

Circular No. 01/2002
2002

February 12,

ALL MEMBERS OF THE INSTITUTE

Dear Member

Attention of members is drawn towards our Circular No. 8/99 dated August 10, 1999 wherein it is stated that IAS 12, *Income Taxes* will be applicable for accounting periods beginning on or after January 1, 2002. Hence companies whose accounting years end on December 31 and June 30 would be required to comply with revised IAS 12 by December 31, 2002 and June 30, 2003 respectively.

Members are advised to keep the above requirements in mind while preparing or reporting on the financial statements for the periods ending on December 31, 2002 onwards.

Thanking you

Yours truly

Syed Sajid Ali
Director Technical Services

Circular No. 02/2002
2002

May 18,

ALL MEMBERS OF THE INSTITUTE

Dear Member

AMENDMENTS IN LISTING REGULATIONS

Members are aware that in the recent past the Securities and Exchange Commission of Pakistan had issued two Directives to the stock exchanges in Pakistan to amend their Listing Regulations. As these Directives were profoundly affecting the accounting profession, these became the subject of extensive discussions and deliberations internally at ICAP and also with the SECP.

Finally, the Council of the Institute authorized a Committee led by the President to discuss the various issues arising out of the Directives with the SECP, the deliberations of which were approved by your Council at its 151st meeting held on April 26-27, 2002.

On May 10, 2002, the SECP has issued the enclosed new Directive to the stock exchanges superseding its earlier two Directives dated February 7, and March 5, 2002.

Following are main changes, which the Directive dated May 10, 2002 has brought about in the two superseded Directives: -

Last three bullet points in the Directive dated February 7, 2002 have been amended to read as under (Deletions are struck off and additions are underlined).

- expresses his opinion on financial statements of any business or enterprise in which he, his firm or a partner in his firm has a substantial interest, ~~unless he discloses his interest in his report;~~
- is penalized under any of the provisions of the Companies Ordinance, 1984 in relation to his function as an auditor of a listed company; and
- is guilty of any other act, which is determined as professional misconduct by the Commission in relation to his function as an auditor of a listed company.

Directive dated March 5, 2002 has been amended as follows:-

- No listed company shall, after 31 May 2002, appoint or continue to retain any person as an auditor who is engaged by the company as a consultant or adviser or to provide any service, including services related to the designing of accounting systems or compilation of accounts.
- A listed company shall not appoint or continue to retain any person as an auditor, if a person associated with the auditor is, or has been, at any time during the preceding ~~six~~ three months engaged as a consultant or adviser or to provide any service related to the designing of accounting systems or compilation of accounts.

However, any services provided by such associate prior to 31 May 2002 shall not be subject to this restriction.

Contd. P/2

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- All contracts / arrangements entered into up to 31 May 2002, for non-audit services as are proposed to be not permissible shall be allowed to be performed until the expiry of such contracts / arrangements or 30 June 2003, whichever is earlier.
- In connection with share registration services, (transfer agents) an auditor or a person associated with him of a listed company rendering such services to its audit clients may continue to do so under existing or renewed contracts / arrangements until 30 June 2003.
- The Commission may, in its sole discretion and to the extent deemed fit and proper, exempt one or more services from the restriction aforesaid. ICAP also may, with the prior written approval of the Commission, and to the extent deemed fit and proper, exempt one or more services from this restriction.
- All listed companies shall be required to change their external auditors after every five years. This requirement, shall however, be effective after 31 December, 2003. However, rotation of auditors shall be encouraged by the listed companies during the period up to 31 December, 2003.

As stated in paragraph 2 of the SECP Directive dated May 10, 2002 enclosed please find Council Directive no. 4.16.

In pursuance to the Council Directive 4.16, following words are hereby added at the end of paragraph 9.5 of Council's Directive No. 6.04 relating to Code of Ethics for Chartered Accountants:-

“However effective May 31, 2002, Chartered Accountants in practice shall not, either directly or through a person associated with such Chartered Accountants in practice, render any services to such listed companies of which they are auditors under section 252 of the Companies Ordinance, 1984 other than the following services (here-in-after referred to as “exempted services”):

1. Attestation, certifications, special purpose audits/reviews and agreed-upon procedures as defined in the International Standards on Auditing (ISAs).
2. Taxation services
3. Opinion on accounting standards
4. Information Risk Management (IRM) Assurance and Risk Management Reviews
5. Corporate law compliance services including representation before authorities.
6. Financial due diligence exercise in relation to acquisitions and mergers

Provided that an auditor of a listed company or a person associated with him may

continue to provide services, other than the above exempted services, under the contracts / arrangements with such listed companies, of which they are auditors, entered into up to May 31, 2002, until the expiry of such contracts / arrangements or June 30, 2003, whichever is earlier.

Contd. P/3

Provided further that an auditor of a listed company or a person associated with him rendering share registration services (transfer agents) to its listed audit clients may continue to provide such services under existing or renewed contracts / arrangements until June 30, 2003.

Provided further that a Chartered Accountant in practice shall not accept any appointment or continue as an auditor of a listed company if a person associated with such auditor is, or has been, at any time during the preceding three months engaged as a consultant or advisor or has provided any service (other than exempted services), including services related to the designing of accounting systems or compilation of accounts,. This restriction shall not apply to a person associated with such auditor in respect of services provided prior to May 31, 2002.

Explanation: For the purposes of this directive the expression “associated with such auditor” shall mean any person associated with the auditor, if the person:-

- a) is a partner in a firm or is a director in a company or holds or controls shares carrying more than twenty percent of the voting power in a company, and the auditor is also partner of that firm or is a director in that company or so holds or controls shares in such company; or
- b) is a company or body corporate in which the auditor is a director or holds or controls shares carrying more than twenty percent of the voting power in that company or has other interest to that extent”.

Printed copy of Directive 4.16 and revised pages 31, 32, 32A and 32B of the Code of Ethics for Chartered Accountants for filing in the Members' Handbook will be sent shortly.

Thanking you

Yours truly

Syed Sajid Ali
Director Technical Services

Encl. As above.

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)
NIC Building, Jinnah Avenue

No.13/SEC/CSM/2001-

Islamabad, May 10, 2002

To:

1. The Managing Director,
Karachi Stock Exchange (Guarantee) Ltd.,
Karachi.
2. The Managing Director,
Lahore Stock Exchange (Guarantee) Ltd.,
Lahore.
3. The Secretary,
Islamabad Stock Exchange (Guarantee) Ltd.,
Islamabad.

The Securities and Exchange Commission of Pakistan (the Commission), in exercise of the powers conferred by sub-section (4) of section 34 of the Securities and Exchange Ordinance, 1969 (XVII of 1969), is hereby pleased to direct, for the purpose of improvement in the quality of audit, all the stock exchanges to insert the following clauses appropriately in their respective regulations within fifteen days of the issue of this directive, namely: -

- (i) All listed companies shall facilitate the Quality Control Review (QCR) of the audit working papers of practising chartered accountants, carried out by the Institute of Chartered Accountants of Pakistan (ICAP) and, therefore, shall authorize their auditors to make available all the relevant information including the audit working papers to the QCR Committee of ICAP.
- (ii) No listed company shall appoint or continue to retain any person as an auditor, who has been found guilty of professional misconduct, by the Commission or by a Court of Law, for a period of three years unless a lesser period is determined by the Commission. In case a firm has been appointed as an auditor, and if any of its partners has been held guilty of professional misconduct, the firm shall only be eligible for appointment as an auditor provided a written confirmation is given by the firm to all the stock exchanges of the country and the Commission with a copy to ICAP to the effect that such a partner shall not be engaged in the audit of any listed company for the specified period.

A person appointed as an auditor shall be guilty of "professional misconduct" if he: -

- fails to report a material misstatement or fact known to him and non-disclosure of which may render the financial statements misleading or disclosure of which is necessary in his professional capacity;
- fails to obtain sufficient information to warrant the expression of an opinion or his exception are sufficiently material to negate the expression of an opinion;
- makes a statement which is misleading or deceptive;
- incites any one to commit a criminal offence, or helps or encourages anyone in planning or execution of a criminal offence which is committed;

- agrees with anyone to prevent or obstruct the course of justice by concealing, destroying or fabricating evidence by a misleading statement which he knows to be untrue;
 - deceives any person, either by making a statement, which he knows to be false, or by suppressing matters relevant to a proper appreciation of its significance;
 - expresses his opinion on financial statements of any business or enterprise in which he, his firm or a partner in his firm has substantial interest;
 - is penalized under any of the provisions of the Companies Ordinance, 1984 in relation to his function as an auditor of a listed company; and
 - is guilty of any other act, which is determined as professional misconduct by the Commission in relation to his function as an auditor of a listed company.
- (iii) No listed company shall, after 31 May 2002, appoint or continue to retain any person as an auditor who is engaged by the company as a consultant or adviser or to provide any service, including services related to the designing or accounting systems or compilation of accounts.
- (iv) A listed company shall also not appoint or continue to retain any person as an auditor, if a person associated with the auditor is, or has been, at any time during the preceding three months engaged as a consultant or adviser or to provide any service, including service related to the designing of accounting systems or compilation of accounts. However, any services provided by such associate prior to 31 May 2002 shall not be subject to this restriction.

Explanation: For the purposes of this regulation, the expression “associated with” shall mean any person associated with the auditor, if the person –

- (a) is a partner in a firm, or is a director in a company, or holds or controls shares carrying more than twenty percent of the voting power in a company, and the auditor is also partner of that firm, or is a director in that company or so holds or controls shares in such company; or
 - (b) is a company or body corporate in which the auditor is a director or holds or controls shares carrying more than twenty percent of the voting power in that company or has other interest to that extent.
- (v) All contracts/arrangements entered into upto 31 May 2002, for non-audit services as are proposed to be not permissible shall be allowed to be performed until the expiry of such contracts/ arrangements or 30 June 2003, whichever is earlier.
- (vi) In connection with share registration services, (transfer agents) an auditor or a person associated with him of a listed company rendering such services to its audit clients may continue to do so under existing or renewed contracts/ arrangements until 30 June 2003.
- (vii) All listed companies shall be required to change their external auditors after every five years. This requirement, shall however, be effective after 31 December, 2003. However, rotation of auditors shall be encouraged by the listed companies during the period upto 31 December, 2003.

2. The Commission may, in its sole discretion and to the extent deemed fit and proper, exempt one or more services from the restriction aforesaid. ICAP also may, with the prior written approval of the Commission, and to the extent deemed fit and proper, exempt one or more services from this

restriction.

3. Any regulations made in pursuance of the previous directives of the Commission issued vide No.13/SEC/CSM/2001 dated 7 February 2002 and even No. dated 5 March 2002 shall be superseded by the revised regulations to be made by the Exchanges in accordance with this directive, from the date such revised regulations are notified in the official Gazette.

Sd/
(Shahid Ghaffar)
Commissioner (SM)

DIRECTIVE ON EXEMPTED SERVICES FOR AUDITORS OF LISTED COMPANIES

In pursuance of the Directive dated May 10, 2002 issued by the Securities and Exchange Commission of Pakistan to the stock exchanges, the Council of the Institute of Chartered Accountants of Pakistan, in exercise of the powers conferred on it under section 15 read with Section 2(2)(iv) of the Chartered Accountants Ordinance, 1961 and with the prior approval of the Securities and Exchange Commission of Pakistan, is pleased to direct that effective May 31, 2002, Chartered Accountants in practice shall not, either directly or through a person associated with such Chartered Accountants in practice, render any services to such listed companies of which they are auditors under section 252 of the Companies Ordinance, 1984 other than the following services (here-in-after referred to as "exempted services"):

1. Attestation, certifications, special purpose audits/reviews and agreed-upon procedures as defined in the International Standards on Auditing (ISAs).
2. Taxation services
3. Opinion on accounting standards
4. Information Risk Management (IRM) Assurance and Risk Management Reviews
5. Corporate law compliance services including representation before authorities.
6. Financial due diligence exercise in relation to acquisitions and mergers

Provided that an auditor of a listed company or a person associated with him may continue to provide services, other than the above exempted services, under the contracts / arrangements with such listed companies, of which they are auditors, entered into up to May 31, 2002, until the expiry of such contracts / arrangements or June 30, 2003, whichever is earlier.

Provided further that an auditor of a listed company or a person associated with him rendering share registration services (transfer agents) to its listed audit clients may continue to provide such services under existing or renewed contracts / arrangements until June 30, 2003.

Provided further that a Chartered Accountant in practice shall not accept any appointment or continue as an auditor of a listed company if a person associated with such auditor is, or has been, at any time during the preceding three months engaged as a consultant or advisor or has provided any service (other than exempted services), including services related to the designing of accounting systems or compilation of accounts. This restriction shall not apply to a person associated with such auditor in respect of services provided prior to May 31, 2002.

Explanation: For the purposes of this directive the expression "associated with such auditor" shall mean any person associated with the auditor, if the person:-

- a) is a partner in a firm or is a director in a company or holds or controls shares carrying more than twenty percent of the voting power in a company, and the auditor is also partner of that firm or is a director in that company or so holds or controls shares in such company; or
- b) is a company or body corporate in which the auditor is a director or holds or controls shares carrying more than twenty percent of the voting power in that company or has other interest to that extent".

The Council's directive contained in paragraph 9.5 of the Code of Ethics for Chartered Accountants (6.04) shall be deemed to have been modified to the extent aforesaid.

(151st meeting of the Council held on April 26-27, 2002 and Resolution by Circulation dated May 7, 2002)

Circular No. 03/2002
2002

May 18,

ALL MEMBERS OF THE INSTITUTE

Dear Member

CODE OF CORPORATE GOVERNANCE

You are aware that the issue of good corporate governance has been occupying the centre stage for quite sometime, largely due to financial collapses at international level. Realizing the importance of the issue the Institute of Chartered Accountants of Pakistan adopted the theme of "Corporate Governance - Myths and Realities" at its 5th All Pakistan Chartered Accountants' Conference held at Karachi in December 1998.

At the conclusion of the Conference it was resolved to develop Recommendations for a Code of Corporate Governance and for this purpose a Committee was formed comprising of Past Presidents of ICAP, President of ICMAP, Chairman of the three stock exchanges of Pakistan and a representative of the SECP to develop the said Recommendations. Later on to expedite the matter, a sub-committee comprising of Mr. Ebrahim Yacoob Sidat, Mr. Syed Masoud Ali Naqvi, Mr. Najmul Islam Chaudhri and Mr. Yasin Lakhani (KSE) was formed, which after extensive deliberations spread over 31 meetings and discussions with various stakeholders drafted Recommendations for a Code of Corporate Governance and presented it to the Committee, for review at its meeting in May 2000. The Committee approved the Code subject to certain amendments, which were incorporated into the Code and circulated to Committee members; the amended draft of Recommendations on the Code was submitted to SECP by the Institute in August, 2000, and subsequently circulated to ICAP members.

At the request of SECP, Mr. Ebrahim Yacoob Sidat and Mr. S. Masoud Ali Naqvi were charged with the responsibility for public exposure of the draft Recommendations, which was done through circulation of the same to various stakeholders and organizing seminars at Karachi, Lahore and Islamabad between November 2000 to November 2001. As a result of the deliberations, a revised Code of Corporate Governance was submitted to SECP in January 2002.

SECP further revised some of the Recommendations and included some other matters, and issued the Code of Corporate Governance on 28 March, 2002 for implementation, vide their Directive to the Stock Exchanges to incorporate the Code in their listing regulations. On May 10, 2002, the SECP has relaxed the condition of rotation of auditors as contained in clause (xli) of the Code whereby "till December 31, 2003 no action will be taken by the Exchange(s) against such listed companies which fail to comply with the requirement of clause (xli) of the Code of Corporate Governance. Non-compliance with clause (xli) in respect of appointments of auditors falling due after December 31, 2003 will be rendered liable to action under the regulations.

The Code issued by SECP has several aspects, which directly affect the accounting profession. To help its members, both in practice as well as in industry, the Professional Standards and Technical Advisory Committee of the Institute is at present developing a comprehensive checklist, format of

auditors' report on statement of compliance and auditors report on limited scope review of half-yearly financial statements, which are expected to be issued shortly.

Contd. P/2

Main highlights of the Directive relating to Code of Corporate Governance are as follows:-

Board of Directors

1. Effective representation of independent non-executive directors on the Board (Voluntary).
2. Minority shareholders as a class to be facilitated to contest election of directors by proxy solicitation (Voluntary).
3. The Board includes at least one independent director representing institutional equity interest of financial institutions (Voluntary).
4. Executive directors, i.e. working or whole time directors, are not more than 75% of the elected directors (Voluntary).

Qualification and Eligibility to Act as a Director

5. No listed company shall have as a director, a person who is serving as a director of ten other listed companies.

Responsibilities, Powers, Functions of Board of Directors and Corporate and Financial Reporting Framework

6. The directors of listed companies shall exercise their powers and carry out their fiduciary duties with a sense of objective judgement and independence in the best interests of the listed company.
7. Every listed company shall ensure that:-
 - A 'Statement of Ethics and Business Practices' is prepared and circulated annually by its Board of Directors.
 - The Board of Directors adopts a vision/mission statement.
 - The Board of Directors shall define the level of materiality.
 - The Board of Directors shall establish a system of sound internal control.
 - The Board of Directors shall establish an Audit Committee, majority of the members of which shall be from among the non-executive directors.
 - The Board of Directors shall establish an internal audit function
8. The Board of Directors of a listed company shall meet at least once in every quarter of the financial year.
9. The directors of listed companies shall inter alia include statements to the following effect in the Directors' Report.

- The financial statements, prepared by the management, present fairly its state of affairs, the result of its operations, cash flows and changes in equity.

Contd. P/3

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- The system of internal control is sound in design and has been effectively implemented and monitored.
- There are no significant doubts upon the listed company's ability to continue as a going concern.

10. **Chief Financial Officer (CFO) and Company Secretary**

- The appointment, remuneration and terms and conditions of employment of the Chief Financial Officer (CFO), the Company Secretary and the head of internal audit of listed companies shall be determined by the CEO with the approval of the Board of Directors.
- The CFO or the Company Secretary of listed companies shall not be removed except by the CEO with the approval of the Board of Directors.

11. **Frequency of Financial Reporting**

All listed companies shall issue:

- The quarterly unaudited financial statements.
- Half-yearly financial statements duly reviewed by their external auditors.

12. **External Auditors and Corporate Governance**

- Auditor, spouse and minor children not to hold shares in Auditee Company (Specific provision of disinvestment on new appointment).
- Auditors to have satisfactory QCR rating.
- Auditors to be compliant with IFAC Code of Ethics as adopted by ICAP for independence, etc.
- Auditors not to:-
 - Perform management functions
 - Make management decisions
 - Provide non-audit services other than exempted services subject to Audit Committee recommendations. (Please also see Council's Directive 4.16)
- Rotation of auditors.

- Firm/or audit partner if rotation of firm not practicable after approval of SECP. (This requirement, shall however, be effective after 31 December, 2003)
- Partner of a firm or an employee engaged in audit (for last two years) or a close relative of such persons cannot be appointed by a Listed Company for position of CEO, CFO, Internal Auditor and Director. Close relative means spouse, parents, dependants and non-dependent children.

Contd. P/4

- External auditor to furnish management letter to the Board not later than 30 days from the date of audit report.
- A partner of the firm shall attend the AGM at which audited accounts are to be considered.
- A statement of compliance with the best practices of Corporate Governance is to be reviewed by auditors where such compliance can be objectively verified before publication by companies.
- Limited scope review report on half-yearly Accounts to be determined by ICAP and approved by SECP.
- Audit Committee to recommend to Board for appointment or reappointment of Auditors.
- Auditors to attend Audit Committee meetings, where issues relating to Accounting and Audit are discussed.
- In case of change of Auditors before three consecutive years, the reasons for the change should be included in the directors' report.
- Internal Auditors report to be provided for review of external auditors.
- Audited Annual Accounts to be circulated not later than four months from close of financial year.

Members are advised to download the Code from SECP Website: secp.gov.pk for a detailed study.

Thanking you

Yours truly

Syed Sajid Ali
Director Technical Services

Circular No. 04/2002
2002

May 27,

ALL MEMBERS OF THE INSTITUTE

Dear Member

AMENDMENTS IN LISTING REGULATIONS

Further to our Circular No. 02/2002 dated May 18, 2002, enclosed please find:-

1. Council Directive 4.16 along with revised Sectional Index
2. Pages 31, 32, 32A and 32B of the Code of Ethics for Chartered Accountants. (Council Directive 6.04)

for filing in Members' Handbook Volume I, Part IV, Section 4 and Section 6 respectively.

Thanking you

Yours truly

Syed Sajid Ali
Director Technical Services

Encl. As above.

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SECTIONAL INDEX

4. PRACTICE ADMINISTRATION AS CHARTERED ACCOUNTANTS

- 4.01 Association with different firms.
- 4.02 Offices to be manned by Chartered Accountants
- 4.03 Partnership firms to send particulars in the prescribed proforma.
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- 4.05 No ban on styling firm against member's name occupying high Government positions.
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- 4.07 Use of designation 'Auditors' by practising firms prohibited.
- 4.08 Sleeping partners of professional firms not to sign form 'C'.
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- 4.10 (Withdrawn)
- 4.11 Permission to refer to association or affiliation with Foreign Firms on stationery etc. of practising firms.
- 4.12 Attestation of Partnership Deed for submission to the Institute.
- 4.13 Quality Control Review Programme
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- 4.15 Quality Control Review
- 4.16 Directive on exempted services for auditors of listed companies

DIRECTIVE ON EXEMPTED SERVICES FOR AUDITORS OF LISTED COMPANIES

In pursuance of the Directive dated May 10, 2002 issued by the Securities and Exchange Commission of Pakistan to the stock exchanges, the Council of the Institute of Chartered Accountants of Pakistan, in exercise of the powers conferred on it under section 15 read with Section 2(2)(iv) of the Chartered Accountants Ordinance, 1961 and with the prior approval of the Securities and Exchange Commission of Pakistan, is pleased to direct that effective May 31, 2002, Chartered Accountants in practice shall not, either directly or through a person associated with such Chartered Accountants in practice, render any services to such listed companies of which they are auditors under section 252 of the Companies Ordinance, 1984 other than the following services (here-in-after referred to as "exempted services"):

1. Attestation, certifications, special purpose audits/reviews and agreed-upon procedures as defined in the International Standards on Auditing (ISAs).
2. Taxation services
3. Opinion on accounting standards
4. Information Risk Management (IRM) Assurance and Risk Management Reviews
5. Corporate law compliance services including representation before authorities.
6. Financial due diligence exercise in relation to acquisitions and mergers

Provided that an auditor of a listed company or a person associated with him may continue to provide services, other than the above exempted services, under the contracts / arrangements with such listed companies, of which they are auditors, entered into up to May 31, 2002, until the expiry of such contracts / arrangements or June 30, 2003, whichever is earlier.

Provided further that an auditor of a listed company or a person associated with him rendering share registration services (transfer agents) to its listed audit clients may continue to provide such services under existing or renewed contracts / arrangements until June 30, 2003.

Provided further that a Chartered Accountant in practice shall not accept any appointment or continue as an auditor of a listed company if a person associated with such auditor is, or has been, at any time during the preceding three months engaged as a consultant or advisor or has provided any service (other than exempted services), including services related to the designing of accounting systems or compilation of accounts. This restriction shall not apply to a person associated with such auditor in respect of services provided prior to May 31, 2002.

Explanation: For the purposes of this directive the expression "associated with such auditor" shall mean any person associated with the auditor, if the person:-

- a) is a partner in a firm or is a director in a company or holds or controls shares carrying more than twenty percent of the voting power in a company, and the auditor is also partner of that firm or is a director in that company or so holds or controls shares in such company; or
- b) is a company or body corporate in which the auditor is a director or holds or controls shares carrying more than twenty percent of the voting power in that company or has other interest to that extent".

The Council's directive contained in paragraph 9.5 of the Code of Ethics for Chartered Accountants (6.04) shall be deemed to have been modified to the extent aforesaid.

(151st meeting of the Council held on April 26-27, 2002 and Resolution by Circulation dated May 7, 2002)

Appointments in Companies

- 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.

Commentary

It is common practice to prohibit chartered accountants in public practice in such situations being appointed as auditors of the companies concerned. It is also clearly desirable that they should not accept from such companies other assignments on which an opinion is required. In the situation described above, it is suggested that the period immediately preceding the assignment should be no less than the years as required by appropriate legislation.

Provision of other Services to Audit Clients

- 9.5 When a chartered accountant in practice, in addition to carrying out an audit or other reporting function, provides other services to a client, care should be taken not to perform management functions or make management decisions, responsibility for which remains with the board of directors and management.

Commentary

It is economic in terms of skill and effort for chartered accountants in practice to be able to offer other financial and management consultancy services to their clients since they already have a close familiarity with the clients' businesses. Many companies (particularly the smaller ones) would be adversely affected if they were denied the right to obtain the other services from their auditors. In the course of performing their professional services chartered accountants in practice offer advice, for example, particularly in the case of smaller businesses, the audit of the accounts and advice on the provision to be made for taxes are often so inextricably linked that they cannot be separated. Moreover, one key concept in auditing involves examination of the system of internal control which necessarily involves suggestions for improvement. For these reasons it is impracticable to define the limitations on the advice which a chartered accountant in practice may give.

The services provided by a chartered accountant in practice in the fields of management consultancy and taxation are advisory services. Such services should not usurp the management functions of client companies.

The independence of a chartered accountant in practice is not impaired by offering advisory services, provided there is no involvement in responsibility assumed for management decisions. The provision of other professional services is not in principle a factor in determining whether the chartered accountant in practice is independent. Nevertheless, the chartered accountant in practice should be careful not to go beyond the advisory function into the management sphere. A chartered accountant in practice who has advised on the installation of a stock recording system should carry out a normal audit review on the working of the system as failure to take all normal audit steps in relation to that system will have an adverse impact on competence and independence.

The preparation of accounting records is a service which is frequently requested of a chartered accountant in practice, particularly by smaller clients, whose businesses are not sufficiently large to employ an adequate internal accounting staff. It is unlikely that large clients need this service other than in exceptional circumstances. In all cases in which independence is required and in which a chartered accountant in practice is concerned in the preparation of accounting records for a client the following requirements should be observed:-

- (a) The chartered accountant in practice should not have any relationship or combination of relationships with the client or any conflict of interest which would impair integrity or independence.
- (b) The client should accept responsibility for the statements.
- (c) The chartered accountant in practice should not assume the role of employee or of management conducting the operations of an enterprise.
- (d) Staff assigned to the preparation of accounting records ideally should not participate in the examination of such records. The fact that the chartered accountant in practice has processed or maintained certain records does not eliminate the need to make sufficient audit tests.

* Please see page 32A and 32B.

Personal and Family Relationships

9.6 Personal and family relationships can affect independence. There is a particular need to ensure that an independent approach to any assignment is not endangered as a consequence of any personal or family relationship.

Commentary

It is recognized that it would be impracticable to attempt to prescribe in detail in ethical requirements the permissible extent of a personal relationship between a chartered accountant in practice and a client or those occupying responsible executive positions (e.g., chief executive, financial officer or another employee in a similar position) with a client.

* “However effective May 31, 2002, Chartered Accountants in practice shall not, either directly or through a person associated with such Chartered Accountants in practice, render any services to such listed companies of which they are auditors under section 252 of the Companies Ordinance, 1984 other than the following services (here-in-after referred to as “exempted services”):

1. Attestation, certifications, special purpose audits/reviews and agreed-upon procedures as defined in the International Standards on Auditing (ISAs).
2. Taxation services.
3. Opinion on accounting standards.
4. Information Risk Management (IRM) Assurance and Risk Management Reviews.
5. Corporate law compliance services including representation before authorities.
6. Financial due diligence exercise in relation to acquisitions and mergers

Provided that an auditor of a listed company or a person associated with him may continue to provide services, other than the above exempted services, under the contracts / arrangements with such listed companies, of which they are auditors, entered into up to May 31, 2002, until the expiry of such contracts / arrangements or June 30, 2003, whichever is earlier.

Provided further that an auditor of a listed company or a person associated with him rendering share registration services (transfer agents) to its listed audit clients may continue to provide such services under existing or renewed contracts / arrangements until June 30, 2003.

Provided further that a Chartered Accountant in practice shall not accept any appointment or continue as an auditor of a listed company if a person associated with such auditor is, or has been, at any time during the preceding three months engaged as a consultant or advisor or has provided any service (other than exempted services), including services related to the designing of accounting systems or compilation of accounts,. This restriction shall not apply to a person associated with such auditor in respect of services provided prior to May 31, 2002.

Explanation: For the purposes of this directive the expression “associated with such auditor” shall mean any person associated with the auditor, if the person:-

- a) is a partner in a firm or is a director in a company or holds or controls shares carrying more than twenty percent of the voting power in a company, and the auditor is also partner of that firm or is a director in that company or so holds or controls shares in such company; or

- b) is a company or body corporate in which the auditor is a director or holds or controls shares carrying more than twenty percent of the voting power in that company or has other interest to that extent”.

* Addition of above words within inverted commas was approved by the Council of the Institute in its 151st meeting held on April 26-27, 2002 and Resolution by Circulation dated May 7, 2002

Circular No. 05/2002
2002

July 3,

ALL MEMBERS OF THE INSTITUTE

Dear Member

CODE OF CORPORATE GOVERNANCE

As stated in paragraph 5 of our Circular No. 03/2002 dated May 18, 2002, the Professional Standards and Technical Advisory Committee of the Institute has in its meeting held on May 18, 2002 approved the issuance of following for the guidance and compliance by the members:-

1. Checklist for Code of Corporate Governance including its Introduction and Explanatory Comments
2. Review Report to the Members on Statement of Compliance with Best Practices of Code of Corporate Governance (Clause (xvi) of the Code)
3. Review Report to the Members on Half-Yearly Financial Statements (Clause (xxi) of the Code)

Format of Review Report to the Members on Half-Yearly Financial Statements has also been approved by the Securities and Exchange Commission of Pakistan vide its letter No. SECP/ICAP/EM/36/2000/117 dated July 2, 2002 as required by clause (xxi) of the Code of Corporate Governance. The scope of review of half -yearly financial statements will be as laid down in ISA 910 on *Engagements to Review Financial Statements*. Members in practice are also advised to issue an Engagement Letter, before taking up the review of half-yearly financial statements, format of which has been given in Appendix I of ISA 910.

Thanking you.

Yours truly,

Syed Sajid Ali
Director Technical Services

Encl.: as above

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

CHECKLIST FOR CODE OF CORPORATE GOVERNANCE

INTRODUCTION AND EXPLANATORY COMMENTS

1. This checklist seeks to provide guidance to the listed companies and their auditors with regard to the statement to be included by the directors and certification by auditors in their annual reports in accordance with the requirements in the Listing Regulations of the Stock Exchange relating to Code of Corporate Governance.
2. The checklist is merely a technical practice aid and in no way represents the authoritative pronouncement of the Institute. It does not aim at interpreting the requirements set out in the Listing Regulations.
3. This checklist seeks to represent minimum requirements and does not purport to be all-inclusive and would need to be constantly reviewed in the light of changes in Regulations from time to time.
4. Users of this checklist are advised to refer directly to the Code of Corporate Governance. In determining the applicability of any clause of the Regulation, its effective date should also be considered.
5. Use of the checklist requires the exercise of individual professional judgment and may require some modification based on the circumstances of individual companies.
6. Respond to each item of the checklist with a check mark (✓) in the appropriate column: Yes - indicating disclosure; No: indicating disclosure not made and N/A showing items not present or relevant.
7. Items marked "No" should be accompanied by an explanatory memorandum to document in what manner and to what extent disclosure or compliance falls short of the Listing Regulations. The explanation should be elaborate and comprehensive

CHECKLIST FOR CODE OF CORPORATE GOVERNANCE

YES NO N/A

CLIENT: _____

PERIOD: _____

BOARD OF DIRECTORS

- *1.1 Does the Board of Directors of the company include at least one Independent director as per explanation in clause (i)(b) of the Code representing institutional equity interest of a banking company, Development Financial Institution, Non-Banking Financial Institution (including a modaraba, leasing company or investment bank), mutual fund or insurance company; (Please look up S205 and Form 29) _____
- *1.2 Are executive directors, i.e. working or whole time directors, more than 75% of the elected directors including the Chief Executive ? _____
- *1.3 If answer to above is 'YES', has SECP given relaxation for this? _____
- 1.4 Have the directors of the company, at the time of filing their consent to act as such, given a declaration in such consent that they are aware of their duties and powers under the relevant law(s) and the company's Memorandum and Articles of Association and the listing regulations of the stock exchange where the company is listed. _____

QUALIFICATION AND ELIGIBILITY TO ACT AS A DIRECTOR

- 1.5 Have the directors of the company filed a declaration to the effect that :-
- a) they are not serving as a director of ten other listed companies _____
- (b) they are borne on the register of National Tax Payers (except where such person is a non-resident; and) _____
- (c) they have not been convicted by a court of competent jurisdiction as a defaulter in payment of any loan to a banking company, a Development Financial Institution or a Non-Banking Financial Institution or he, being a member of a stock exchange has not been declared as a defaulter by such stock exchange. _____
- (d) his / her spouse is not engaged in the business of stock brokerage (unless specifically exempted by the SECP) _____

* Not Mandatory

TENURE OF OFFICE OF DIRECTORS

1.6 Are the director of the company being elected after every three years. _____

RESPONSIBILITIES, POWERS AND FUNCTIONS OF BOARD OF DIRECTORS

1.7 Has a 'Statement of Ethics and Business Practices' been prepared and circulated annually by its Board of Directors to establish a standard of conduct for directors and employees, which Statement shall be signed by each director and employee in acknowledgment of his understanding and acceptance of the standard of conduct; _____

1.8 Has the Board of Directors adopted a vision/ mission statement and overall corporate strategy for the company and also formulated significant policies, as detailed in the Code of Corporate Governance having regard to the level of materiality _____

1.9 Has the Board of Directors established a system of sound internal control, which is effectively implemented at all levels within the listed company; _____

1.10 Are the following powers exercised by the Board of Directors on behalf of the company and decisions on material transactions or significant matters are documented by a resolution passed at a meeting of the Board:

(a) investment and disinvestment of funds where the maturity period of such investments is six months or more, except in the case of banking companies, Non-Banking Financial Institutions, trusts and insurance companies? _____

(b) determination of the nature of loans and advances made by the listed company and fixing a monetary limit thereof? _____

(c) write-off of bad debts, advances and receivables and determination of a reasonable provision for doubtful debts? _____

(d) write-off of inventories and other assets; and _____

(e) determination of the terms of and the circumstances in which a law suit maybe compromised and a claim/ right in favor of the listed company may be waived, released, extinguished or relinquished; _____

1.11 Are the appointment, remuneration and terms and conditions of employment of the Chief Executive Officer (CEO) and other executive _____

directors of the company determined and approved by the Board of Directors?

1.12 In the case of a modaraba or a Non-Banking Financial Institution, whose main business is investment in listed securities, has the Board of Directors approved and adopted an investment policy, as required in the Code of Corporate Governance which is stated in each annual report of the modaraba/Non-Banking Financial Institution.

1.13 Has the Chairman of a the company been preferably elected from amongst the non executive directors of the listed company.

1.14 Has the Board of Directors clearly defined the roles and responsibilities of the Chairman and Chief Executive, whether or not these offices are held by separate individuals or the same individual.

MEETINGS OF THE BOARD

1.15 Does the Chairman of the company, if present, preside over meetings of the Board of Directors.

1.16 Has the Board of Directors of the company met at least once in every quarter of the financial year.

1.17 Have the written notices (including agenda) of meetings been circulated not less than seven days before the meetings, except in the case of emergency meetings, where the notice period might have been reduced or waived?

1.18 Has the Chairman of the company ensured that minutes of meetings of the Board of Directors are appropriately recorded and circulated not later than 30 days thereof unless a shorter period is provided in the Company's Articles of Association.

SIGNIFICANT ISSUES TO BE PLACED FOR DECISION BY THE BOARD OF DIRECTORS

1.19 Are the significant issues as detailed in the Code being placed for the information, consideration and decision of the Boards of Directors of the companies.

ORIENTATION COURSES

1.20 Has the company made appropriate arrangements to carry out orientation courses for its directors to acquaint them with their duties and responsibilities and enable them to manage the affairs of the company.

CHIEF FINANCIAL OFFICER (CFO) AND COMPANY SECRETARY

APPOINTMENT AND APPROVAL

- 1.21 Have the appointment, remuneration and terms and conditions of employment of the Chief Financial Officer (CFO), the Company Secretary and the head of internal audit of the company being determined by the CEO with the approval of the Board of Directors. _____

- 1.22 Have the CFO or the Company Secretary of the company been removed except by the CEO with the approval of the Board of Directors. _____

QUALIFICATION OF CFO AND COMPANY SECRETARY

- 1.23 Is the CFO of a the company a:
 - (a) member of a recognized body of professional accountants; or _____

 - (b) graduate from a recognized university or equivalent, having at least five years experience in handling financial or corporate affairs of a listed public company or a bank or a financial institution. _____

- 1.24 Is the Company Secretary a:
 - (a) a member of a recognized body of professional accountants; or _____

 - (b) a member of a recognized body of corporate/ chartered secretaries; or _____

 - (c) a lawyer; or _____

 - (d) a graduate from a recognized university or equivalent, having at least five years experience of handling corporate affairs of a listed public company or corporation. _____

REQUIREMENT TO ATTEND BOARD MEETINGS

- 1.25 Do the CFO and the Company Secretary of the company attend meetings of the Board of Directors. _____

CORPORATE AND FINANCIAL REPORTING FRAMEWORK

THE DIRECTORS' REPORT TO SHAREHOLDERS

- 1.26 Have the directors of the company included statements to the

following effect in the Directors' Report, prepared under section 236 of the Companies Ordinance, 1984:

- (a) The financial statements, prepared by the management of the company, present fairly its state of affairs, the result of its operations, cash flows and changes in equity. _____
- (b) Proper books of account of the company have been maintained. _____
- (c) Appropriate accounting policies have been consistently applied in preparation of financial statements and accounting estimates are based on reasonable and prudent judgment. _____
- (d) International Accounting Standards, as applicable in Pakistan, have been followed in preparation of financial statements and any departure there from has been adequately disclosed. _____
- (e) The system of internal control is sound in design and has been effectively implemented and monitored. _____
- (f) There are no significant doubts upon the company's ability to continue as a going concern. _____
- (g) There has been no material departure from the best practices of corporate governance, as detailed in the listing regulations. _____

1.27 Has the Directors' Reports of the company also included the following, where applicable:-

- (a) If the company is not considered to be a going concern, the fact along with reasons have been disclosed. _____
- (b) Significant deviations from last year in operating results of the Company have been highlighted and reasons thereof explained. _____
- (c) Key operating and financial data of last six years has been Summarized. _____
- (d) If the company has not declared dividend or issued bonus Shares for any year, the reasons thereof have been given. _____
- (e) Where any statutory payment on account of taxes, duties, Levies and charges is outstanding, the amount together with a Brief description and reasons for the same have been Disclosed. _____

- | | | | | |
|-------|---|-------|-------|-------|
| (f) | Significant plans and decisions, such as corporate Restructuring, business expansion and discontinuance of Operations, have been outlined along with future prospects, Risks and uncertainties surrounding the company. | _____ | _____ | _____ |
| (g) | A statement as to the value of investments of provident, gratuity and pension funds, based on their respective audited accounts, has been included. | _____ | _____ | _____ |
| (h) | The number of Board meetings held during the year and Attendance by each director has been disclosed. | _____ | _____ | _____ |
| (i) | Has the pattern of shareholding been reported to disclose the Aggregate number of shares (along with name wise details) Where required, held by: | _____ | _____ | _____ |
| (i) | associated companies, undertakings and related parties (name wise details); | _____ | _____ | _____ |
| (ii) | NIT and ICP (name wise details); | _____ | _____ | _____ |
| (iii) | directors, CEO and their spouses and minor children (name wise details); | _____ | _____ | _____ |
| (iv) | executives; | _____ | _____ | _____ |
| (v) | public sector companies and corporations; | _____ | _____ | _____ |
| (vi) | banks, Development Finance Institutions, Non-Banking Finance Institutions, insurance companies, modarabas and mutual funds; and | _____ | _____ | _____ |
| (vii) | shareholders holding ten percent or more voting interest in the listed company (name wise details). | _____ | _____ | _____ |
| (j) | Have trades in the shares of the company, carried out by its Directors, CEO, CFO, Company Secretary and their spouses and minor children been disclosed. | _____ | _____ | _____ |

FREQUENCY OF FINANCIAL REPORTING

- | | | | | |
|------|--|-------|-------|-------|
| 1.28 | Are the quarterly unaudited financial statements of the company being published and circulated along with directors' review on the affairs of the company. | _____ | _____ | _____ |
| 1.29 | Have the half-yearly financial statements of the company been Suaquated to a limited review by the statutory auditors. | _____ | _____ | _____ |

- 1.30 Has the company immediately disseminated to the SECP and the stock exchange on which its shares are listed all material information relating to the business and other affairs of the listed company that will affect the market price of its shares according to the mode of dissemination of information as prescribed by the stock exchange on which shares of the company are listed?

RESPONSIBILITY FOR FINANCIAL REPORTING AND CORPORATE COMPLIANCE

- 1.31 Were the financial statement presented to the Board duly signed by Chief Executive Officer and Chief Financial Officer of the company and issued and circulated after Board's approval. _____

- 1.32 Has the Secretarial Compliance Certificate been filed with the annual return of the company? _____

AUDIT COMMITTEE

COMPOSITION

- 1.34 Has the Board of Directors of the company established an Audit Committee which: _____

Comprises not less than three members, including the chairman. Are the majority of the members of the Committee from amongst the non-executive directors of the company. _____

- 1.35 Are the names of members of the Audit Committee disclosed in each annual report of the company? _____

FREQUENCY OF MEETINGS

- 1.36 Is the Audit Committee of the company meeting at least once every quarter of the financial year. _____

- 1.37 Have the above meetings been held prior to the approval of interim results of the listed company by its Board of Directors and before and after completion of external audit. _____

- 1.38 Has a meeting of the Audit Committee been held with the external auditors without the CFO and head of internal audit being present? _____

ATTENDANCE AT MEETINGS

- 1.39 Have the CFO, the head of internal audit and a representative of the external auditors attended meetings of the Audit Committee at which issues relating to accounts and audit are discussed?

1.40 Has at least once a year, the Audit Committee met the external auditors without the CFO and the head of internal audit being present?

1.41 Has at least once a year, the Audit Committee met the head of internal audit and other members of the internal audit function without the CFO and the external auditors being present?

TERMS OF REFERENCE

1.42 Has the Board of Directors of the company determined the terms of reference of the Audit Committee as detailed in paragraph (xxxiii) of the Code?

REPORTING PROCEDURE

1.43 Has the Audit Committee of the company appointed a secretary of the Committee.

1.44 Has the secretary circulated minutes of meetings of the Audit Committee to all members, directors and the CFO within a fortnight.

INTERNAL AUDIT

1.45 Is there an internal audit function in the company.

1.46 Have internal audit reports been provided for your review. Have any major findings in relation to the reports been discussed with the Audit Committee.

COMPLIANCE WITH THE CODE OF CORPORATE GOVERNANCE

1.47 Has the company published and circulated a statement along with its annual report to set out the status of their compliance with the best practices of corporate governance set out above.

REVIEW REPORT TO THE MEMBERS ON STATEMENT OF COMPLIANCE WITH BEST PRACTICES OF CODE OF CORPORATE GOVERNANCE

We have reviewed the Statement of Compliance with the best practices contained in the Code of Corporate Governance prepared by the Board of Directors of ----- Ltd. to comply with the Listing Regulation No. ----- of the ----- Stock Exchange where the Company is listed.

The responsibility for compliance with the Code of Corporate Governance is that of the Board of Directors of the Company. Our responsibility is to review, to the extent where such compliance can be objectively verified, whether the Statement of Compliance reflects the status of the Company's compliance with the provisions of the Code of Corporate Governance and report if it does not. A review is limited primarily to inquiries of the Company personnel and review of various documents prepared by the Company to comply with the Code.

As part of our audit of financial statements we are required to obtain an understanding of the accounting and internal control systems sufficient to plan the audit and develop an effective audit approach. We are not required to consider whether the Board's statement on internal control covers all risks and controls, or to form an opinion on the effectiveness of such internal controls, the Company's corporate governance procedures and risks.

Based on our review *except for the matters noted in the previous paragraph(s), nothing has come to our attention which causes us to believe that the Statement of Compliance does not appropriately reflect the Company's compliance, in all material respects, with the best practices contained in the Code of Corporate Governance.

Date

AUDITOR

Address

* In case of deviation

REVIEW REPORT TO THE MEMBERS

We have reviewed the annexed balance sheet ofas at, and the related profit and loss account, cash flow statement and statement of changes in equity together with the notes forming part thereof (here-in-after referred to as the “financial statements”) for the half-year then ended. These financial statements are the responsibility of the Company’s management. Our responsibility is to issue a report on these financial statements based on our review.

We conducted our review in accordance with the International Standard on Auditing applicable to review engagements. This Standard requires that we plan and perform the review to obtain moderate assurance as to whether the financial statements are free of material misstatement. A review is limited primarily to inquiries of company personnel and analytical procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Based on our review, nothing has come to our attention that causes us to believe that the annexed financial statements are not presented fairly, in all material respects, in accordance with approved accounting standards as applicable in Pakistan.

Date

AUDITOR

Address

Circular No. 06/2002
2002

July 13,

ALL MEMBERS OF THE INSTITUTE

Dear Member

PRESERVATION OF ACCOUNT AND AUDIT RECORDS

In supercession of circulars No. TAC/96 dated June 29, 1996 and 2/98 dated July 27, 1998 the Professional Standards and Technical Advisory Committee of the Institute in its meeting held on May 18, 2002 has decided to issue the following circular on the above subject for the guidance of members:-

1. Preservation of accounts records:-

Different statutes prescribe different periods for the preservation of accounts records.

With a view to facilitating the members, the preservation period prescribed by various statutes is given below:-

S. No.	Legal Enactments	Relevant Section	Years
i.	The Companies Ordinance, 1984	230 (6)	10
ii.	The Income Tax Ordinance, 2001	174 (3)	05
iii.	The Banking Companies Ordinance, 1962	-	as that
iv.	The Insurance Ordinance, 2000 prescribed	-	
v.	The Modaraba Companies and Modaraba (Floatation & Control) Ordinance, 1980 Ordinance, 1984	-	in the Companies

There appears to be no mandatory requirements in respect of serial numbers iii, iv and v above. However, the practice is to retain accounting records for a minimum period of ten years. Provisions of Section 503 of the Companies Ordinance, 1984 provide applicability of the Companies Ordinance, 1984 to companies governed by special enactments. Hence, Section 230 (6) of the Companies Ordinance, 1984 is applicable to these companies.

2. Preservation of audit working papers:-

Following paragraph 13 of ISA 230 on *Documentation* is very clear on the subject and needs no clarification:-

“The auditor should adopt appropriate procedures for maintaining the confidentiality and safe custody of the working papers and for retaining them for a period sufficient to meet the needs of the practice and in accordance with legal and professional requirements of record retention.”

Thanking you.

Yours truly,

Syed Sajid Ali
Director Technical Services

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Circular No. 07/2002
2002

August 31,

ALL MEMBERS OF THE INSTITUTE

Dear Member

CODE OF CORPORATE GOVERNANCE

The Council of the Institute by a Resolution by Circulation dated August 20, 2002 has approved the recommendation of the Professional Standards & Technical Advisory Committee to amend paragraph 3 of the Review Report to the Members on Statement of Compliance with Best Practices of Code of Corporate Governance.

Revised Review Report is as follows (Deletions have been struck off and additions have been underlined):-

REVIEW REPORT TO THE MEMBERS ON STATEMENT OF COMPLIANCE WITH BEST PRACTICES OF CODE OF CORPORATE GOVERNANCE

We have reviewed the Statement of Compliance with the best practices contained in the Code of Corporate Governance prepared by the Board of Directors of ----- Ltd. to comply with the Listing Regulation No. ----- of the ----- Stock Exchange where the Company is listed.

The responsibility for compliance with the Code of Corporate Governance is that of the Board of Directors of the Company. Our responsibility is to review, to the extent where such compliance can be objectively verified, whether the Statement of Compliance reflects the status of the Company's compliance with the provisions of the Code of Corporate Governance and report if it does not. A review is limited primarily to inquiries of the Company personnel and review of various documents prepared by the Company to comply with the Code.

As part of our audit of financial statements we are required to obtain an understanding of the accounting and internal control systems sufficient to plan the audit and develop an effective audit approach. ~~We are not required to consider whether the Board's statement on internal control covers all risks and controls, or to form an opinion on the effectiveness of such internal controls, the Company's corporate governance procedures and risks.~~ We have not carried out any special review of the internal control system to enable us to express an opinion as to whether the Board's statement on internal control covers all controls and the effectiveness of

such internal controls.

Contd. Page 2

- 2 -

Based on our review *except for the matters noted in the previous paragraph(s), nothing has come to our attention which causes us to believe that the Statement of Compliance does not appropriately reflect the Company's compliance, in all material respects, with the best practices contained in the Code of Corporate Governance.

Date

AUDITOR

Address

* In case of deviation

Thanking you.

Yours truly,

Syed Sajid Ali
Director Technical Services

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ALL MEMBERS OF THE INSTITUTE

Dear Member

TRANSFER PRICING AND OVER-/UNDER-INVOICING

A question has been raised regarding over-/under-invoicing and transfer pricing in the corporate sector. (Copy of SECP letter dated July 16, 2002 enclosed).

As the issue has an impact on almost all industries, it has been decided to obtain our members comments on the matter before formulating any guidelines and reporting requirements.

Following are the concerns to be addressed: -

- The practice of over- or under-invoicing by companies during procurement or sale of raw materials, fixed assets or finished products and the use of agents or sponsor-owned/controlled entities to indulge in transfer-pricing to achieve this, leads to a distortion of the true and fair view of the business in the financial statements.
- Whether:
 1. the problems of over-or under- invoicing and transfer pricing can be addressed by including adequate steps in the audit procedures to ensure independent verification by the auditors.
 2. the standard audit report or a supplemental audit report should state whether or not the auditor has applied adequate checks to determine that there had been no over-invoicing or under-invoicing or transfer-pricing involved in any material purchases or sales of the company and in the event the auditor has not been able to do so, the reasons to be stated.
 3. the auditor should certify that adequate checks have been applied to determine the possible effects of transfer pricing and over-/ under-invoicing.

The members are requested to consider the impact of the above in their respective areas and send their comments (if any) within 10 days of the receipt of this Circular. The Institute on consideration of your comments may formulate its final recommendations for the issue of any guidelines and reporting requirements on the said matter.

Thanking you.

Yours truly,

Syed Sajid Ali
Director Technical Services

Encl. as above

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Khalid A. Mirza
Chairman

CS/ICAP/ED-109/2002
July 16, 2002

Mr. A. Husain A. Basrai
President
The Institute of Chartered Accountants of Pakistan
Chartered Accountants Avenue, Clifton
KARACHI-75600

Dear Mr. Basrai,

We would like to draw your attention to certain prevalent practices of over-invoicing and transfer-pricing in the corporate sector, which in our view have not received adequate attention from the accounting profession. The practice of over or under-invoicing by companies during procurement or sale of raw materials, fixed assets or finished products and the use of agents or sponsor-owned/controlled entities to indulge in transfer-pricing to achieve this, leads to a distortion of the 'true and fair' view of the businesses in their financial statements.

We strongly urge ICAP to address the problem of over-invoicing and transfer-pricing by including adequate steps in the audit procedures to ensure independent verification by the auditors. The standard audit report or a supplemental report can, for example, state whether or not the auditor had applied adequate checks to determine that there had been no over-invoicing or under-invoicing and no transfer-pricing involved in any material purchases or sales of the company. In the event, the auditor has not been able to do so, the reasons must be stated.

In an age of spectacular corporate failures and accounting scandals, we have to be doubly careful and take all necessary steps to ensure that listed companies are properly governed and their state of affairs are accurately reported to the general public. Otherwise, investor confidence will be adversely affected. In the context of Pakistan, a true and fair view is impossible to obtain unless due cognizance is taken of transfer-pricing and over and under-invoicing which are known to be rampant in the corporate sector, even among multi-nationals.

An auditor should certify that adequate checks have been applied to determine the possible effect of these ills, if any. I would urge ICAP to look into this matter and come up with appropriate guidelines and reporting requirements in this connection.

Yours sincerely,

(Khalid A. Mirza)

ALL MEMBERS OF THE INSTITUTE

Dear Member,

REVIEW OF AUDITING TECHNICAL RELEASES , REVISION OF TR-22 ON BOOK VALUE PER SHARE AND ISSUANCE OF A NEW TR-29 ON CARRY-OVER-TRANSACTIONS (COT)

A - AUDITING TECHNICAL RELEASES

The Technical Advisory Committees and the Professional Standards & Technical Advisory Committee of the Institute have carried out a thorough review of all Auditing Technical Releases keeping in view the latest International Standards on Auditing issued in the last couple of years.

It was noted that ATR-2 and ATR-5 already stand withdrawn as having been merged with the Code of Ethics for Chartered Accountants.

The Committees recommended that out of remaining fourteen Auditing Technical Releases, four ATRs should be withdrawn immediately and two ATRs later on when the revised Chartered Accountants Ordinance and Bye-Laws become operative. They also recommended a standard format for the remaining ATRs. These recommendations were approved by the Council in its 151st meeting held on 26 and 27 April, 2002.

The Auditing Technical Releases approved for immediate withdrawal are :-

- ATR-3 Incoming auditors to help in clearing professional dues of retiring auditors
- ATR-4 Audit of government corporations
- ATR-7 Some glaring omissions by the auditors pointed out by Corporate Law Authority
- ATR-10 Communication of consent by incoming auditors

Following ATRs will be withdrawn as and when the revised Chartered Accountants Ordinance and Bye-Laws become effective:-

- ATR-1 Only members to sign audit documents
- ATR-9 Signing of correspondence and financial statements by members

Following reformatted Auditing Technical Releases are enclosed along with a revised Sectional Index which the members are requested to file in Members' Handbook, Volume II, Part II, Section C:-

- ATR-6 Audit by ex-employees
- ATR-8 Preparation of accounts from incomplete records and report thereon as auditors
- ATR-11 Appointment of auditors-I
- ATR-15 Qualification in auditor's report-going concern assumption for organization formed with a limited life

There is no change in the following ATRs:-

- ATR-12 Appointment of auditors-II
- ATR-13 Lien on books of accounts due to non-payment of professional dues
- ATR-14 Minimum hourly charge out rates for audit work by practising members
- ATR-16 Acceptance of audit assignments by new auditor(s) when audit fee of existing auditors(s) is outstanding

B - REVISION OF TR-22

The Council of the Institute in its 151st meeting held on April 26-27, 2002 has also accepted the Professional Standards & Technical Advisory Committee's recommendation to revise TR-22 on Book Value Per Share.

A copy of revised TR-22 is enclosed, which the members are requested to file in Members' Handbook Volume II, Part I, Section-C.

C - ISSUE OF TR-29

The Council of the Institute in its 152nd meeting held on July 19-20, 2002 has accepted the Professional Standards & Technical Advisory Committee's recommendation to issue a new TR-29 on Carry-Over-Transactions (COT).

A copy of new TR-29 is enclosed, which the members are requested to file along with a new Sectional Index in Members' Handbook Volume II, Part I, Section-C.

Thanking you.

Yours truly,

Syed Sajid Ali
Director Technical Services

Encl. As above

SECTIONAL INDEX

PART II SECTION C

TECHNICAL RELEASES

ATR-1	Only members to sign audit documents
ATR-2	Withdrawn
ATR-3	Withdrawn
ATR-4	Withdrawn
ATR-5	Withdrawn
ATR-6	Audit by ex-employees (Reformatted 2002)
ATR-7	Withdrawn
ATR-8	Preparation of accounts from incomplete records and report thereon as auditor (Reformatted 2002)
ATR-9	Signing of correspondence and financial statements by members
ATR-10	Withdrawn
ATR-11	Appointment of auditors-I (Reformatted 2002)
ATR-12	Appointment of auditors-II
ATR-13	Lien on books of accounts due to non-payment of professional dues
ATR-14	Minimum hourly charge out rates for audit work by practising members (Revised)
ATR-15	Qualification in Auditor's Report-Going Concern Assumption for organization formed with a limited life (Reformatted 2002)
ATR-16	Acceptance of Audit Assignments by New Auditor(S) when Audit Fee of Existing Auditor(S) is Outstanding

AUDIT BY EX-EMPLOYEES

The Issue

Whether an ex-employee of an enterprise can take up audit of that enterprise for the period when he was their employee.

Technical Committee's Recommendations

Section 254(3)(a) and (b) of the Companies Ordinance, 1984 has already laid down following restrictions on audit of a company by its ex-employees: -

None of the following persons shall be appointed an auditor of the company, namely: -

- (a) a person who is or at any time during the preceding three years was, a director, other officer or employee of the company;
- (b) a person who is a partner of, or in the employment of, a director, officer or employee of the company;

The above restriction is also covered in section 9.4 of the Code of Ethics in case of companies.

Members in practice should observe a similar restraint in case of employers other than companies.

PREPARATION OF ACCOUNTS FROM INCOMPLETE RECORDS AND REPORT THEREON AS AUDITORS**The Issue**

Can practising auditors act as accountants and auditors for the same company/client even if they have prepared accounts from incomplete records?

Definition of incomplete records:

All vouchers, cheques and other details are available but are not recorded in books such as cashbook, ledger etc.

Technical Advisory Committee Recommendations

It is not uncommon for accountants, acting as auditors of companies, to provide concurrently other professional services for the same client, including the writing-up of books of account and the preparation of final accounts. This does not relieve the officers and directors of the company from their statutory and financial responsibilities. It is their responsibility to see that proper books of account are kept and that accounts giving a true and fair view are prepared. Auditors performing accounting services act in that connection in a separate capacity of accountants, but while this may assist them in carrying out their auditing duties, it in no way impinges on or modifies their responsibility and duties as auditors. Dual responsibilities as accountants and auditors are not regarded as necessarily incompatible professionally nor are they prohibited by law, but all practising auditors have to bear in mind that certain "judgements" are exercised while performing the accounting function and in this regard they should either ensure segregation of function or should not undertake accounting assignments which would impair their independence as auditors.

Note: The restrictions on certain non-audit services to audit clients being listed companies shall, however, prevail over this ATR to the relevant extent.

AUDITING

ATR-11 (Reformatted 2002)

APPOINTMENT OF AUDITORS

1. This Technical Release supersedes ATR-11 "Appointment of Auditors" issued on July 10, 1982.

2. The Issue

The ATR seeks to explain certain aspects relating to the appointment of auditors.

3. Raison d'être

Additional clarifications/guidance in respect of following matters are required.

- (a) What shall be the procedure if no auditors are appointed at an annual general meeting?
- (b) Can retiring auditors continue to hold office, if no auditors are appointed at an annual general meeting?
- (c) In case of default in complying with the provisions of section 252 of the Companies Ordinance 1984 (the Ordinance) and no auditors are appointed until the next annual general meeting,
 - (i) can an auditor or auditors appointed at the next annual general meeting be considered auditors for the period from the conclusion of last annual general meeting?
 - (ii) Whether the incoming auditor or auditors are required to communicate with the retiring auditor or auditors at the last annual general meeting ?
- (a) Can an auditor or auditors audit pending accounts of a Company?
- (b) In case no auditors are appointed at an annual general meeting and also the accounts are not prepared before the meeting, can the retiring auditors continue to hold the office to complete the audit of the accounts which is in progress.

3. Technical Committee's Recommendations

- 4.1 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.

Further sub section (6) of section 252 of the Ordinance requires that, where at an annual general meeting no auditors are appointed, the Securities and Exchange Commission of Pakistan (the Commission) may appoint a person to fill the vacancy.

Whenever such situation arises, the Company under sub section (7) of section 252 of the Ordinance is required to give notice of that fact to the Commission, within one week of the Commission's power becoming exercisable. The remuneration of auditors so appointed shall be fixed by the Commission.

In case of default by a company in complying with any of the provision of section 252 of the Ordinance, the company and every officer of the company who is knowingly and willfully a party to the default shall be punishable with fine which may extend to two thousand rupees. (Section 259)

- 4.2 As explained in para 4.1 above, only the Commission can appoint an auditor or auditors if no auditors are appointed at an annual general meeting. Therefore retiring auditors can not continue to hold the office.

4.3 In case of continuing default in complying with the provision of section 252 of the Ordinance, the office of auditors shall remain vacant and auditors appointed at the next annual general meeting can not be considered auditor for the default period. Further the company shall remain at default in complying with the requirements of section 252 of the Ordinance.

Although the office of auditors remained vacant and there are no retiring auditors, the incoming auditors should communicate with the retiring auditors of the last annual general meeting.

4.4 Since the auditors are appointed for a period up to the conclusion of the next annual general meeting, they can audit more than one year's accounts during their period in the office. However such situation can only arise if a company fails to prepare and present the accounts at the annual general meeting as required under section 230 of the Ordinance. Under sub-section (6) of the section 233 of the Ordinance, any person who is a party to the default in complying with this requirement shall:

(a) in respect of a listed company, be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than ten thousand rupees nor more than twenty thousand rupees, and a further fine which may extend to two thousand rupees for every day after the first during which the default continues; and

(b) in respect of any other company, be punishable with imprisonment for a term, which may extend to six months and with fine, which may extend to five thousand rupees.

4.5 As explained in para 4.1 above, only the Commission can appoint an auditor or auditors if no auditors are appointed at an annual general meeting. Therefore retiring auditors cannot continue to hold the office to complete the pending audit of the accounts. In such a situation, the commission may appoint the retiring auditor to hold the office until the next annual general meeting.

QUALIFICATION IN AUDITOR'S REPORT- GOING CONCERN ASSUMPTION FOR ORGANIZATION FORMED WITH A LIMITED LIFE

The issue

Some organizations are formed for carrying out specified projects and for a relatively short life. Whether or not in such cases, the Auditor's Report be qualified near the final year's operations on the assumption that going concern concept is not appropriate.

The Technical Advisory Committee Recommendation

Paragraph 3 of revised ISA 570 on Going Concern states:-

“The going concern assumption is a fundamental principle in the preparation of financial statements. Under the going concern assumption, an entity is ordinarily viewed as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulations.”

Accordingly, in the circumstances stated, if the financial statements of the company each year disclose the activities and objective of the company, “going concern” qualification would not be necessary.

SECTIONAL INDEX

PART I SECTION C

TECHNICAL RELEASES

TR-1	Withdrawn
TR-2	Withdrawn
TR-3	Withdrawn
TR-4	Withdrawn
TR-5	IASC Standards-Council's Statement on Applicability (Reformatted - 2000)
TR-6	Fixed Assets Register (Reformatted - 2000)
TR-7	Withdrawn
TR-8	Clarification Regarding Basis of Calculation of Workers' Profit Participation Fund (Reformatted - 2000)
TR-9	Withdrawn
TR-10	Deferred Taxation
TR-11	Depreciation on Idle Fixed Assets (Reformatted - 2000)
TR-12	Debt Extinguishment
TR-13	Withdrawn
TR-14	Revaluation of Fixed Assets-Accounting Treatment (Reformatted - 2000)
TR-15	Bonus Shares-Accounting Treatment (Reformatted - 2000)
TR-16	Withdrawn
TR-17	Withdrawn
TR-18	Withdrawn
TR-19	Excise Duty-Accounting Treatment (Reformatted - 2000)

TR-20	Accounting for Expenditure During Construction Period (Reformatted - 2000)
TR-21	Date of Commencement of Commercial Production (Reformatted - 2000)
TR-22	Book Value Per Share (Revised - 2002)
TR-23	Accounting for Investments (Revised-1998)
TR-24	Exchange Risk Fee-Accounting Treatment (Reformatted - 2000)
TR-25	Prudential Regulations for Banks (Reformatted - 2000)
TR-26	Withdrawn
TR-27	IAS 12, Accounting for Taxes on Income
TR-28	Golden Handshake-Accounting for
TR-29	Carry-Over-Transactions (COT)

BOOK VALUE PER SHARE**THE ISSUE**

Different practices and policies are being used for computing book value (commonly known as break-up value in Pakistan) of shares. For instance in some cases all the assets including intangibles, deferred costs and fictitious assets are included in considering the book value without regard to their recoverability. In some other cases, intangibles are excluded from the shareholders' equity. Practices also vary regarding adjustment of contingent and other losses.

TECHNICAL COMMITTEE RECOMMENDATIONS

Book value per share in the equity capital of the company is the amount each share is worth on the basis of carrying value per balance sheet, prepared in accordance with a framework of recognized accounting standards. Such standards provide that:-

- (a) An asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.
- (b) A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

Computation of Book Value Per Share

Book value per share is computed by dividing shareholders' equity with the number of shares issued. Shareholders' equity includes:-

- a) Paid up capital
- b) Revenue reserves and retained earnings, (less accumulated losses if any).
- c) Capital reserves

Where the auditors have issued a qualified report and the qualification has been quantified in monetary terms, that amount should be deducted from equity.

Where the qualification is not quantified then the members issuing a certificate regarding book value should mention this fact in the certificate.

- d) Surplus created as a result of revaluation of fixed assets.

If the balance sheet of an entity includes balance of surplus on revaluation, the book value per share should be computed separately both, including and excluding such surplus, to enable comparability with those entities where fixed assets have not been revalued.

The book value for any specific purposes in accordance with any statute would have to be computed per requirements or criteria laid down in that respect by the concerned regulatory agency or as set out in the relevant law.

CARRY-OVER-TRANSACTIONS (COT)**THE ISSUE**

The Karachi Stock Exchange (Guarantee) Limited (KSE) had enforced Carry-Over Transactions Regulations (“the Regulations”) with effect from 11 January 1993. These regulations were introduced to enhance the stock market liquidity and parallel regulations were also enforced by the other stock exchanges of the country. Following paragraphs summarise the mechanism of COT along with its accounting treatment generally being followed.a

1. Carry over transaction, as defined in section 2(e) of the Regulations, means the combination of two transactions taking place simultaneously and settled in two clearings in sequence. According to section 4(iii) of the regulations, the buyer of shares in current clearing period (“the first transaction”) would become seller of the same shares in the immediate next clearing period (“the second transaction”) and the seller of shares in current clearing period (“the first transaction”) would become buyer of the same shares in the immediate next clearing period (“the second transaction”).
2. Buyer / Seller enters into the first transaction on Friday after normal trading hours and its settlement takes place on succeeding Wednesday through Clearing House of KSE along with settlements of normal transactions. Simultaneously, seller / buyer enters into the second transaction on the same Friday and its settlement takes place through Clearing House but on succeeding second Wednesday. However, the contract ticket of the second transaction (which is prepared on Friday) bears the date of succeeding Monday, not of Friday. Share Price of the second transaction is marked-up and generally does not match with the prevailing market quotes of the succeeding Monday. The marking-up of second transaction is dependent on demand and supply of funds in the Carry-Over Market.
3. Paragraph 10 of International Accounting Standard 39 “Financial Instruments: Recognition and Measurement” defines *“repurchase agreement (Repo) as an agreement to transfer a financial asset to another party in exchange for cash or other consideration and a concurrent obligation to reacquire the financial asset at a future date for an amount equal to the cash or other consideration exchanged plus interest”*. If we consider the series of above two Carry-Over-Transactions as a whole, its commercial effect takes form of a Repo in which lending / borrowing of funds against pledge of shares takes place for one week i.e. from Wednesday to Wednesday.
4. Paragraph 13 of the IAS 18 “Revenue” states that the *“revenue recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole”*. Paragraph 13 further gives an example of *an enterprise that may sell goods and at the same time enter into a separate agreement to repurchase the goods at a later date thus negating the substantive effect of the transaction; in such a case the two transactions are dealt with together*. However, dealing with first and second transactions separately, revenue / expense from COT is generally accounted for as capital gain / loss and not as interest income / expense.
5. Paragraph 27 of IAS 39 states that *“an enterprise should recognise a financial asset or financial liability on its balance sheet when, and only when, it becomes a party to the contractual provisions of the instrument”*. In the case of first transaction COT, generally the buyer recognises purchase of shares as investment in its balance sheet (and not recognise a lending) without considering the second transaction. However, simultaneousness of the second transaction of COT does not constitute the buyer in substance a party to the contractual provisions of the equity instrument.

6. Paragraph 35 of IAS 39 states that “an enterprise should derecognise a financial asset or a portion of a financial asset when, and only when, the enterprise loses control of the contractual rights that comprise the financial asset (or a portion of the financial asset).” Further, paragraphs 38 & 39 state that a transferor has not lost control of a transferred financial asset and, therefore the asset is not derecognised if the transferor has the right to reacquire the transferred asset unless either (i) the asset is readily obtainable in the market or (ii) the reacquisition price is fair value at the time of reacquisition. In the case of first transaction of COT, generally the seller de-recognises the investment in shares from its balance sheet (and not recognising a borrowing) without considering the second transaction. However, simultaneousness of the second transaction of COT gives the seller a right to repurchase the shares at a fixed price. Further, the respective shares are not readily obtainable in the market on succeeding Monday because their prices are fixed in advance i.e. on Friday.

Keeping in view the above practise and the form as well as substance of COT a question has arisen whether COT is a Repo or not?

TECHNICAL COMMITTEE RECOMMENDATIONS

The appropriate Committee of the Institute has examined all aspects of the query regarding Carry-Over-Transactions (COT) and is of the opinion that a Carry-Over-Transaction is a Repo transaction as the substance of the transaction and not its form should be considered and accordingly it should be treated as a financing transaction. in the books of accounts.

The aforesaid clarification provides the accounting treatment for Carry-Over-Transactions under International Accounting Standards. However for the purposes of other statutes, the transaction would have the effect according to the relevant provisions of that law.

(152nd meeting of the Council - July 19-20, 2002)

ALL MEMBERS OF THE INSTITUTE

Dear Member,

ACCOUNTING POLICY FOR DEPRECIATION ON FIXED ASSETS

A question has been raised that a number of companies follow an accounting policy for fixed assets whereby depreciation for the full year is charged on additions while no depreciation is charged on assets disposed off during the year.

If the accounting year of a company ends on, say, June 30 and it purchases items of fixed assets in the month of June, the accounting policy referred to above would result in depreciation on these additions being charged for the whole year. In case the purchases are material, the resultant depreciation charge would also be material. While depreciation for the full year would be charged the economic benefits derived from the use of these fixed assets during the year of purchase would be negligible. Similarly, when major deletions are made close to the year-end date no depreciation is charged for the year although economic benefits have been obtained during the major part of the year.

The accounting practice discussed above when viewed in the context of the cardinal principle of "matching of cost with revenue" does not appear to be in strict compliance therewith. Although those who adopt this policy give the argument and rightly so that the additional depreciation charged in the year of purchase is adjusted when no depreciation is charged in the year of disposal and the policy when applied on a consistent basis mitigates the effect of under and over-charge of depreciation expense from one period to the other. However, it is an irrefutable fact that depending on the quantum of additions and deletions the policy may lead to distortion in accounting results of the two periods.

The appropriate Committee of the Institute has examined the issue whether or not the above-referred policy of charging depreciation is correct and meets the criteria laid down in para 20 of IAS 1, and is of the opinion that the International Accounting Standards (IASs) do not recommend any specific policy on this practice. However, IAS 16 does provide that the depreciation charge must reflect appropriately the value of consumption of the respective assets economic benefits.

The adoption of the said policy, and for that matter any other policy, by the companies, deals with the allocation of depreciation expenses in the "accounting and reporting periods" in which the depreciable asset is utilized by the company. Till the very recent past, most of the companies followed "yearly" / six monthly (un-audited) accounting and reporting period. Accordingly, the said policy did not materially affect the fair presentation of the financial statements.

- 2 -

The appropriate Committee of the Institute is of the considered view that in order to improve the qualitative characteristics of the financial statements, companies should be encouraged to adopt in future a more representative policy with regard to the depreciation charge on additions / deletions of fixed assets. However, such policy may vary from company to company depending on their financial reporting requirements and the expected economic benefits of the asset and may include charging of depreciation on daily / weekly / monthly / quarterly basis.

The members are advised to encourage adoption of an appropriate depreciation policy for additions and deletions in line with the financial reporting requirements pertinent to the concerned entity.

Thanking you.

Yours truly,

Syed Sajid Ali
Director Technical Services

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ALL MEMBERS IN PRACTICE

Dear Member

GUIDANCE ON REPORTING ON GOING CONCERN ASSUMPTION:

1. The Institute while reviewing the published financial statements of listed companies has found instances where an unmodified/ unqualified auditor's report has been issued despite the fact that adequate indicators existed to suggest uncertainty regarding the appropriateness of going concern assumption and the financial statements had been prepared on a going concern basis. For example negative capital and reserves, current liabilities in excess of current assets, default in repayment of debt installments. Moreover, the directors in their report to the members did not mention any strategy to overcome the liquidity problems being faced by the company and the company's plan to manage the repayment of debts and recover losses. The financial statements also did not give any indication as to the uncertainty of going concern assumption in their notes to the accounts.

The Institute would like to remind its members that they have a duty to provide a reasonable level of care while performing work for those they serve. They will be failing in their duty if they omit to address in their report such significant matters like the fact that although the financial statements have been prepared on a going concern basis, there are clear indications that such assumptions are unfounded.

2. **GOING CONCERN ASSUMPTION CONSIDERED - APPROPRIATE**

Paragraph 32 of ISA 570 on Going Concern provides that in case where going concern assumption is appropriate, but, a material uncertainty exists, the auditor should consider whether the financial statements: -

- (a) adequately describe the principal events or conditions that give rise to the significant doubt on the entity's ability to continue in operation and management's plans to deal with these events or conditions.
- (b) state clearly that there is a material uncertainty related to events or conditions which may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

Paragraph 33 provides guidance on reporting an audit opinion where adequate disclosure is made in the financial statements:

"If adequate disclosure is made in the financial statements, the auditor should express an unqualified opinion but modify the auditor's report by adding an emphasis of matter paragraph that highlights the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern and draws attention to the note in the financial statements that discloses the matters set out in paragraph 32".

3. **GOING CONCERN ASSUMPTION CONSIDERED – DOUBTFUL**

In many instances it has been observed that a modified auditors' report has been issued where an entity's ability to continue as a going concern is considered to be in doubt. The modification is found to be in the following form:

“Without qualifying our opinion, we draw attention to Note 1 to the financial statements”.

The above modification does not appear to be sufficient to draw attention of the users of financial statements regarding the uncertainty of the going concern assumption. Members must be aware of the fact that preparation and presentation of financial statements including notes to the accounts is the responsibility of management and a disclosure in the notes to the accounts does not absolve the auditor from his/ her responsibility to appropriately report the matter in the auditor's report. Para 33 of ISA 570 “Going Concern” gives the specimen on emphasis of matter paragraph where the auditor is satisfied as to the adequacy of the disclosure note in the financial statements:-

“Without qualifying our opinion, we draw attention to Note X in the financial statements which indicates that the Company incurred a net loss of ZZZ during the year ended December 31, 20XI and, as of that date, the Company's current liabilities exceeded its total assets by ZZZ. These conditions, along with other matters as set forth in Note X, indicate the existence of a material uncertainty which may cast significant doubt about the Company's ability to continue as a going concern”.

Practicing members are advised that the auditor's report should be modified as per the prescribed format.

If the financial statements do not adequately disclose the significant uncertainty, which may cast doubt on the company's ability to continue as a going concern, a qualified or adverse opinion should be issued as required by Para 34 of ISA 570.

4. **GOING CONCERN ASSUMPTION CONSIDERED – INAPPROPRIATE**

In several cases a modified auditor's report has been issued referring to the fact that the company is no longer a going concern, while the financial statements are still presented on a going concern basis. In our view, such a modification does not appear to be sufficient considering the severity of the matter.

Members' attention is drawn to paragraph 35 of ISA 23, which states that:

“If, in the auditor's judgment, the entity will not be able to continue as a going concern, the auditor should express an adverse opinion if the financial statements have been prepared on a going concern basis”.

It further states that:

Contd. Page 3

“If on the basis of the additional procedures carried out and the information obtained, including the effect of management’s plans, the auditor’s judgment is that the entity will not be able to continue as a going concern, the auditor concludes, regardless of whether or not disclosure has been made that the going concern assumption used in the preparation of financial statements is inappropriate and expresses an adverse opinion”.

The Institute would like to advise the members in practice to ensure that the audit report is appropriately modified/qualified and a mere disclosure in the notes to the financial statements is not taken as a compliance with ISA.

5. **GOING CONCERN ASSUMPTION WHERE AN ENTITY IS NEAR THE END OF ITS PROJECT OR OPERATION FOR WHICH IT WAS FORMED**

In cases where the entity formed for carrying out specified projects or for a relatively short period of operation has reached near the end of its project or operation, following guideline should be followed.

- a) Ensure that the financial statements of the entity disclose the activities and objectives of the company.
- b) Audit report is modified to draw attention of the users towards the disclosure mentioned above. Following format may be used for the modification of the audit report.

We draw attention to Note X in the financial statements which indicates that the company was formed for a limited objective / life and is about to achieve that objective or is near its end of life, which indicates existence of a material uncertainty that the company will continue its operations beyond the stated period.

Consequent upon the issuance of this Circular, the Council of the Institute in its 154th meeting held on October 25-26, 2002 has decided to withdraw ATR – 15 on *Qualification in Auditor’s Report - Going Concern Assumption for Organization Formed with a Limited Life*

Thanking you.

Yours truly,

Syed Sajid Ali
Director Technical Services

Circular No. 12/2002
2002

November 26,

ALL MEMBERS OF THE INSTITUTE

1. **ATR-17, AUDITORS' REPORT TO THE TRUSTEES / BOARD OF GOVERNORS / MANAGEMENT COMMITTEE**
2. **ADOPTION OF ISA 545 ON AUDITING FAIR VALUES MEASUREMENTS AND DISCLOSURES**
3. **ADOPTION OF IFAC'S SUBJECT MATTER BASED NUMBERING FOR INTERNATIONAL STANDARDS ON AUDITING**

Dear Member

The Council of the Institute in its 154th meeting held on October 25-26, 2002 has decided:-

- 1) to issue enclosed ATR-17 to prescribe a standard format of Auditors' Report to the Trustees/Board of Governors/Management Committee of Societies/NGOs and Charity Organizations.
- 2) to adopt ISA 545 on Auditing Fair Values Measurements and Disclosures.
- 3) to adopt IFAC's Subject Matter Based Numbering for International Standards on Auditing for the reasons stated below:-

"Initially the numbering of Auditing Standards (AS) as adopted by ICAP and that of International Standards on Auditing (ISA) as issued by IFAC was same. For the last couple of years, the IFAC has changed the numbers to three digits instead of two digits, with ISAs on a subject matter being grouped together.

It has been noted that the difference in numbering sequence of AS and ISA is causing difficulties for the users.

The subject matter based numbering is being used in the ISA while making cross-references between ISA. For instance in para 33 of ISA 700 (adopted in Pakistan as AS 13), a reference has been made to ISA 570 (adopted as "AS 23" in Pakistan) stating:

"An illustration of an emphasis of matter paragraph relating to going concern is set out in ISA 570, "Going Concern"

It is felt that unless we adopt the IFAC numbering the cross references could not be established with uniformity and would continue to cause confusion among the users.

Another problem associated with the auditing standards is the term "Auditing Standards" used by us in Pakistan for the "International Standards on Auditing". As we adopt the ISAs in full and do not formulate our own auditing standards, it is felt that there is no need of maintaining the term "Auditing Standards" and that it may be replaced with the term "International Standards on Auditing" to bring it in line with the international practice.

Contd. Page 2

The Council has, therefore, decided that

1. The prefix AS for auditing standards be changed to ISA – International Standards on Auditing.
2. Numbering of ISA be changed to bring them in line with IFAC numbering system. (Please see annexure)

Thanking you.

Yours truly,

Syed Sajid Ali
Director Technical Services

Encl. ATR-17
Revised Numbers of ISAs
ISA-545
Sectional Index of ATR to be filed in Members' Handbook, Volume II, Part II, Section C.

**AUDITORS' REPORT TO THE TRUSTEES / BOARD OF GOVERNORS /
MANAGEMENT COMMITTEE****The Issue**

What should be the format of the auditors' report in case of audit of Societies, NGOs & Charity Organizations?

Technical Advisory Committee Recommendations

As there is no standard format of auditors' report and also there is no provision for maintenance of accounts and audit of these societies either in the Trust Act, 1882 or Societies Registration Act, 1860 the Council has approved the enclosed format of auditors' report.

Members are advised to follow the enclosed format while reporting on the financial statements of such organizations.

**AUDITORS' REPORT TO THE TRUSTEES / BOARD OF GOVERNORS / MANAGEMENT
COMMITTEE**

[SOCIETIES, NGOs & CHARITY ORGANIZATIONS]

We have audited the annexed balance sheet¹ of the _____² as at 31 December, 20X1 and the related income and expenditure account / cash receipts and disbursements account¹ together with the notes forming part thereof (here-in-after referred to as the " financial statements) for the year then ended.

These financial statements are the responsibility of the Trustees / Board of Governors / Management Committee. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements.. An audit also includes assessing the accounting policies used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

As described in Note X, the financial statements have been prepared on the cash receipts and disbursements basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles³.

In our opinion:-

- (a) the payments made and / or the expenditure incurred during the year was for the purpose of the approved objects of the organization;

- (b) where funds were received for a specific stated purpose, these have been spent for that purpose only; and
- (c) the financial statements referred to above present fairly, in all material aspects, the cash receipts and disbursements of ----- for the year ended December 31, 20X1, on the basis of accounting described in Note X.

Or

the financial statements give a true and fair view of the _____'s affairs as at 31 December 20X1 and of the results of its operations for the year then ended.

Date

Signature
[Name(s) of Auditors]

Place

NOTES

- 1. Delete whatever is not applicable.
- 2. Here give the name of the organization
- 3. This paragraph will be applicable if only a cash receipt and disbursement statement is being reported upon.

(154th meeting of Council held on October 25-26, 2002)

SECTIONAL INDEX

PART II SECTION C

TECHNICAL RELEASES

ATR-1	Only members to sign audit documents
ATR-2	Withdrawn
ATR-3	Withdrawn
ATR-4	Withdrawn
ATR-5	Withdrawn
ATR-6	Audit by ex-employees (Reformatted 2002)
ATR-7	Withdrawn
ATR-8	Preparation of accounts from incomplete records and report thereon as auditor (Reformatted 2002)
ATR-9	Signing of correspondence and financial statements by members
ATR-10	Withdrawn
ATR-11	Appointment of auditors-I (Reformatted 2002)
ATR-12	Appointment of auditors-II
ATR-13	Lien on books of accounts due to non-payment of professional dues
ATR-14	Minimum hourly charge out rates for audit work by practising members (Revised)
ATR-15	Withdrawn
ATR-16	Acceptance of Audit Assignments by New Auditor(S) when Audit Fee of Existing Auditor(S) is Outstanding
ATR-17	Auditors' Report to the Trustees/Board of Governors/Management Committee

NEW NUMBERING ANNEXURE

Given below are the Subject Matter numbers to be used by ICAP and the corresponding (superseded) AS numbers:-

IFAC Subject Matter Number	TITLE	AS (Superseded Number)
<u>INTERNATIONAL STANDARDS ON AUDITING</u>		
<u>100-199 Introductory Matters</u>		
100	Assurance Engagements	Not assigned
120	Framework of International Standards on Auditing	Not assigned
<u>200-299 Responsibilities</u>		
200	Objective and General Principles Governing an Audit of Financial Statements	AS-1
210	Terms of Audit Engagements	AS-2
220	Quality Control for Audit work	AS-7
230	Documentation	AS-9
240	The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements (Effective for periods ending on or after June 30, 2002)	AS-11
240A	Fraud and Error (Effective for periods ending on or before June 29, 2002)	
250	Consideration of Laws and Regulations in an Audit of Financial Statements	AS-31
260	Communications of Audit Matters with Those Charged with Governance	Not assigned
<u>300-399 Planning</u>		
300	Planning	AS-4
310	Knowledge of the Business	AS-30
320	Audit Materiality	AS-25
<u>400-499 Internal Control</u>		
400	Risk Assessments and Internal Control	AS-6
401	Auditing in a Computer Information Systems Environment	AS-15
402	Audit Considerations Relating to Entities Using Service Organizations	Addendum 2 to AS-6
<u>500-599 Audit Evidence</u>		
500	Audit Evidence	AS-8
501	Audit Evidence-Additional Considerations for Specific Items	Addendum to AS 8
505	External Confirmations	Not assigned
510	Initial Engagements-Opening Balances	AS-28
520	Analytical Procedures	AS-12
530	Audit Sampling and Other Selective Testing Procedures	AS-19
540	Audit of Accounting Estimates	AS-26
545	Auditing Fair Values Measurements and Disclosures	Not assigned
550	Related Parties	AS-17
560	Subsequent Events	AS-21
570	Going Concern	AS-23

IFAC Subject Matter Number	<u>TITLE</u>	AS (Superseded Number)
<u>600-699 Using Work of Others</u>		
600	Using the Work of Another Auditor	AS-5
610	Considering the Work of Internal Auditing	AS-10
620	Using the Work of an Expert	AS-18
<u>700-799 Audit Conclusions and Reporting</u>		
700	The Auditor's Report on Financial Statements (adopted with qualification that form of Auditor's Report should be in accordance with the Companies Ordinance, 1984 and other relevant laws). (Effective for periods ending on or after September 30 2002)	AS-13
700A	The Auditor's Report on Financial Statements. (Effective for periods ending on or before September 29, 2002)	AS-13A
710	Comparatives	AS-32
720*	Other Information in Documents Containing Audited Financial Statements	ISA-14*
<u>800-899 Specialized Areas</u>		
800	The Auditor's Report on Special Purpose Audit Engagements	AS-24
810	The Examination of Prospective Financial Information	AS-27
<u>900-999 Related Services</u>		
910	Engagements to Review Financial Statements	ISA/RS 1&2
920	Engagements to Perform Agreed-Upon Procedures Regarding Financial Information	ISA/RS 3
930	Engagements to Compile Financial Information	ISA/RS 4
<u>1000-1100 International Auditing Practice Statements</u>		
1000	Inter-Bank Confirmation Procedures	Not assigned
	<i>Supplements # 1-3 to Subject Matter 400:</i>	
1001	IT-Environments – Stand-Alone Personal Computers	Not assigned
1002	IT-Environments – On-Line Computer Systems	Not assigned
1003	IT-Environments – Database Systems	Not assigned
1004	The Relationship Between Bank Supervisors and External Auditors	Not assigned
1005	The Special Consideration in the Audit of Small Entities	Not assigned
1006	The Audit of International Commercial Banks	Not assigned
1008	Risk Assessments and Internal Control-CIS Characteristics and Considerations	Addendum 1 to AS-6
1009	Computer-Assisted Audit Techniques	AS-16
1010	The Consideration of Environmental Matters in the Audit	Not assigned
1012	Auditing Derivative Financial Instruments	Not assigned

* Not adopted by ICAP.

IAPS 1007 and 1011 have been withdrawn.



**The Institute of
Chartered Accountants
of Pakistan**

HEAD OFFICE

Circular No. 13/2002

November 26, 2002

ALL MEMBERS OF THE INSTITUTE

Dear Member,

The Committee on Accounting and Auditing Standards for Interest Free Modes of Financing and Investments of the Institute has developed an Exposure Draft for Islamic Financial Accounting Standards (IFAS) on Murabaha.

The Committee would like to mention that this Exposure Draft is to a large extent based on the concept and principles expounded in the book "An Introduction to Islamic Finance" by Maulana Muhammad Taqi Usmani, to whom the Committee would like to express its gratitude.

All members of the Institute are invited to offer their comments, if any, on the Exposure Draft. Comments would be more helpful if they indicate the specific paragraph or group of paragraphs to which they relate, clearly explaining the issue(s), and providing a suggestion for alternative text preferably giving rationale for the suggested change.

Members are requested to send their comments to the undersigned by December 21, 2002.

Thanking you.

Yours truly,

Syed Sajid Ali
Director Technical Services

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(Established under the Chartered Accountants Ordinance, 1961 - X of 1961)

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ISLAMIC FINANCIAL ACCOUNTING STANDARD

EXPOSURE DRAFT

IIFAS 1 MURABAHHA

**The Institute of Chartered
Accountants of Pakistan**

ISLAMIC FINANCIAL ACCOUNTING STANDARDS

IFAS 1 MURABAHA

1. Background

- 1.1 Since early eighties banks and non-banking financial institutions ("bank") in the Islamic countries have been faced with the problem of financing different sectors of economy through modes which do not contravene the injunctions of *Shariah* regarding *riba* or interest.
- 1.2 One of the most popular modes used by banks in Islamic countries to promote *riba* free transactions is Murabaha. The ratio in which this instrument is being used varies from bank to bank.
- 1.3 Basically Murabaha is a particular type of sale. Ideal mode of financing according to *Shariah* would be Mudarabah or Musharakah. However, in the perspective of the current economic set up there are certain practical difficulties in using Mudarabah and Musharakah instruments in every type of financing. Therefore, the contemporary *Shariah* experts have emphasized on Murabaha basically as a trading mode of transaction but in the contemporary context, the use of Murabaha subject to certain conditions on deferred payment basis has been allowed as a permissible mode.
- 1.4 It should be emphasized here that the instrument of Murabaha should be used as a transitory step taken in the process of the Islamization of the economy, and its use should be restricted only to those cases where the Mudarabah and Musharakah are not practicable.
- 1.5 The second important point is that the Murabaha transaction does not come into existence by merely replacing the word " interest " by the words " profit " or " mark-up ". Unless basic conditions as laid down by *Shariah* are fully observed, a Murabaha is not valid. In fact, it is the observance of these conditions, which can draw a clear line of distinction between the interest-bearing loan and a trading transaction of Murabaha. If any of these conditions is not met, the transaction ceases to be Murabaha according to *Shariah*.
- 1.6 The accounting treatment of Murabaha and its disclosure and presentation in the financial statements also varies from bank to bank.
- 1.7 Such diversity of accounting treatment and disclosure has reduced the utility of financial statements of such banks to the users of such statements.
- 1.8 Hence there is a need to formulate an accounting standard regarding Murabaha to be observed in the presentation of financial statements of banks and to promote their widest possible acceptance and observance.

1.9 Definitions

Murabaha : Murabaha is a particular kind of sale where seller expressly mentions the cost he has incurred on the commodities to be sold and sells it to another person by adding some profit or mark up thereon which is known to the buyer.

Thus Murabaha is a cost plus transaction where the seller expressly mentions the cost of a commodity sold and sells it to another person by adding mutually agreed profit thereon which can be either in lump-sum or through an agreed ratio of profit to be charged over the cost.

Inventories : Inventories are assets held for sale under Murabaha transactions in the ordinary course of business.

2. Basic *Shariah* Principles and Features of Murabaha

Basic principles governing Murabaha can be divided into three categories. Principles regarding sale, deferred payment and other principles.

2.1 Principles regarding sale

2.1.1 "Sale" is defined in *Shariah* as " the exchange of a thing of value by another thing of value with mutual consent".

2.1.2 The subject matter of sale must be existing at the time of sale.

Thus, a thing which has not yet come into existence cannot be sold. If a non-existent thing has been sold, though by mutual consent, the sale is void according to *Shariah*.

Example: A sells the unborn calf of his cow to B. The sale is void.

2.1.3 The subject matter of sale must be in the ownership of the seller at the time of sale, and he must have a good title to it.

Thus, what is not owned by the seller cannot be sold. If he sells something before acquiring its ownership, the sale is void according to *Shariah*.

Example: A sells to B a car which is presently owned by C, but A is hopeful that he will buy it from C and shall deliver it to B subsequently. The sale is void.

2.1.4 The subject matter of sale must be in the physical or constructive possession of the seller when he sells it to another person.

Examples: i) A has purchased a car from B. B has not yet delivered it to A or to his agent. A cannot sell the car to C. If he sells it before taking its delivery real or constructive from B, the

sale is void.

ii) A has purchased a car from B. B has placed the car in a garage where A has free access and B has allowed him to take the delivery real or constructive from that place whenever he wishes. The car is in the constructive possession of A. If A sells the car to C without acquiring physical possession, the sale is valid.

2.1.5 The gist of the principles mentioned in paras 2.1.2 to 2.1.4 is that a sale under Murabaha arrangement is not valid under Shariah principles unless a thing or commodity:-

- is in existence
- is owned by the seller.
- is in the physical or constructive possession of the seller.

2.1.6 The major difference between an actual sale and a mere promise to sell is that an actual sale cannot be effected unless the above three conditions are fulfilled. However one can promise to sell something which is not yet owned or possessed by him. This promise initially creates just a moral obligation on the promisor to fulfill his promise, which is normally not legally enforceable.

But the actual sale will have to be effected after the commodity comes into the possession of the seller. This will require separate offer and acceptance, and unless the sale is effected in this manner, the legal consequences of the sale shall not follow.

2.1.7 The sale must be prompt and absolute. Thus a sale attributed to a future date or a sale contingent on a future event is void. If the parties wish to effect a valid sale, they will have to effect it fresh when the future date comes or the contingency actually occurs.

2.1.8 The subject matter of sale must be a property of value. Thus, a thing having no value according to the usage or custom or trade cannot be sold or purchased. Further the subject matter of sale must be specifically known and identified to the buyer.

Explanation: The subject matter of sale may be identified either by pointation or by detailed specification which can distinguish it from other things not sold.

Example: There is a building comprising of a number of apartments built on the same pattern. A, the owner of the building says to B " I sell one of these apartments to you". B accepts it. The sale is void unless the apartment intended to be sold is specifically identified or pointed out to the buyer.

And lastly it should not be a thing which is forbidden (Haram) by *Shariah*.

2.1.9 The delivery of the sold commodity to the buyer must be certain and should not depend on a contingency or chance.

Example: A sells his car stolen by an anonymous person and the buyer purchases it under the hope that he will manage to recover it. The sale is void.

2.1.10 The absolute certainty of price is a necessary condition for the validity of a sale. If the price is uncertain, the sale is void.

Example: A says to B, "if you pay within a month, the price is Rs.50/. But if you pay after two months, the price is Rs.55/- B agrees without absolutely determining one of the two prices. In this case as the price remains uncertain the sale is void, unless anyone of the two alternatives is settled by the parties at the time of concluding the transaction.

2.1.11 The sale must be unconditional. A conditional sale is invalid, unless the condition is recognized as a part of the transaction according to the usage of or custom of trade.

Example: (1) A buys a car from B, with a condition that B will employ his son in his firm. The sale is conditional, hence invalid.

(2) A buys a refrigerator from B, with a condition that B undertake its free service for 2 years. The condition, being recognized as a part of the transaction, is valid and the sale is lawful.

2.1.12 In case of imports the issuance of bill of lading in favour of bank would be considered constructive possession.

2.2 Principles regarding deferred payment

2.2.1 A sale in which the parties agree that the payment of price shall be deferred is called a "*Bai'Mu'ajjal*".

2.2.2 *Bai'Mu'ajjal* is valid if the price and due date of payment is fixed in an unambiguous manner.

2.2.3 The due time of payment can be fixed either with reference to a particular date, or by specifying a period of time, but it cannot be fixed with reference to a future event, the exact date of which is unknown or is uncertain. If the time of payment is unknown or uncertain, the sale is void.

2.2.4 If a particular period is fixed for payment, like one month, it will deem to commence from the time of delivery, unless the parties have agreed to otherwise.

- 2.2.5 The deferred price may be more than the cash price, but it must be fixed at the time of sale.
- 2.2.6 Once the price is fixed, it cannot be decreased in case of earlier payment, nor can it be increased in case of default.
- 2.2.7 In order to ensure the buyer pays the installments promptly, he may be asked to promise that in case of a default, he will pay certain amount of penalty for a charitable purpose. Such penalty shall not constitute bank's income and shall be utilized for charitable purposes only.
- 2.2.8 If a commodity is sold on installments, the seller may put a condition on the buyer that if he fails to pay any installment on its due date, the remaining installments will become due immediately.
- 2.2.9 In order to secure the payment of price, the seller may ask the buyer to furnish a security whether in the form of a mortgage or in the form of a lien or a charge on any of his existing assets.
- 2.2.10 The buyer can also be asked to sign a promissory note or a bill of exchange which cannot be discounted or sold to a third party.

2.3 Other Principles regarding Murabaha

2.3.1 Murabaha would be valid in case a commodity is to be imported and its exact cost is unknown but the seller (bank), who is importing the commodity, and the eventual buyer (client) have agreed to some profit or margin of profit which could be on FOB or C&F cost or on the final landed cost. Further, the elements of cost to be incurred by the bank and to be included in the calculation of any of these costs have been agreed to beforehand by the client.

2.3.1.1 It is not necessary that the bank should bear full cost of import. It may make itself responsible for FOB or C&F cost only and all other duties, levies and importation charges or any part thereof may be borne by the client.

2.3.1.2 The FOB or C&F cost may be fixed beforehand with reference to a fixed or forward rate of conversion or only the foreign currency cost may be agreed to initially and the conversion to the local currency may be left to actual rate prevailing on the date of payment for import.

3.0 Modalities of Murabaha

3.1 The Murabaha should fulfill all the conditions necessary for a valid sale, i.e.:-

- The thing or commodity is in existence.
- It is owned by the seller.

- The bank must have a good title to the commodity before it sells it to its client.
 - The commodity must come into the possession of the bank, whether physically or constructive, in the sense that the commodity must be at its risk, though for a short period.
- 3.2 For a Murabaha transaction, the bank itself may purchase the commodity and keep it in its own possession, or purchase the commodity through a third person appointed by the bank as agent, before bank sells it to the customer. However it is also allowed that bank makes the customer its agent to buy the commodity on its behalf. In this case the client first purchases the commodity and takes its possession as such on behalf of the bank. Thereafter, he purchases commodity from the bank for a deferred price. His possession over the commodity in the first instance is in the capacity of an agent of his bank. In this capacity he is only a custodian while the ownership vests in the bank and the risk of the commodity is also borne by the bank as a logical incidence of the ownership. But as soon as the client purchases the commodity from the bank, the ownership, as well as the risk, passes to the client.
- 3.3 As mentioned earlier, the sale cannot take place unless the commodity comes into the possession of the seller, but the seller can sign an “agreement to sell” after the bank has acquired ownership title to the goods though the commodity is not in its possession.
- 3.4 Having regard to the Shariah principles of the Murabaha a bank can use the Murabaha by adopting the following procedure:-
- 3.4.1 The client and the bank sign an “ agreement to sell “ whereby the bank promises to sell and the client promises to buy commodity upto a maximum amount of purchases at a profit margin of X percentage or amount over cost.
- 3.4.2 The bank appoints the client as his agent for purchasing the commodity on its behalf, and an agreement of agency is signed by both the parties.
- 3.4.3 The client purchases the commodity on behalf of the bank and takes its possession as an agent of the bank.
- 3.4.4 The client informs the bank that he has purchased the commodity on its behalf and has taken possession thereof, and at the same time, makes an offer to purchase it from the bank at profit margin over cost as agreed to in the “ agreement to sell “ referred to in 3.4.1.
- 3.4.5 The bank accepts the offer and the sale is concluded whereby the ownership as well as the risk of the commodity is transferred to the client. An invoice shall be raised by the bank in respect of the commodity sold to the client.
- 3.4.6 Another very important point to be followed is that the Purchase Order, Material Receiving Report and Delivery Challan, by whatever name called, should be in the name of the bank.

- 3.4.7 Finally the payment for the commodity purchased may be made directly by the bank to the supplier or through the agent.
- 3.5 The purchase of the commodity from the client himself on "buy back" agreement is not allowed in *Shariah*.
- 3.6 The above mentioned procedure of the Murabaha is a complex transaction where the parties involved have different capacities in different stages.
- 3.6.1 At the first stage, the bank and the client agree to sell and purchase commodity in future. This is not an actual sale. It is just a promise to effect a sale in future on Murabaha basis. Thus at this stage the relationship between the bank and the client is that of a promisor and a promisee.
- 3.6.2 At the second stage, the relationship between the parties is that of a principal and an agent.
- 3.6.3 At the third stage, the relationship between the bank and the supplier is that of a buyer and a seller.
- 3.6.4 At the fourth and fifth stage, the relationship of seller and buyer comes into operation between the bank and the client and thereby relationship of a debtor and creditor emerges.

4. Standard Accounting Practice

- 4.1 Scope -This Standard should be applied to financial statements prepared in the context of historical cost convention in accounting for Murabaha transactions undertaken by a bank.
- 4.2 Cost of inventories should comprise all costs of purchases and other costs incurred in bringing the inventories to their present location and condition.
- 4.3 Inventories remaining unsold with the bank on the balance sheet date shall constitute bank's inventory and shall be valued in accordance with International Accounting Standard applicable to inventories and shown under " Other Assets ".
- 4.4 The financial statements of a bank should disclose all the information prescribed by International Accounting Standard applicable to inventories.
- 4.5 In case the inventories was acquired by the bank for a client who has eventually defaulted on his promise to purchase the inventories, it shall be valued in accordance with International Accounting Standard applicable to inventories.
- 4.6 Murabaha receivable shall be recorded by the bank at the invoiced amount.
- 4.7 Profit Recognition

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Profit recognition should be related to schedule of payment, i.e. it would be

recognized as and when the payment is due, whether it is due in one accounting period or in different accounting periods. Purchase and sales would be disclosed in the Profit and Loss account. Profit on that portion of payment not due would be accounted for by debit to an account "Unrealized Income Account" which should be transferred to Profit and Loss account. Correspondingly the amount would be credited to a Deferred Income account and correspondingly shown in the balance sheet before current liabilities.

4.8 Murabaha Receivable

The banks shall disclose Murabaha Receivable as trade debts and classifying them as follows:-

Trade debts considered good in respect of which the bank is fully secured.

Trade debts considered good for which the bank holds no other security than the debtors' personal security.

Trade debts considered good secured by the personal liabilities of one or more parties in addition to the personal security of the debtors.

Trade debts considered doubtful or bad not provided for.

Trade debts due by directors or officers of the bank or any of them either severally or jointly with any other persons.*

Trade debts due by companies or firms in which the directors of the bank are interested as directors or partners or in the case of private companies, as members.*

Trade debts due by subsidiary companies, controlled firms, managed Modarabas and other associated undertakings.*

* The maximum aggregate amount of trade debts outstanding at any time since the date of incorporation or since the date of previous balance sheet, whichever is later. Such maximum amount to be calculated by reference to month-end balances.

5. Effective date

This standard shall be effective for financial statements of banks for the financial periods beginning on or after _____.