



United Nations Conference on Trade and Development

Distr.: General
22 August 2007

Original: English

Trade and Development Board

Commission on Investment, Technology and Related Financial Issues

Intergovernmental Working Group of Experts on

International Standards of Accounting and Reporting

Twenty-fourth session

Geneva, 30 October–1 November 2007

Item 3 of the provisional agenda

Review of practical implementation issues of International Financial Reporting Standards

Case study of Pakistan*

Note by the UNCTAD secretariat**

Executive summary

In concluding its twenty-third session, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) agreed to conduct additional studies and reviews of practical implementation issues of International Financial Reporting Standards (IFRS) with a view to developing guidance on good practices. Accordingly, country case studies of Pakistan, South Africa and Turkey were prepared.

This report presents the findings of the case study of Pakistan. The Institute of Chartered Accountants of Pakistan (ICAP) is the accounting standards-setting body in Pakistan. It works closely with the Securities and Exchange Commission of Pakistan (SECP), which is the regulator of corporate sector and stock exchanges. ICAP also works closely with the State Bank of Pakistan. In recent years, Pakistan has made significant progress in adopting and implementing IFRS for listed companies through joint efforts and close cooperation of the accounting profession and regulatory bodies. This case study presents the regulatory framework, enforcement of accounting standards and challenges faced in the process of converging to IFRS, capacity-building issues and lessons learned in the process.

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** This document was submitted on the above-mentioned date as a result of processing delays.

The main objective of this case study is to draw lessons learned from the experience of Pakistan in converging with IFRS and to discuss the findings with member States, with a view to facilitating sharing of experience among countries that are either implementing IFRS or that intend to do so in the future.

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I. Introduction

A. Overview of economic indicators

1. With a population of about 160 million, Pakistan's economy delivered yet another year (2006/2007) of solid economic growth – 7 per cent, despite the continuing surge in oil prices that created adverse effects on its trade balance. Achieving gross domestic product (GDP) growth of around 7 per cent over the last five years indicates that Pakistan's upbeat momentum remains on track as it continues to maintain its position as one of the fastest growing economies in Asian region, along with China, India and Viet Nam.

2. Foreign direct investment in Pakistan is expected to reach \$6 billion¹ in fiscal year 2007 compared to around \$3 billion the previous year. International investors call for comparable financial information from countries competing for foreign investments. This requires that the corporate sector in Pakistan comply with internationally-acceptable standards on financial reporting. Pakistan, which currently has about 660 listed companies, has created a statutory framework to regulate business activities, including establishment of regulatory institutions for enforcing accounting and auditing standards. In order to ensure high-quality corporate financial reporting, appropriate enforcement mechanisms have been put in place.

B. Requirements relating to IFRS implementation

3. With regard to compliance with IFRS, the SECP is empowered under Section 234 of the Companies Ordinance to prescribe the appropriate international accounting standards. SECP notifies the accounting standards based on the recommendation of ICAP.

4. IFRS considered appropriate to the local environment are adopted verbatim. Pakistan is amongst those few countries that started following the International Accounting Standards (IAS) regime early. The Council of ICAP has been adopting IAS since the 1970s and through its efforts 18 IAS were notified by SECP back in 1986.

C. Accounting framework in Pakistan

5. The institute had issued the following revised statement to ensure compliance with the IAS/ IFRS, via its Circular 01/2003 dated Feb 24, 2003:

“These financial statements have been prepared in accordance with approved accounting standards as applicable in Pakistan and the requirements of Companies Ordinance, 1984. Approved accounting standards comprise of such International Accounting Standards as notified under the provisions of the Companies Ordinance, 1984. Wherever the requirements of the Companies Ordinance, 1984 or directives issued by the Securities and Exchange Commission of Pakistan differ with the requirements of these standards, the requirements of Companies Ordinance, 1984 or the requirements of the said directives take precedence.”

6. In some situations, Accounting Technical Releases are formulated where IFRS do not deal with a certain issue specific to the local environment or where additional guidance is required. These are mainly formulated in line with the principles underlined in IFRS. Departures from the requirements of IFRS are avoided to the maximum extent possible. Companies Ordinance, 1984 also prescribes presentation and disclosure requirements. Additionally, the State

¹ Pakistan Economic and Strategic Outlook – Research conducted by Global Investment House.

Bank of Pakistan, which regulates the commercial banks and development finance institutions, prescribes the recognition and measurement requirement in respect of loans, advances and investments.

D. Due process for adoption of IFRS

7. ICAP, a statutory body established under the Chartered Accountants Ordinance, 1962 is the regulator of the accountancy profession in Pakistan. All public companies are required to have their financial statements audited by chartered accountants, who are members of ICAP. All members of ICAP are required to comply with the professional standards covering accounting, auditing and ethical pronouncements. ICAP has been adopting the IFRS issued by the International Accounting Standards Board (IASB), and International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Boards for over 20 years. ICAP has also adopted the Code of Ethics issued by the Ethics Board under the aegis of the International Federation of Accountants (IFAC).

8. ICAP has established a due process of technical review and consultation by setting up various committees which review IFRS, disseminate the exposure drafts to the corporate sector and its members, and consult with the stakeholders and then recommend to the council adoption of a particular standard.

9. After completion of the due process, the Council of ICAP recommends to the SECP adoption of a particular standard. Thereafter, after undergoing its internal deliberations and review process, SECP notifies the adoption of such standards for listed companies.

10. It may be noted that, through the above process, Pakistan has been adopting the IFRS without making any amendments in such standards.

E. Council's strategy for IFRS

11. While in the past, the Council of the ICAP and SECP have adopted most of the IASs so as to make Pakistan Generally Accepted Accounting Principles (GAAP) largely based on such international standards, the Council of ICAP has decided that ICAP will work together with SECP and the State Bank of Pakistan (SBP) to ensure that Pakistan GAAP becomes fully compliant with IFRS, as far as public interest entities are concerned, by the end of 2009. For this purpose, the Professional Standards and Technical Advisory Committee has formed a committee to carry out a detailed gap analysis, especially in terms of identifying inconsistencies between the prevailing law and the requirements of IFRS.

F. Current status of adoption of IFRS

12. Pakistan has made significant progress in closing the gap between local requirements for corporate financial reporting and international standards by not only adopting IFRS but also by establishing mechanisms to ensure their enforcement. Over the past few years, this has contributed to significant improvement in corporate financial reporting.

13. At the time of the Reports on Observance of Standards and Codes review that was carried out by the World Bank in 2005, all IASs had been adopted by ICAP and notified by SECP for listed companies except IAS 29 (financial reporting in hyperinflationary economies) and IAS 41 (agriculture), and IFRS 1 to 6. Subsequently, SECP, on the recommendation of ICAP, has notified IAS 41, IFRS 2, IFRS 3, IFRS 5 and IFRS 6.

14. In the case of the banking sector, on the recommendation of Pakistan Bank's Association and ICAP, SBP has suspended the application of IAS 39 and

IAS 40. However, SBP has agreed in principle with ICAP that these standards, together with other IFRS, will also be adopted over the next two years, so as to ensure that banks and financial institutions' financial reporting becomes fully compliant with IFRS.

G. Three-tiered structure and SME standards

15. The mandatory application of all IFRS for all companies tends to burden the small and medium-sized enterprise (SME). Given the substantial volume and complexities of IFRS, it is not possible for SMEs to ensure full compliance with all the requirements of IFRS. In reality, these SMEs do not have adequate technical capabilities and resources to ensure compliance with complicated reporting requirements.

16. While ICAP has been pursuing the objective of adoption and use of international standards for the preparation of general purpose financial statements over the years, it is also cognizant of the difficulties faced by SMEs in complying with the full set of IFRS that have been made applicable for listed companies.

17. In order to address the needs of the SMEs, the Council of ICAP initiated a project to develop a separate set of standards for such entities in line with similar work done in various other countries as well as the SME Guidelines on Accounting (SMEGA) issued by UNCTAD-ISAR in 2003. After several months of research on SME accounting standards by its committees, ICAP has developed two SME standards: Accounting and Financial Reporting Standard for Medium-Sized Entities (MSEs) and Accounting and Financial Reporting Standard for Small-Sized Entities (SSEs). The Council has also laid down a three-tiered framework of accounting standards as described in paragraph 20 below.

18. While the Council of ICAP approved the aforementioned three-tiered structure as well as the two SME standards in its meeting on 28 July 2006, it is expected that SEPC will shortly notify these standards and three-tiered structure as part of the law, as such framework and the standards were developed in consultation with SECP, which has in principle agreed to incorporate these requirements as part of the statute applicable to all companies.

19. Pakistan's initiative for developing standards for SMEs was recognized by the South Asian Federation of Accountants (SAFA), comprising professional accounting bodies of India, Pakistan, Bangladesh, Sri Lanka and Nepal. SAFA has adopted these standards as SAFA standards/guidelines.

20. The institute has suggested the three-tiered structure as shown in table 1 for the applicability of these standards.

Table 1. Three-tiered structure for SME standards

Tier 1	Publicly Interest Entities (listed entities, entities that are considered large and entities that have public accountability)	The complete set of IFRS that is approved by the Council of ICAP and notified by SECP shall be applicable to these entities.
Tier 2	Medium-Sized Entities (entities that are neither Public Interest Entities nor SSEs)	The Accounting and Financial Reporting Framework and Standard for Medium-sized Entities issued by the Institute of Chartered Accountants of Pakistan are applicable to these entities.

Tier 3	Small-Sized Entities (small entities that have turnover and paid up capital below specified threshold)	The Accounting and Financial Reporting Framework and Standard for Small-Sized Entities issued by the Institute of Chartered Accountants of Pakistan are applicable to these entities.
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H. Impediments in implementing IFRS

21. While ICAP's Council is committed to complying with the full set of IFRS by 2009 so as to enable all public interest entities to give an unreserved compliance with all IFRS issued by IASB, there are various impediments and difficulties in achieving such compliance which are being addressed. These include the following:

- (a) Historically, there have remained some provisions in the Companies Ordinance, 1984 and other local laws that are inconsistent with the requirements of IFRS. ICAP has been working with the regulators to remove such inconsistencies, and has had reasonable success in recent years. Nevertheless, it takes significant time to reach agreement with regulators and also get the amendments incorporated through the legislative process.
- (b) Some of the IFRS – such as IAS 39, IAS 19, IFRS 3, etc. – are quite complex. Because of limited capacity available in Pakistan in terms of understanding, interpreting and training on the subject of such IFRS, the preparers require more time in implementing such standards.
- (c) Due to limited capacity available with the regulators, and frequent changes at key positions, it takes considerable time to persuade the regulators to adopt IFRS.
- (d) Although the State Bank of Pakistan has agreed to full implementation of IAS 39 and IAS 40, some of the preparers (some banks and financial institutions) are still not fully convinced of their adoption. Resistance from such stakeholders may further delay full implementation of IFRS.
- (e) There is a shortage of faculty for training and continuing education on IFRS.

I. Compliance gaps between IFRS and local statutes

22. At present, there are certain requirements of Companies Ordinance, 1984 and its Fourth Schedule (this contains disclosure requirements for listed companies) and SECP directives that are in conflict with the requirements of IFRS.

23. The developments in this regard include revision of the Fourth Schedule to the Companies Ordinance, 1984 issued by SECP on 5 July 2004, after which almost all the conflicting requirements and duplications have been eliminated.

24. Compliance gaps that still exist between IFRS and local statutes are summarized in table 2.

Table 2. Gaps between IFRS and local statutes

Companies Ordinance, 1984	IAS/IFRS
Surplus on revaluation of fixed assets shown in the balance sheet after capital and reserves.	Credited directly to equity under the heading of revaluation surplus (IAS 16.37).
Redeemable preference share classified as "Subscribed share capital". Redemption allowed only out of profits.	Classified as financial liability if it provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, etc. (IAS 32.22).

SECP Directive	IAS/IFRS
<i>To facilitate application of Revised Fourth Schedule, transitional relaxation has been granted by SECP to the listed companies for the following items:</i>	
The listed companies carrying deferred cost as on 5 July 2004 are allowed to treat such cost as per superseded Fourth Schedule. However, after that date, any further deferral of costs will not be allowed.	The concept of deferred cost no longer exists in the IAS/IFRS.
The listed companies having outstanding liabilities for foreign currency loans as on 5 July 2004 are allowed to capitalize fluctuation of exchange gain/loss as per superseded Fourth Schedule up to 30 September 2007. Any exchange gain/loss on foreign currency loan contracted on or after 5 July 2004 will not be allowed to be capitalized.	The revised IAS 21 (the effects of changes in foreign exchange rates, effective 1 January 1 2005) has withdrawn the requirement of the old IAS 21, which allowed capitalization of exchange differences resulting from a severe devaluation or depreciation of currency.

25. In addition to the above, Prudential Regulations issued by the State Bank of Pakistan also include certain requirements that are in conflict with IAS 39. Some examples that constitute impediments to adoption of IAS 39 include:

- (a) Banks and development financial institutions are required to use age criteria (the number of days default/overdue mark-up/interest or principal) for the purpose of determining loan loss provisions) rather than estimating the expected cash flows in terms of IAS 39.
- (b) Unquoted securities are stated at cost.
- (c) Staff loans are recorded at the amount of cash disbursed and income on such loans is recorded at the subsidized rates.
- (d) Since many of the financial assets are required to be valued on a mark-to-market basis with changes in fair value being recognized in profit and loss, it results in recognition of unrealized gains and losses. Since recognition of unrealized gains could become taxable, banks and financial institutions are reluctant to adopt this standard. This is considered a major impediment to implementation of this standard.

26. ICAP, as part of its strategy, has been persuading both SECP and SBP to eliminate barriers in adoption of IAS/IFRS.

27. As discussed above, ICAP has developed and issued two separate sets of accounting and financial reporting standards for MSEs and SSEs. The standards await SECP notification for their applicability on SMEs.

28. In December 2006, SECP on the recommendation of ICAP, notified the following IAS / IFRS:

- (a) IAS 41 – Agriculture;
- (b) IFRS 2 – Share-based payments;
- (c) IFRS 3 – Business combinations;
- (d) IFRS 5 – Non-current assets held for sale and discontinued operations; and
- (e) IFRS 6 – Exploration for and evaluation of mineral resources.

29. To ensure effective implementation of SME standards, a revision of the Fifth Schedule to the Companies Ordinance, 1984 is in process (which prescribes presentation and disclosure requirements for non-listed public entities and private entities). Effort is being made to remove all such requirements from the schedule that are in conflict with the SME standards.

30. Regarding adoption of remaining IFRS/IAS (i.e. IFRS 1, 4, 7 and 8; and IAS 29 and IAS 41), the following strategies and action plans have been decided by ICAP:

- (a) IFRS 1 – It will be adopted once all other IAS/IFRS are adopted.
- (b) IFRS 4 – Previously, its adoption was deferred until finalization of phase II of IASB's Insurance Project, as it would necessitate some amendments to the Insurance Ordinance, 2000 and Regulations. However, it has recently been decided that, instead of waiting for the completion of Phase II of the project, ICAP will consider the standard for adoption. The Insurance Committee of ICAP is actively deliberating on the adoption of this standard.
- (c) IFRS 7 – ICAP has approved its adoption and SECP has been recommended by ICAP for its notification.
- (d) IFRS 8 – This standard is applicable for the accounting periods beginning on or after January 2009 and its adoption by ICAP is expected shortly as the standard supersedes IAS 14 (segment reporting) which was already adopted in the country.
- (e) IAS 29 – It was not previously adopted because it was not considered relevant in Pakistan's economic environment. However, the matter of adoption of IAS 29 is under active consideration by ICAP on the premise that there might be instances where a Pakistani company operates in or transacts with an entity of a hyperinflationary economy in which case the standard could become applicable.
- (f) IAS 39 – In the Finance Act 2007–2008, the taxation laws have been amended so that the adjustments that are made to the financial statements of the bank to comply with the requirements of IAS 39 (financial instruments: recognition and measurement) and IAS 40 (investment property) have been allowed to be excluded while calculating the taxable income of banks. These exclusions have been allowed to safeguard the bank from being taxed on unrealized gains as the above standards require measurement and recognition of financial instrument and investment property on the basis of their fair market value prevailing on the balance sheet date.
- (g) IAS 40 – The standard allows investment property to be measured either at cost or fair value. Therefore, if a bank/development financial institution chose the fair value model then it could distribute unrealized gains arising

out of an upward revaluation of investment property, which is not considered appropriate by the regulator (SBP). This matter has been addressed through appropriate amendment introduced through Finance Act 2007 to the existing Section 248 (2) of the Companies Ordinance, 1984 by restricting all the corporate entities to pay dividends out of their realized profits only (as is the case with United Kingdom company law). It is expected that after this amendment, the deferment of IAS 40 by SBP will be eliminated.

31. At ICAP's request, SECP has also re-notified the IASs (only number and name) that were previously notified by reproducing the full text of the IAS. This step was taken to avoid lengthy process of adoption and notification each time an IAS is revised.

II. Regulatory framework and enforcement

A. Securities and Exchange Commission of Pakistan

32. The Securities and Exchange Commission of Pakistan (SECP) was set up in pursuance of the Securities and Exchange Commission of Pakistan Act, 1997 to succeed the Corporate Law Authority. This act institutionalized certain policy decisions relating to the constitution, structure, powers and functions of SECP, thereby giving it administrative authority and financial independence in carrying out its regulatory and statutory responsibilities.

33. SECP became operational in January 1999. It was initially concerned with the regulation of the corporate sector and capital market. Over time, its mandate has expanded to include supervision and regulation of insurance companies, non-banking finance companies and private pensions. SECP has also been entrusted with oversight of various external service providers to the corporate and financial sectors, including chartered accountants, credit rating agencies, corporate secretaries, brokers, surveyors, etc. The challenge for SECP has grown with the increase of its mandate.

B. The Companies Ordinance, 1984

34. The Companies Ordinance, 1984 sets primary requirements for financial reporting of all companies incorporated in Pakistan. The Companies Ordinance requires the preparation, presentation and publication of financial statements, including disclosures and auditing of all companies incorporated in Pakistan. In addition to the various provisions pertaining to financial reporting, the Fourth Schedule of the Ordinance lays down the form, content and certain disclosure requirements for preparing financial statements for listed companies, while the Fifth Schedule outlines the same for non-listed companies. As discussed above, various provisions of the Companies Ordinance, including the Fourth Schedule, have already been revised in compliance with the requirements of IFRS.

35. It is mandatory for holding companies incorporated in Pakistan that have subsidiaries to prepare consolidated financial statements in accordance with requirements of the IFRS notified by SECP.

C. The Insurance Ordinance of 2000

36. The Insurance Ordinance of 2000 regulates the financial reporting practices of insurance companies operating in Pakistan. The ordinance empowers SECP to monitor and enforce the applicable laws and standards, including the accounting and auditing for the insurance companies. The financial statements of all insurance companies are required to be audited by

chartered accountants (members of ICAP). The auditor is appointed from the SECP-approved panel. The audited financial statements of insurance companies should be submitted to SECP within four months of the financial year end. As per the Insurance Ordinance, insurance companies are required to obtain actuarial certification that their reserves adequately meet all obligations to their respective policyholders.

D. Non-Banking Financial Companies Department of SECP

37. The Non-Banking Financial Companies (NBFC) Department of SECP regulates the non-banking financial institutions in Pakistan, including their accounting and reporting. This department is responsible for regulating investment banks, leasing companies, discount houses, housing finance companies and venture capital companies.

38. The Enforcement and Monitoring and Department (EMD) of SECP is responsible for enforcing IFRS compliance, investigation, compliance with relevant laws and regulations by listed companies, and for prosecution (except in relation to specialized companies and insurance companies for which the SECP has specialized enforcement wings).

39. Listed companies are required to comply with SECP requirements with respect to financial reporting and disclosures. In pursuance of the authority granted under the Companies Ordinance (subsection (3), Section 234), SECP issues special regulatory orders prescribing mandatory IFRS application to listed companies.

40. EMD monitors the compliance with IFRS through regular review of the annual and quarterly financial statements published and filed with SECP by listed companies, NBFC and insurance companies. On identifying any disclosure deficiencies or other non-compliance of IFRS, EMD imposes fines and penalties on the preparers and their auditors. Over the last few years, EMD has penalized several companies, including nearly 25 firms of auditors. Further, EMD also refers the cases of defaulting auditors to ICAP for further disciplinary action through its investigation committee.

41. The NBFC Department of SECP is authorized to monitor and enforce the accounting and auditing requirements for the non-banking financial institutions as set by the Non-Banking Finance Company Rules 2003. The financial statements of the non-banking financial institutions must be audited by the ICAP members.

42. The Insurance Division of SECP is empowered to monitor and enforce the applicable laws and standards, including the accounting rules and regulations for the insurance companies.

E. State Bank of Pakistan

43. The State Bank of Pakistan (SBP) is the central bank of Pakistan. While its constitution, as originally stated in the State Bank of Pakistan Order 1948, remained basically unchanged until 1 January 1974, when the banks were nationalized and the scope of its functions was considerably enlarged. The State Bank of Pakistan Act 1956, with subsequent amendments, forms the basis of its operations today.

44. Currently, over 50 financial institutions are supervised by SBP. These include banks, development finance institutions (DFIs), and microfinance banks/institutions. Banks operating in the country include public and private sector banks incorporated in Pakistan and branches of foreign banks.

F. The Banking Companies Ordinance, 1962 and the role of SBP in the monitoring and enforcement of standards

45. The Banking Companies Ordinance empowers SBP to regulate and supervise commercial banks and financial institutions, including financial reporting by such institutions. The accounting and auditing requirements as outlined in the Banking Companies Ordinance are in addition to the requirements contained in the Companies Ordinance. SBP has prescribed formats for financial statements, including disclosure requirements that each bank must follow. Due to the exemption granted to financial institutions from the applicability of IAS 39 and IAS 40, these formats deviate from full compliance with IFRS. All banks and DFIs must publish audited annual financial statements and file those statements with SBP. The financial statements of all banks and DFIs are required to be audited by firms of chartered accountants, whose names are included in the panel/list of qualified auditors maintained by SBP. Exercising the authority conferred by Section 35(3) of the Banking Companies Ordinance, SBP issues guidelines for the auditors, primarily for the purpose of prudential regulations. Bank auditors are required to hold meetings with SBP inspectors before commencement of their on-site inspection. Also, inspectors are required to share their concerns with the respective auditors upon completion of the inspection. Furthermore, the auditors are required to send copies of the management letter and any other letters to bank management to the SBP within one week of issuance of such letters.

46. The Banking Inspection Department (BID) is one of the core departments at SBP. Its mission is to strive for soundness and stability of the financial system and to safeguard interest of stakeholders through proactive inspection, compatible with best international practices.

47. In order to assess a financial institution, BID conducts regular on-site inspection of all scheduled banks inclusive of the foreign banks and DFIs. The regular on-site inspection is conducted on the basis of the CAMELS (Capital, Asset Quality, Management, Earnings, Liquidity, Sensitivity and System and Controls) Framework. CAMELS is an effective rating system for evaluating the soundness of financial institutions on a uniform basis and for identifying those institutions requiring special attention or concern. The focus of inspection is generally on risk assessment policies and procedures of the banks and control environment to keep attached risks within acceptable limits and compliance with laws, regulations and supervisory directives. In continuation of the inspection process, discussions are held with external auditors to review banks' internal controls, compliance with legislation, prudential standards and adequacy of provisions. BID works in close coordination with the Off-Site Surveillance Desk at Banking Supervision Department and other departments in SBP.

48. The Off-Site Supervision and Enforcement Department (OSED) is one of the newly created departments emerging in the wake of the re-organization of the former Banking Supervision Department under recent SBP restructuring. OSED is responsible for off-site supervision of the financial institutions coming under regulatory purview of SBP. The department also ensures effective enforcement of regulatory and supervisory policies, monitors risk profiles, evaluates operating performance of individual banks/DFIs and takes necessary enforcement actions against institutions for their non-compliance (with laws of the land and regulations put in place by SBP) as identified by the inspection teams of BID during their on-site examinations, and/or by the supervisors of this department based on submitted returns, interaction with financial institutions and market information.

49. In recent years, SBP has inducted a number of chartered accountants and other professionals to strengthen its oversight on financial reporting by banks and other institutions. SBP also works very closely with ICAP and seeks its input/advice on accounting and auditing matters.

G. The Institute of Chartered of Accountants of Pakistan

50. ICAP is an autonomous statutory body established under the Chartered Accountants Ordinance, 1961 (CA Ordinance). It is governed by a council comprising 16 members that includes 12 elected members and four members nominated by the federal Government. The Government nominees include the Chairman of SECP, Chairman of the Federal Board of Revenue, Chairman of the National Tariff Commission and the Federal Secretary Privatization Commission. Under the CA Ordinance, the basic purpose of the institute is to regulate the profession of accountants. In order to discharge such responsibility, including reliable financial reporting by corporate entities, ICAP has been working together with government agencies and regulators such as SECP and SBP. For this purpose, there are joint committees of ICAP–SECP that usually meet on a quarterly basis.

51. ICAP is an active member of international and regional organizations, e.g. IFAC, Confederation of Asia Pacific Accountants and South Asian Federation of Accountants.

52. While ICAP has established robust regulatory mechanisms, the Government of Pakistan, on the recommendation of the Council of the Institute, has agreed to make necessary amendments in the CA Ordinance to further empower the council and to strengthen its disciplinary and regulatory processes

53. ICAP acts both as an examining body for awarding chartered accountancy qualifications and the licensing and disciplinary authority for members engaged in public practice. ICAP's aggregate membership in July 2006 was 3,864, of which about 15 per cent are engaged in public practice.

H. ICAP's enforcement role as a regulator of the accountancy profession

54. Members of ICAP are required to follow the ICAP Code of Ethics for Chartered Accountants, which was revised in 2003 in line with the IFAC Code of Ethics for Professional Accountants, which was issued in November 2001. ICAP is currently deliberating adoption of the revised IFAC Code of Ethics issued in June 2005.

55. Members of ICAP are required to ensure compliance with IFRS: ICAP Council's directive TR 5 requires its members, who are auditors of the companies, to ensure that the financial statements they audit comply with the requirements of the IFRS (except IAS 29, and IFRS 1, 4, 7 and 8, which are being considered for adoption by ICAP).

56. ICAP's disciplinary process: The CA Ordinance has prescribed a procedure to deal with any breach of professional ethics and other instances of misconduct by the members. The Directorate of Corporate Affairs and Investigation works in conjunction with the Institutes Investigation Committee formed by the council to investigate such breaches. Under the CA Ordinance, all complaints of misconduct against members of ICAP are required to be investigated by the Investigation Committee, which reports to the council for final decision.

57. During 2007, 20 cases were referred to the Investigation Committee and 10 cases were disposed off as follows:

Closed	3
Members reprimanded by name	2
Reprimanded by name + penalty Rs. 1000	1
Members reprimanded without name	2
Members cautioned	0
Membership suspended for six months	1
Reference made to High Court (for termination of membership above five years period)	1
Total	10

58. ICAP has the authority to penalize, reprimand or terminate the membership of the member who is found guilty of misconduct or negligent in performing his or her professional duties. The nature of the penalty depends on the nature and extent of misconduct by members.

I. Quality Control Review

59. The Directorate of Professional Standards Compliance and Evaluation (DPSC&E) of ICAP carries out the Quality Control Reviews (QCR) of practicing firms that conduct audit of companies. The Quality Assurance Board (QAB) monitors the ICAP QCR programme, under which it examines audit working papers and identifies noncompliance with ISAs/IASs, etc. to the concerned auditors. If major departures or noncompliances are observed, then the case is forwarded to the Investigation Committee for further action against the member.

60. QCRs of the practicing firms are carried out with dual purposes. The primary objective is to determine whether a practicing firm has a satisfactory QCR rating (which is determined based on assessment of whether or not the audit work was done in accordance with the ISAs) to enable it to carry out audits of the listed companies. Secondly, it is ICAP's endeavor that the practicing firms that are not able to obtain satisfactory rating are helped and guided to develop an appropriate knowledge and skill base so that they can achieve the requisite standard.

J. Quality Assurance Board

61. The Quality Assurance Board (QAB) of IPAC was formed in September 2005 to replace the Quality Control Committee, which used to monitor the quality assurance programme of ICAP up to that date. The board consists of various stakeholders, including representatives from SECP, SBP, the Central Board of Revenue and the Karachi Stock Exchange. The chairman of the board is a non-practicing chartered accountant.

62. The QAB suggested revision in the QCR Framework, which was approved by the council on 12 September 2006. The salient features of the revised framework are as follows:

- (a) QCR of a practicing firm will now be carried out after two and a half years instead of two years.
- (b) A QCR must cover at least 25 per cent of audit partners of a practicing firm.
- (c) The QCR report will be issued on a whole firm (instead of branch) basis.
- (d) Additional files will be reviewed in case one file is assessed to be "not-in-accordance" with the ISA applicable in Pakistan.
- (e) Files will be short-listed before the review has been done away with.

63. The QAB is currently in the process of incorporating International Standard on Quality Control 1 into the QCR programme of ICAP, taking into account the practical difficulties of small and medium practices.

III. Capacity-building: The role of ICAP in creating awareness of IFRS

A. Facilitating regulators

64. ICAP, at the request of regulators, holds separate seminars, workshops on IFRS and ISAs for their teams, i.e. Federal Board of Revenue (FBR), SECP, SBP, etc.

65. These programmes have in fact resulted in bridging the perception gap amongst ICAP and the regulators, and assisted in developing better understanding of standards by the regulators leading to smooth implementation and handling of IFRS-related issues.

B. Guidance

66. ICAP was closely monitoring changes in the IFRS and ISAs, and conducting seminars and workshops whenever a new IFRS or ISA issued by the standard setters for the guidance of its members. The Directorate of Technical Services (DTS) of ICAP caters to the needs of the members, especially in the practice. DTS issues guidance in the form of technical releases and circulars for the benefit of the members on local issues. ICAP is not authorized to issue interpretations, which can only be issued by the International Financial Reporting Interpretations Committee (IFRIC).

C. Awareness programmes

67. Continuous awareness programmes have been organized by ICAP for improving the degree of compliance with IFRS requirements covering almost all the topics. In the First South Asian Accounting Summit, organized by ICAP, prominent scholars from widely recognized bodies such as IASB were invited to address different issues faced by the accounting profession globally and especially in the context of Pakistan.

D. Members' information and education series

68. Considering the needs of its members, especially those in industry, ICAP has started a series of publications called "Members Information and Education Series". This initiative has been very much appreciated by the members.

E. Disclosure checklist

69. ICAP also develops financial statement disclosure checklists to facilitate preparers and auditors in achieving compliance with disclosure requirements of IFRS as well as local regulatory requirements. The checklist seeks to provide guidance to the reporting companies and their auditors with regard to the disclosures to be made in the financial statements prepared in accordance with the approved accounting standards (IFRS notified by SECP) and the requirements of the Companies Ordinance, 1984.

F. Training workshops for small and medium practices

70. In the year 2006, ICAP initiated a series of training workshops designed for the students of small and medium practices (SMPs). The response from SMPs was overwhelming and it was encouraging to note that they are keen to

improve their procedures and practices, and have made efforts to bring them in line with the ISAs issued by the International Assurance and Auditing Standards Board (IAASB).

71. ICAP plans to continue such training programmes on a monthly basis all over Pakistan. It is hoped that these workshops will add value to the quality of audits and bring about a positive change in working of various practicing firms.

G. Capacity-building measures

72. Capacity-building is imperative to consolidate the prior achievements, improve the knowledge base among auditors and the preparers of financial statements, and strengthen the monitoring and enforcement mechanisms for ensuring compliance with applicable standards and codes. This includes improving the capacity of regulators and professional bodies, upgrading accountancy education and training with focus on practical application of IFRS and ISA, issuing and disseminating implementation guidance on applicable standards, developing simplified SME reporting requirements, upgrading the licensing procedure of professional accountants and auditors, and enhancing the delivery of continuing professional education.

H. Capacity-building at ICAP

73. ICAP is committed to IFAC's seven statements of membership obligations. In fact, the council has carried out a gap analysis with a view to achieving full compliance with such statements in the near future. While ICAP played an effective leadership role in the past for adoption and implementation of international accounting and auditing standards, it continues to make endeavors for further enhancing its capacity to fulfill its responsibility in the public interest of regulating the accounting profession in line with international best practices. ICAP has also proved itself to be an active member of IFAC, SAFA and CAPA, and participated actively in international events. The governance structure of ICAP is also considered to be in line with the best practices followed by other international bodies. Further, in recent years, ICAP has substantially increased the number of qualified people in its different departments. For instance, it has increased the number of CAs employed by ICAP to 25, compared to 17 in 2005.

I. Upgrading the licensing procedure of professional accountants and auditors

74. ICAP is working towards upgrading the licensing procedure of professional accountants and auditors. This involves bringing changes in the by-laws to introduce more stringent licensing and renewal requirements and strengthening practical training aspects.

75. Audit of listed companies is only performed by the firm having a satisfactory QCR rating. Under the QCR framework, every firm of chartered accountants performing audit of listed companies is required to obtain a satisfactory QCR rating at least once every two and half years.

76. In order to strengthen practical training aspects, new training regulations have been introduced. These regulations cover the requirements as stipulated in the International Education Standard (IES) 5 – Practical Experience Requirement.

77. ICAP is currently developing guidelines for networking of audit firms. This will help SMPs in enhancing their resources, thus improving the quality of audits.

J. Enhancing the delivery of continuing professional education

78. The Continuing Professional Development (CPD) Programme of ICAP is already in place, aimed at keeping the members abreast of the changes in the international accounting and auditing standards besides other relevant subjects. The CPD programme is in line with IES 7, and CPD committees and regional committees organize seminars and workshops on IFRS, ISAs and relevant local pronouncements on a regular basis. Members are required to gather a minimum number of 40 hours during the year by attending such seminars and workshops. The process is planned to be further strengthened and to make it available across the country.

79. To achieve this goal, ICAP organized the First South Asian Accounting Summit in 2006, bringing together senior representatives from the global standards setters, including the chairman of IASB Sir David Tweedie, office bearers of the major accounting bodies in the South Asian region and leading accounting professionals of the country.

K. Developing simplified SME reporting tools

80. ICAP aspires to extend practical assistance to SMEs in implementing SME standards for which it is developing illustrative financial statements and disclosure checklists.

L. Adoption of interpretations issued by IFRIC

81. All interpretations on IAS/IFRS that are issued by IFRIC (or its predecessor body SIC) are considered as adopted. ICAP does not formally adopt any of the interpretations issued by IFRIC for the reason that interpretations (issued by SIC or IFRIC) always relate to a particular standard (IAS/IFRS) and are presumed to be automatically adopted with the adoption of the relevant standard as are revisions to standards.

M. Training regulations

82. Training regulations have been implemented with effect from April 2006. This will further strengthen various aspects of gaining practical experience. These regulations generally cover the requirements as stipulated in IES 5 – Practical Experience Requirement, issued by IFAC to ensure that future members acquire skills and values necessary for responding to the dynamics of the profession.

N. Board of Studies

83. In 2006, ICAP re-established the Board of Studies to be headed by a full-time chairman. The board shall perform functions including educational research and development, description of courses and development of their syllabi and course outlines, identifying books for recommended reading and development of study material.

84. An advisory committee with members from various professional fields and different stakeholders has been constituted to advise the Board of Studies on various matters.

O. Pakistan Accounting Research Foundation

85. In March 2006, the Council of ICAP approved in principle the formation of the trust Pakistan Accounting Research Foundation (PARF). The trust has been established for education, research and development of the accounting

profession and allied services, and shall exist on a non-profit basis. The primary functions of PARF include:

- (a) Forming a state-of-the-art university of accounting and finance;
- (b) Providing assistance including financial and professional support to persons involved in research and development;
- (c) Making endeavours to improve the standards of the accountancy profession;
- (d) Arranging coordination between local and foreign students; and
- (e) Arranging bilateral exchange of information, etc.

IV. Lessons learned

86. In Pakistan, the regulators of the corporate and financial sectors and ICAP that represent the accounting profession are of the firm view that financial reporting by public interest entities should be in conformity with the international financial reporting standards so as to generate high-quality financial information that is relevant, comparable, consistent and transparent so as to serve the needs of stakeholders. In this regard, ICAP's proactive leadership of the profession and collaborative approach of working together with the regulators has helped bring about significant improvement in the quality of financial reporting in line with international standards. Further, ICAP's strategy of adoption of IFRS over the last two decades, rather than adaptation, has also helped in acceptability, understanding and compliance with IFRS by the preparers as well as users of the financial statements. The process involved overcoming challenges such as limitations of technical resources, capacity issues, coordination and effective advocacy with the regulators, to ensure smooth implementation of IFRS in the country. The major lessons learned during the process are discussed below.

A. Verbatim adoption of IFRS

87. From the very beginning, ICAP followed the approach of verbatim adoption of IAS/IFRS instead of making any changes to the text of standards to bring them in line with the local regulatory and business environment. The approach has been to bring the regulatory requirements in line with IFRS rather than the contrary. While this approach involved considerable difficulties at the initial adoption and implementation stage for which ICAP faced criticism, sometimes from its own members, in the long run this approach has served the interest of the profession and the country, as most people now agree that Pakistan has been able to develop high-quality financial reporting due to this approach. Also, Pakistan can achieve full IFRS compliance over the next two to three years, without too much difficulty.

B. Staying at par with revisions/conforming amendments to IFRS

88. Revisions and conforming amendments to IAS/IFRS by IASB are a regular feature now, and keeping track of whether the individual revision/amendment has been adopted and notified has become all the more challenging.

89. ICAP as a matter of strategy decided that once a standard is adopted by ICAP and notified by SECP, any subsequent revision/conforming amendment made by IASB is considered as adopted unless otherwise specified.

90. This strategy has helped us stay at par with the latest developments in the standards which otherwise, with the limited availability of technical resources,

would have become extremely difficult had we opted for adoption of each and every revision/amendment.

C. Implementation of certain requirements of IFRS – a gradual process

91. Adopting IFRS is not just an accounting exercise. It is a transition that requires participation and support of all stakeholders, including preparers, auditors and users. While adopting and implementing IFRS, one should consider the fact that, in certain cases, it may cause undue hardship to the industry, at least to begin with. For instance, Pakistan's banking industry was not prepared to apply the provisions of IAS 39 immediately due to capacity and other related issues discussed earlier. Transitory measures had to be adopted, including providing them adequate time, for gradual implementation.

D. Following an approach of working together with the regulators

92. Since its inception, ICAP has played a key role in adoption, creating awareness and education, and implementation of IFRS. A major factor in achieving this success was the collaborative approach adopted by ICAP of working together with the main corporate and financial regulators in public interest.

E. Addressing differences in IFRS and law

93. As a recommending authority of financial reporting standards, ICAP has learned that where the accounting treatments prescribed in various IFRS are in conflict with the corresponding legal requirements, its role has become all the more important, acting in the best interest of the country and stakeholders at large, as well as balancing its responsibilities as a signatory to the membership obligations of IFAC. The approach adopted to deal with such issues varied with the nature and magnitude of the issue.

1. Changes in law as per the accounting requirements

94. Since most of the commercial and corporate laws of the country have evolved from statutes drafted several decades ago, in most cases such laws are not consistent with the financial reporting needs of the corporate sector. Consequently, ICAP has in most cases worked to persuade the government officials and regulators of the need for making necessary amendments to bring them in conformity with international standards.

2. Making a particular accounting requirement inapplicable to a sector of the economy

95. While in most cases laws and regulations are modified to make them consistent with IFRS, in certain cases immediate application of IFRS would be counterproductive, so ICAP has adopted a more pragmatic approach of either allowing more time or providing exemption to certain sectors. For instance, in the case of IAS 39, ICAP supported the banking sector's demand of providing them more time and deferral of the standard for a considerable period. Similarly, keeping in view the genuine difficulties faced by the Independent Power Producers on account of IFRIC-4, which would have converted all of these entities into leasing companies, ICAP supported the deferral of IFRIC-4 up to 2009.

F. IFRS are not made to fit all entity sizes

96. ICAP realized that mandatory application of all IFRS to all companies is not practical and separate standards must be developed for SMEs before embarking on full IFRS compliance regime in the country.

97. Given the substantial increase and complexities of IFRS, it is not possible for SMEs to ensure full compliance with all their requirements. In reality, these SMEs lack adequate technical capabilities and resources to ensure compliance with complicated reporting requirements. Consequently, ICAP took the initiative of developing two separate financial reporting standards for MSEs and SSEs, which are expected to be notified by SECP soon.

G. Involvement of stakeholders in the adoption and implementation process

98. In order to create awareness and ensure stakeholder participation, ICAP has been holding seminars, roundtables and workshops to get sufficient support from the stakeholders in the process of adoption and implementation of IFRS. This approach is considered essential for effective implementation.

H. Role of QAB in improving standards of auditing and financial reporting

99. The QCR programme, in addition to ensuring compliance with the standards, is also educative in nature. Over the years, effective and regular quality assurance reviews conducted by ICAP's professional standards compliance department under the supervision of the Quality Assurance Board (previously Quality Control Committee) have helped in bringing about sustained improvements in the audit quality as well as compliance of IFRS.

I. Investment in training and education in IFRS

100. An extensive and effective training and education programme is considered imperative for proper understanding and implementation of IFRS. More specifically, some of the complex accounting standards – such IAS 39, IAS 36, etc. – require significant effort in training and education for proper understanding and implementation. While ICAP has been pursuing a continuing education programme for its members and other stakeholders, there is a need for further investment in this area.

101. With the issuance of newer accounting standards or revision of existing ones on the basis of IFRS, various new concepts are being introduced (e.g. fair value concept) for which the preparers, auditors, analysts and other users need to be adequately trained and educated.

V. Conclusions

102. With all three factors – i.e. implementation, regulatory framework and quality assurance – moving in the right direction, Pakistan is on track and not too far away in achieving full IFRS compliance in the next two to three years, in line with the IFRS strategy approved by the Council of ICAP.

103. The target date for achieving full IFRS compliance is December 2009, i.e. the financial statements prepared in Pakistan for the periods beginning on or after 1 January 2010 should be IFRS compliant so that all publicly accountable entities are able to give an unreserved compliance with IFRS.

104. The ICAP QCR programme is committed to a process of continuous and sustained improvement. The ultimate objective of this very important regulatory

and educative programme is to maintain and enhance the reputation and image of this prestigious profession.
