Provincial Governments are the Annual Budget Statement and the National Accounts.

The Annual Budget Statement is issued in total format and in summary style to the National and Provincial Assemblies. The Annual Budget Statement includes the following information:

- The overall Budgetary Position of the previous financial year including original and Revised Budget figures for Resources and Expenditure, Revenue Receipts, Capital Receipts, Development Expenditure and a summary of salient features.
- A comparative Budgetary Position including details for the previous years original budget, the previous years revised budget and current years budget, for the following:
 - Resources – both Internal and External
 - Expenditure – both Current and Development
 - Resource Position
 - Revenue Receipts Summary
 - Detailed Information on Revenue Receipts
 - Capital Receipts and Public Account
 - Provincial Share in Federal Receipts
 - Current Expenditure including Debt Servicing
 - Law and Order
 - Community Services

- Social Services
- Economic Services
- Grants to Provinces/Local Authorities
- Subsidies
- Public Sector Development Program
- Special Program
- Social Action Program
- Current Loans
- Development Loans and Advances by the Federal Government
- Federal Government Investments in Financial and Non-financial Institutions
- Budget at a Glance

A Supplementary Budget Statement is prepared for new items and an Excess Budget Statement is prepared for excess expenditure and presented to the National Assembly (Article 84).

A Summary of the National Accounts for the Federation and Provinces is presented to National Assemblies as:

- Appropriation Accounts for each Division and Department detailed under Functional and Object classifications. The figures are set out under the headings
 - Final Grant or Appropriation
 - Actual Expenditure
 - Excess(+) Savings (-)
 - Actual Expenditure for the Previous Year

A comprehensive Audit Observations Report is given for each ministry detailing noncompliance with regulations.

- Finance Accounts which consist of a Summary at a Glance, Balance Sheet, Receipts and Payments Account, Audit Certificate and Fiscal Account. Details are provided for Consolidated Fund (Revenue Receipts and Expenditure and Capital Expenditure), Public Account and Accounts of Reserve Funds.

Project for Improvement to Financial Reporting and Auditing

Details of the Annual Budget Statement Reports recommended under PIFRA are included in the chapter headed Budget Procedures.

The Financial Accounting Reports for the Federation, Provinces and the Republic, recommended under PIFRA, are included in the Financial Reporting Manual (Exposure Draft) issued for comment by the Auditor-General of Pakistan in June 1999.

A brief summary of the financial and accounting reports recommended is as follows.

The accounting reports required on a monthly basis are:

- Revenue and Expenditures Statement – Consolidated Funds
- Division/Department Schedule – Consolidated Funds
- Public Account Summary Schedule
- Statement of Cash Flows
- Grant Expenditure Analysis
- Programs Report

The monthly accounts will present “Summary Schedules” for both Consolidated Fund and Public Accounts separately, supported by “Division/Department Schedules” for each Division/Department within the Consolidated Fund section.

The Cash Flow Statement will be compiled on an activity basis and these statements will be included in the Grant Expenditure analysis and the Programs/Function Report. These Reports will also be consolidated into quarterly reports.

Project Expenditure Statements will also be prepared from the Monthly Accounts and will include:

- brief description of the project
- life to-date cost at the start of the reporting period
- costs during the period
- year to-date costs at the reporting date
- budget for the project (including reappropriations and supplementary budget) and budget for the reporting period
- all the above information for the previous year, where applicable

A statement of Fixed Assets will also be prepared which will provide the following details:

- owner Division/Department
- asset categories
- cost at beginning of the reporting period (for each category)
- additions during the reporting period (at cost)
- disposals during the period (at cost)
- cost at end of reporting period (for each category)

A physical stock-take, with valuations, will need to be done at or before implementation date in order to complete the statement of fixed assets.

A comprehensive Report will also be prepared showing the National Debt position at the end of each month, and a Losses Report

will be prepared which will identify the Department concerned and the amount of the loss with comments.

The Annual Financial Statements of the Federation, Provinces and the Republic will include the following:

- Summary – Financial Statements
- Statement of Assets and Liabilities
- Statement of Revenues and Expenditures
- Statement of Cash Flows
- Analysis of Surplus/Deficit
- Notes to the Financial Statements
- Analysis of Revenues by Divisions/Departments
- Summary of Appropriation Accounts by Grants and Appropriations
- Appropriation Accounts by Economic Functions and Departments / Divisions
- Appropriation Accounts by Grant

The Annual Financial Statements can be produced on the basis of the Consolidated Quarterly Returns.

The draft Public Sector Accounting Standards Guidelines produced by the Public Sector Committee of the International Federation of Accountants (IFAC) have been taken into consideration when preparing these draft Annual Financial Statements.

Financial Control Reports will be produced on a monthly basis and these include the following:

- Revenue Confirmation Statement
- Disbursement Confirmation Statement
- Division/Department Statement
- Exchange and Settlement Control Account

The reports outlined above are required from Departments and Divisions which are currently the responsibility of the Pakistan Audit Department (PAD) to carry out the accounting function. Similarly reports will also be required from external sources as follows:

- Self-accounting Entities will produce similar reports to PAD except for Defense and Railways that will provide more simplified reports.
- Economic Affairs Department will provide comprehensive additional information on loans.
- Central Board of Revenue will supply a comprehensive summary of receipts and forecast of receipts.

- State Bank of Pakistan will provide a monthly reconciliation with PAD's accounts, for each bank account.
- Government-owned entities will provide information on a specified format at the end of each financial year.

5. Private Sector Reporting

The Companies Ordinance, 1984

The purpose of this Ordinance is to ensure the viability and growth of corporate enterprises, protection of investors and creditors, promotion of investment and development of the economy and matters arising out of or in connection with enterprises that render it necessary to take immediate action. This law conferred the powers to be enforced by the SEC of Pakistan formerly known as the Corporate Law Authority (CLA).

The Securities and Exchange Ordinance, 1969 and Securities and Exchange Rules, 1971 describe the matters relating to eligibility criteria for the registration of stock exchanges in Pakistan, allowed practices for dealing of securities on these exchanges and other matters including the qualification of members of the stock exchanges and rules relating to the form and content of their records and documents.

Stock Exchange Listing Rules provide the guidelines for the companies regarding listing on the stock exchange. (Refer to Appendix 15 for a summary of the Securities and Exchange Commission of Pakistan Act, 1997)

Part Two. Auditing

6. Introduction

The Auditor-General is appointed by the President and is responsible for the accounting function and auditing function of the Federation and Provinces. His Department is nominated as the Supreme Audit Institute of Pakistan. In the private sector members of ICAP and Institute of Cost and Management Accountants (ICMA) usually perform audits. No independent international body exists for the audit profession as distinct from accounting bodies.

7. Auditor-General

The Constitution of the Islamic Republic of Pakistan

The main Articles in the Constitution relating to the Auditor-General are as follows:

- Article 168 The President will appoint the Auditor-General. The Terms and Conditions of appointment will be determined by an Act of Parliament or, until so determined, by the Order of the President [refer Pakistan (Audit and Accounts) Order 1973].
- Article 169 The Auditor-General, as determined by an Act of Parliament, or until determined, by Order of the President, will perform such functions and exercise such powers in relation to the Accounts of the Federation and Provinces or any authority established by the Federation or Provinces.
- Article 170 The accounts to be kept in such form as the Auditor-General directs.
- Article 171 The reports of the Auditor-General will be submitted to the President or the Governors who will submit them to the Assemblies.

Pakistan (Audit and Accounts) Order 1973

- Section 9(1) The Auditor-General shall be responsible for keeping of the Accounts of the Federation and Provinces.
- Section 9(3) The President may, after consultation with the Auditor-General, make provision by rules relieving the Auditor-General of responsibility for keeping accounts of any class or character.
- Section 11(1) Audit all expenditure from the revenues of the Federation and Provinces. Audit all transactions relating to debts, deposits, sinking funds, advances, suspense accounts and remittance businesses. Audit all trading, manufacturing and profit and loss accounts and balance sheets. Audit the accounts of any authority or body established by the Federation or a Province.

Note: Accounts of Railways, Forests and Defense are excluded.

Organizational

The Auditor-General is appointed by the President and is responsible for both the accounting function and the auditing function of the Federation and the Provinces.

This situation gives rise to a serious conflict of interest which has been the subject of critical comment by ADB and other donors over recent years. To the credit of the Government, a high-level committee has been appointed to review this situation (The Committee's terms of reference are provided in Appendix 16).

The Deputy Auditor-General and the Controller General of Accounts report to the Auditor-General. The Accountant-General Pakistan Revenues and the Accountant-General of each Province report to the Controller-General of Accounts. The Director-General Audit for each Province report to the Deputy Auditor-General.

There are approximately 11,000 employees in the Auditor-General's Department with 60 percent working for Accounts and 40 percent working for Audit. There are approximately 1,500 qualified Accountants working in the Department, and almost all of these personnel are qualified through the Pakistan Institute of Public Finance Accountants.

Challenge to the Powers of the Auditor-General

There is a concerted effort being made at federal and provincial levels to at least bring into question the powers of the Auditor-General.

A major case in point involves the audit of Pakistan Telecommunications Company Ltd (PTCL). The Pakistan Government Telegraph and Telephone Department underwent two establishment changes, first to a Corporation, then to a Private Limited Company in accordance with the Pakistan Telecommunication (Reorganization) Act of 1996. It continues to remain a majority State-owned enterprise. The audit of the accounts by the Auditor-General was refused by PTCL on the grounds of Section 38(3) of the Act which PTCL contends refers to the audit being conducted in accordance with the provisions of the Companies Ordinance 1984. The Auditor-General contends that his Department is responsible for the audit of PTCL in accordance with the provisions of Articles 169 and 171 of the Constitution.

This dispute has serious constitutional overtones and needs to be resolved immediately.

8. Public Accounts Committee

The standing Public Accounts Committees (PACs) are established by Federal and Provincial Governments to examine the accounts of governments and their agencies and other matters brought to their notice by the Auditor-General. Each PAC consists of not more than 12 members elected by the Assembly and the Minister for Finance is an ex-officio member.

The functions of the Committee are to examine the accounts showing the appropriation of sums granted by the Assembly for the expenditure of the Government, the report of the Auditor-General of Pakistan and other matters as the Minister for Finance may refer to the Committee.

In accordance with the National Assembly Rules of Procedure on Standing Committees, the PAC is required to ensure that:

- the moneys shown in the accounts as having been disbursed were legally available for, and applicable to the service or purpose to which they were applied or charged
- the expenditure conforms to the authority which governs it, and
- every reappropriation has been made in accordance with the rules framed by the Ministry of Finance.

The PAC is also required to:

- examine the statement of accounts showing the income and expenditure of state corporations, trading and manufacturing schemes, concerns and projects together with the balance sheets and statements of profit and loss accounts which the President may have required to be prepared or are prepared under the provisions of the statutory rules regulating the financing of a particular corporation trading or manufacturing scheme or concern or project and the relevant report of the Auditor-General of Pakistan
- examine the statement of accounts showing the income and expenditure of autonomous and semi-autonomous bodies, the audit of which may be conducted by the Auditor-General of Pakistan either under the directions of the President or under an Act of Parliament, and
- consider the report of the Auditor-General of Pakistan in cases where the President may have required him to conduct the audit of any receipts or to examine the accounts of stores and stocks.

If any money has been spent on any service during a financial year in excess of the amount granted by the Assembly for that purpose, the

Committee examines the facts of each case, the circumstances leading to such an excess, and makes recommendations.

The report of the Committee is required to be presented within one year from the date on which the Assembly referred to it unless the Assembly extends the period by resolution.

Any report memorandum or note that the PAC may have prepared, or any evidence that the PAC may have taken before the dissolution of the Assembly, shall be made available to the new PAC.

The PACs should give the final decision or direction on Audit Reports. The Federal PAC has recently been reactivated; however, in the case of provincial PACs, most of these reports have not been considered due mainly to the following reasons:

- PACs are not constituted or intermittently constituted after long delays.
- Even when PACs are constituted, meetings are very seldom held.
- In some cases, a chairperson has not been appointed and therefore meetings are not called.
- It has been stated that responsiveness to Audit Reports has never been considered as a priority.

9. Private Sector Auditing

The Companies Ordinance, 1984, Sections 252 to 260 outlines the audit requirements in relation to companies.

Section 252 requires that every company will, at each annual general meeting appoint an auditor to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting. The first auditor of a company will be appointed by the directors within 60 days of the date of incorporation of the company and the auditor will hold office until the conclusion of the first annual general meeting.

Section 260 prescribes the penalties that may be imposed on the auditor or any other person who signs the report which is found to be not in compliance with the Companies Ordinance or if any untrue statements are made or if any material facts are not brought out in the report.

All new International Standards on Auditing (ISA) issued by the International Auditing Practices Committee (IAPC) are made known to members of the national accounting bodies through publication in accounting journals, e.g., "The Pakistan Accountant" and various newsletters.

10. International Accounting and Auditing Firms

The “big five” international accounting and auditing firms are represented in Pakistan through their local associated firms as follows:

International Firm	Local Associate
PriceWaterhouseCoopers	A. F. Fergusons
KPMG	Taseer Hadi Khalid
Arthur Andersen	Sadaat Hyder Qamar Maqbool
Deloitte & Touche	Khalid Majeed Hussain Shah Rehman
Ernst & Young	Ford Rhodes Robinson Morrow

Most of these organizations have Pakistani citizens as their senior partners, partners and managers.