

**Deloitte.**

**Accounting, Auditing & Governance  
Framework for Private Sector in  
Pakistan**

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# Presentation Outline

- **Need for transparency & good governance : imperative for preventing corruption & sustained economic growth.**
- **Fraud / Corruption cost**
- **Fraud Triangle**
- **Accounting Framework**
- **Governance Framework**
- **Auditing Standards**
- **Evolving Regulatory Environment**
- **ICAP's Role in Standard Setting & as Regulator of Accountants**
  - **Accounting & Auditing Standards**
  - **Quality Control**
  - **Disciplinary Process**
  - **Commitment to IFAC's SMOs**
- **Way Forward**

“The governance of the corporation is now as important in the world economy as the government of countries”



- James D. Wolfensohn  
President, The World Bank

# Importance of Corporate Sector for the Economy

**“Corporations create jobs, generate tax, income, provide a wide range of goods & services... and increasingly manage our savings and secure our retirement income.**

**Amid Growing reliance world wide on private sector, the issue of corporate governance has similarly risen in prominence.”**

**(OECD Principles of Corporate Governance)**

# Importance of capital markets to the economy

- More and more people have a stake in the performance and conduct of public companies, through stocks, mutual funds and pension plans.
- Investing in public companies has become an activity open to anyone with a computer and a few dollars.
- This has greatly increased importance of capital markets for the economy.
- The globalization of business and communications and increasingly complex financial transactions, mean that a business failure anywhere touches people everywhere.
- With WTO / dismantling of trade barriers, the cross border holdings and investment will further accelerate.
- A failure in London or New York impacts the markets in Colombo, Bombay & Karachi.....

## **Size of the market and their impact**

- **In US and other western countries, the capital markets are as large as their economy.**
- **One major fraud like Enron can take a toll of the market upto 10 to 20%.**
- **20% drop in the NYSE means a loss of \$ 220 billion, which would be around 20% of the US GDP and around 6% of the world GDP.**
- **East Asian Crisis : result of banking / financial sector crisis**
- **Thus, world can not afford Corporate Governance failures that were witnessed in the recent past.**

## **Corporate Governance Failures in recent past**

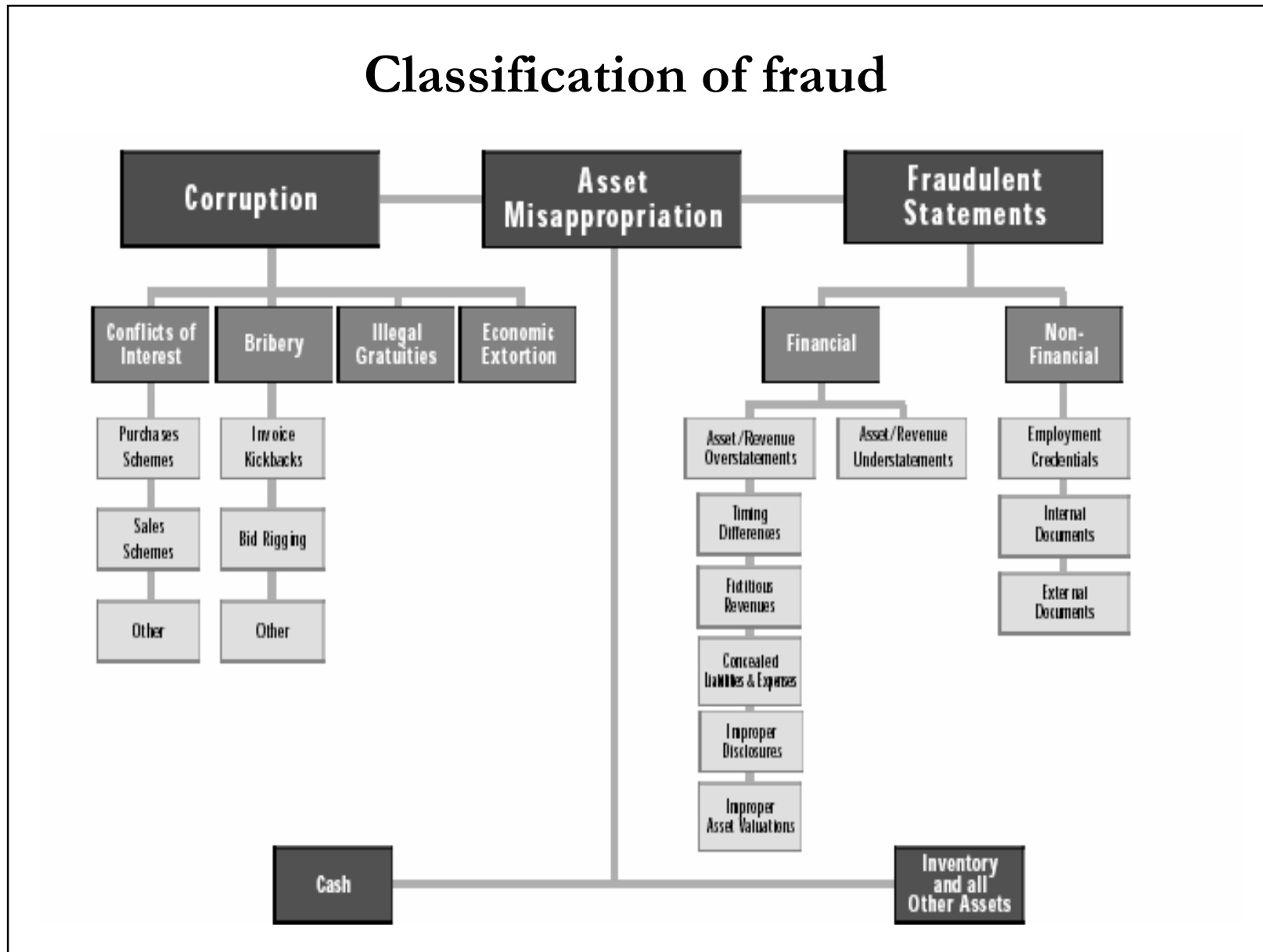
- **Enron**
- **WorldCom**
- **Adelphia**
- **Global Crossing**
- **Xerox**
- **Qwest**
- **Palmalat**
- **BCCI**
- **Baring**
- **Credit Lyonnaise**
- **Waist management**
- **Sunbeam**
- **Ahold**

# Fraud Definition

- **It is like an elephant,  
Easier to recognize than to define.**
- **An intentional act done by one or more individual among management, those charged with governance, employees or third parties involving the use of deception to obtain an unjust or illegal advantage. *(ISA 240 – )***



# Classification of fraud



## Measuring Cost of Fraud

- **Determining the true cost of fraud & abuse is an impossible task, because fraud is a crime based on concealment.**
- **Some Frauds are never detected, or only caught after they have gone on for several years.**
- **Many frauds that are detected are never reported for variety of reasons, including reputation issue. And those that are reported, are often not prosecuted.**
- **Finally, there is no agency or organization specifically charged with gathering comprehensive fraud related information.**
- **All of the above factors combine to make an estimate the total cost just that: an estimate.**

## Fraud- statistics

### **2004 survey by Association of Certified Fraud Examiners of US on fraud:**

- **On an average, US organizations lose 6% of their revenue.**
- **Estimated Loss US \$ 660 billion a year – about \$4,500 for every worker.**
- **59% of frauds occur due to weaknesses in internal controls.**
- **95% of US companies reported employee theft.**

## Fraud- statistics

### 2004 survey by ACFE

- **Fraud and abuse is widespread problem that affects practically every org, regardless of size, location & industry.**
- **Most common fraud (over 90%) involves asset misappropriation. Examples are theft or misuse of assets such as stealing of inventory, cash, payroll fraud, skimming of revenues etc. The asset that is most frequently targeted is Cash.**
- **Corruption, in which fraudsters wrongfully use their influence in a business transaction in order to procure some benefit for themselves or another person, contrary to their duty to employer or the rights of another. (common example include kickbacks, engaging in conflicts of interest.)**
- **Fraudulent fin. Statements, were least commonly reported but are the costliest. As against the median loss of \$ 93k for asset misappropriation, median loss for fin. Statement fraud was over \$ 1 million.**

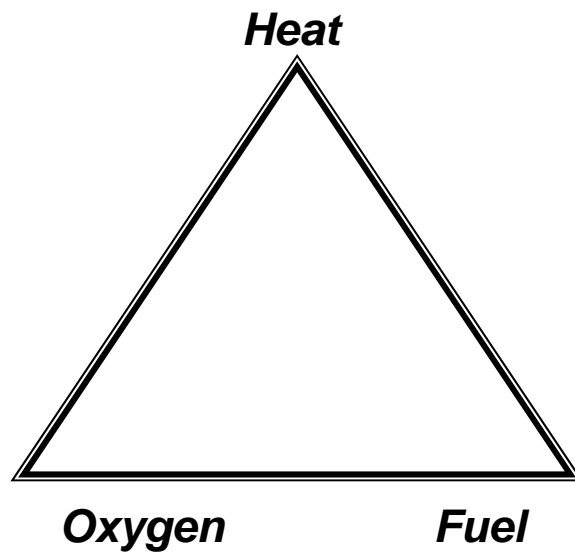
# Cost of Fraud?

- It's much less expensive to prevent an embezzlement than it is to investigate one.
- According to one study, it is estimated that for each \$ 1 lost due to any Fraud, the orgs loses an additional \$ 4. These calculations are conservative, and don't take into account other losses the org will ultimately suffer, including reputation loss.

# What Does Fraud Really Cost?

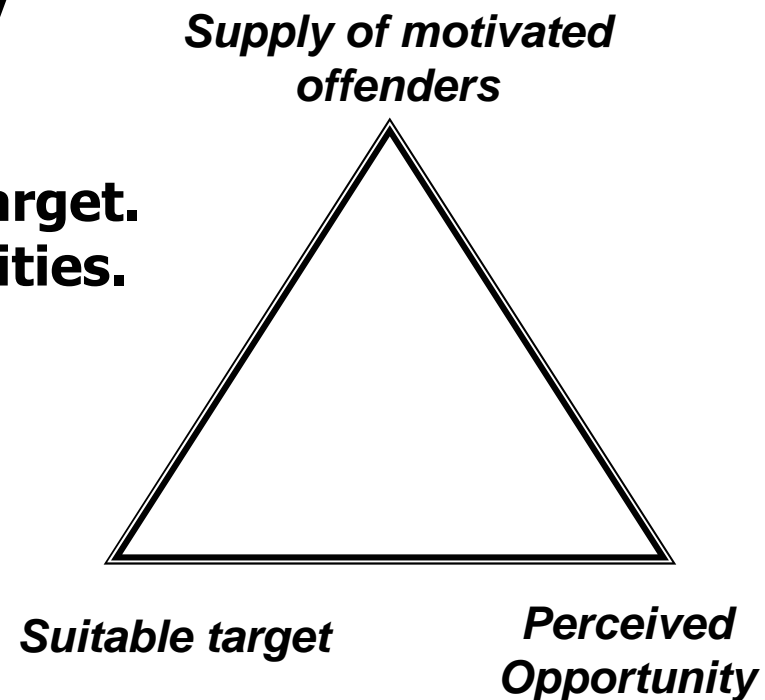
- To put it another way, each loss caused by internal or external fraud costs at least five times the original amount:
  - \* One dollar in actual cash or property value is lost;
  - \* A second dollar is spent identifying how the crime was committed;
  - \* A third dollar is spent in identifying who committed the crime;
  - \* A fourth dollar is spent prosecuting the person who committed the crime; and
  - \* A fifth dollar is spent in suing the person who committed the crime for the recovery of the money taken.

# Fraud Triangle



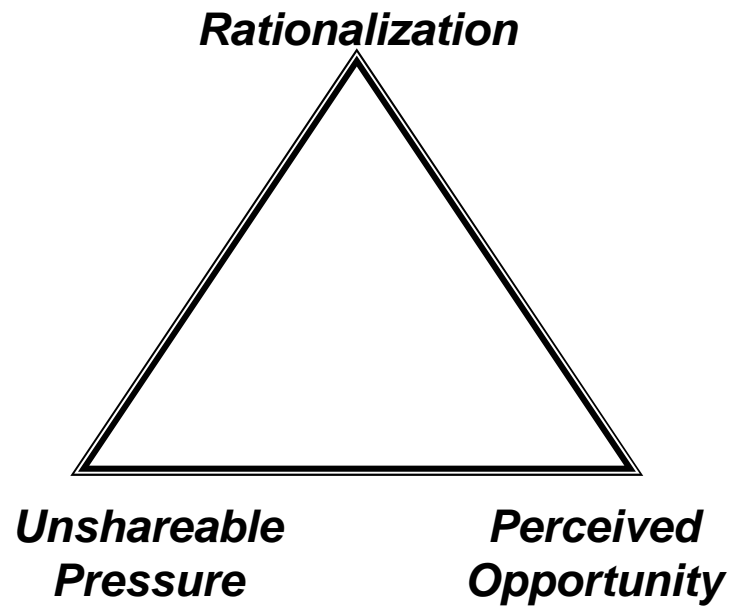
# Fraud Prevention at macro level.

- **Anti-corruption strategy**
  - **Reduce Supply of motivated offenders.**
  - **Educate the public/target.**
  - **Reduce the opportunities.**



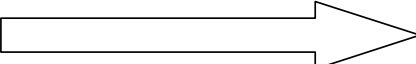


# The Fraud Triangle



# Financial Statement Fraud

- Financial statement fraud causes a decrease in market value of stock of approximately 500 to 1,000 times the amount of the fraud.

\$7 million fraud  \$2 billion drop in stock value

# Accounting Framework

- **Financial Statements of listed companies & banks are prepared:**
  - **In accordance with approved accounting standards and the requirements of Companies Ordinance, 1984 (CO).**
  - **Apprd Acctg Stds : comprise of IASs notified by SECP.**
  - **Wherever the requirements of the CO / BCO or directives issued by the SECP / (SBP for Banks) differ with the standards, the requirements of CO /BCO or the requirements of the directives take precedence.**
- **Legal Requirements now largely in line with IFRSs.**
- **Accounting Standards are notified by SECP on Recommendation of ICAP.**
- **SBP has issued a circular detailing disclosure requirements / format of banks, based on ICAP advice.**

# Accounting Framework

- **All IASs adopted except for:**
  - IAS 29 (hyper inflationary Economy)
  - IAS 41 (Agriculture)
  - Six IFRSs
- **IASs 29 not applicable and little relevance of IAS 41 in Pakistan.**
- **IFRSs are in the process of being adopted.**
- **On the whole, the accounting & reporting framework considered in line with International Best Practices.**
- **Enforcement of IASs and disclosure requirements by listed companies & Banks considered effective:**
  - **Effective monitoring by SECP (nearly 20 companies auditors penalized)**
  - **Effective disciplinary process (severe penalties, including removal from membership imposed)**

# Corporate Disclosure in Pakistan

- **Companies Ordinance, 1984**
  - Sections 230, 234
  - 4th schedule
  - IFRS / IASs
- **Code of Corporate Governance / Listing Rules of stock exchanges**
- **Good Corporate Governance Disclosure includes voluntary disclosures that provide information over & above minimum statutory & regulatory requirements (going for beyond compliance approach).**

# Disclosures Required

- **Corp Govnce disclosure**
  - **Fin. Stats. True & Fair**
  - **Proper books of account**
  - **Accounting policies: consistent application & prudent judgment.**
  - **Applicable IASs have been followed.**
  - **System of Int. Control is sound in design & effective**
  - **No doubts on ability as going concern.**
  - **No departure from the best practices of Corp. Govnce.**
  - **Operating & Fin. Data of six years.**
  - **Value of investments of staff retirement funds.**

# Disclosures Required

- **Corporate disclosure**
  - **Names of board members & meetings attended by each of them.**
  - **Pattern of Shareholding**
  - **Best practice on transfer pricing**
  - **Statement of Ethics & Business Practices**
  - **Orientation courses of directors**
  - **Vision, Mission & Strategy**
- **Compliance Statement with requirements of Code by directors & reviewed by auditors**

# Disclosures Required

- **Compliance Statement**
  - Appointments of CFO & head of int. audit & CS made with the approval of BODs.
  - Report of the Board in line with Code.
  - CEO & CFO certify the Fin. Statement.
  - Directors, CEO & Executives shareholding.
  - Compliance with the financial reporting reqs on the Code.
  - Audit Committee, its composition & TOR.
  - Number of Audit Committee meetings.
  - Statutory auditors compliance with IFAC code & QCR rating.
  - Non-audit services of statutory auditors.
  - Confirmation that all other material principles of the Code have been complied.



# External & Internal Audit

## ■ External Audit

- The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework.
- Auditor's opinion helps establish credibility of the Fin. Stats. It provides reasonable, not absolute assurance, about the fair presentation of Fin. Stats.
- Reports to shareholders / work used by external parties.

## ■ Internal Audit

- An independent, objective assurance and consulting activity that adds value to and improves an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.
- Reports to the Audit Committee/ Board & CEO.

# Auditing Standards

- All public companies are required to have their accounts audited by CAs.
- International Standards on Auditing (ISAs) issued by the IFAC are considered and adopted by ICAP for mandatory compliance by all members.
- All ISAs except one adopted by ICAP are mandatory for compliance.
- Reference to ISAs is required in audit reports.

# **Evolving Regulatory Environment in Pakistan**

- **Stringent Enforcement of laws by SECP**
  - Over 20 auditors fined
  - Independence Rules more stringent than US.
  - Rotation of firms / Partner, IFAC code
  - Enhanced level of Penalties
  - Closer monitoring of ICAP
- **SBP**
  - Downgrading of firms
  - Internal Control Guidelines
  - Risk Management Guidelines
  - More effective inspections & monitoring of external & internal auditors
  - Corporate Governance / closely working with ICAP

# **ICAP's Role as Regulator of Accounting Profession**

- **Adoption of IFRSs**
- **Adoption and enforcement of ISAs**
- **Continuing Professional Development of members  
& other professionals**
- **Education and Examination**
- **Technical Committee**
- **Taxation Committee**
- **Quality Control Committee**
- **Investigation Committee**
- **Corporate Governance Committee**

# ICAP's Role as Regulator of Accounting Profession

- Advisory Role to the Government of Pakistan and Regulators:
  - SECP : Joint Coordination Committee
  - SBP : Joint Coordination Committee
  - CBR : Joint Coordination Committee
- Commitment to continuing improvement in line with International Best Practices
- Commitment to full implementation of SMOs

# Quality Control Program

- **Mandatory for all members : once in two years for every firm.**
- **Listed companies can only appoint auditors who are “rated as satisfactory” by QCR committee of ICAP.**
- **Two unsatisfactory reviews or gross negligence leads to investigation for misconduct.**
- **Not a peer review.**
- **QCR performed by full time employees (CAs) to ensure compliance with ISAs and quality of work.**
- **QCR framework and list of firms rated as satisfactory are on the ICAP’s web site.**

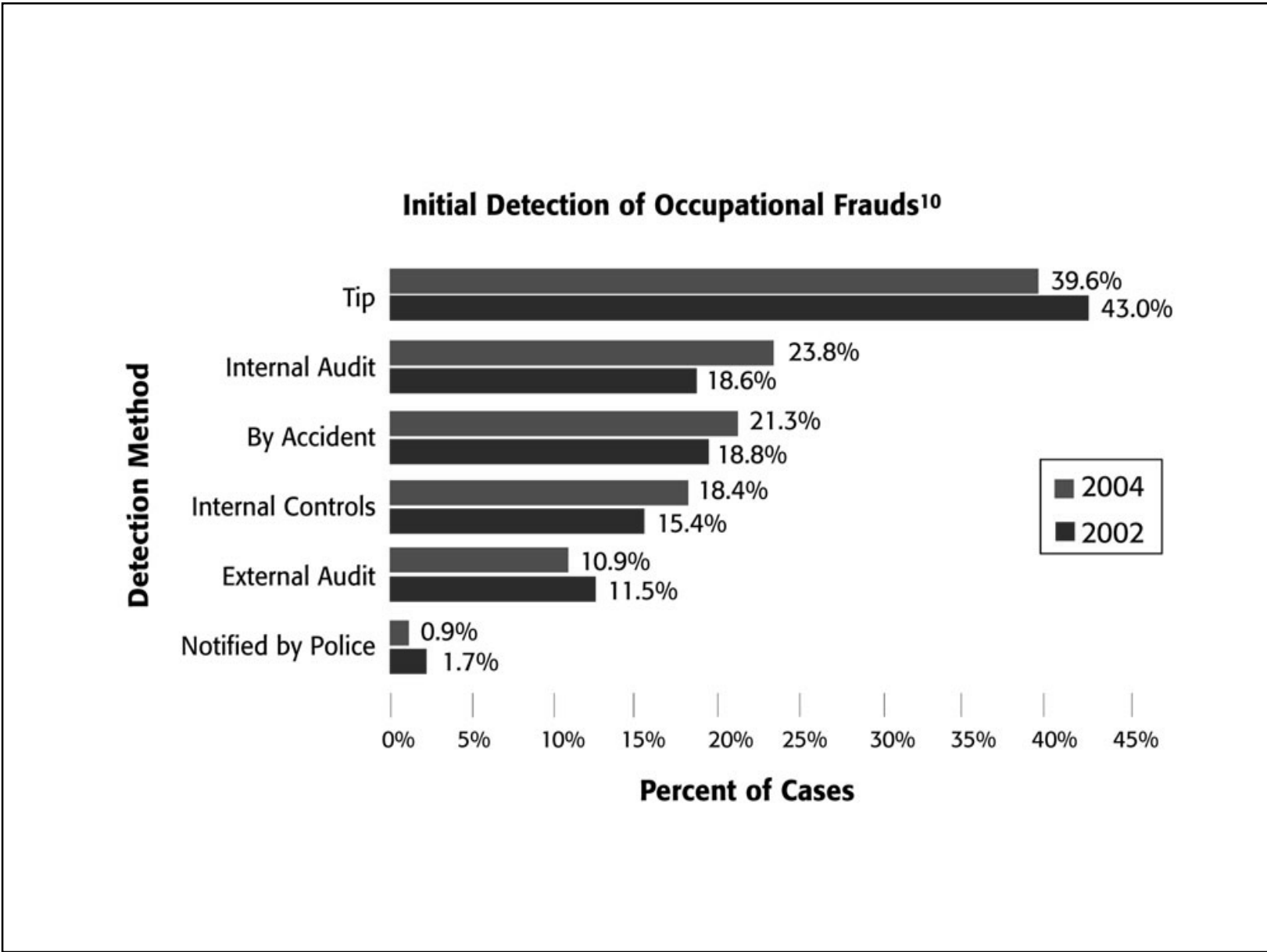
# Statements of Membership Obligations

- **Benchmarks for member bodies of IFAC**
  - **SMO 1 : Quality Assurance**
  - **SMO 2 : International Education Standards for Prof. Accountants.**
  - **SMO 3 : Compliance with International Auditing Auditing & Assurance Standards.**
  - **SMO 4 : IFAC Code of Ethics for Prof. Accountants.**
  - **SMO 5 : International Public Sector Accounting Standards**
  - **SMO 6 : Investigation and Discipline**
  - **SMO 7 : International Financial Reporting Standards**

# Way Forward

- **Facilitate amendments in CA Ordinance to further enhance ICAP's ability to strengthen IFRS, ISA compliance, quality control system.**
- **Improvements in Code of Corporate governance to focus on developing corporate culture, ethics / tone at the top / values.**
- **Independent directors be made mandatory for listed companies.**
- **Guidance on review of internal control by using a framework of internal control such as Turnbull, COSO or COCO.**
- **Audit Committee members should be financially literate.**
- **More specific requirements on fraud reporting (hot lines, protection of whistle blowers, anonymous reporting etc).**





# Way Forward

- **Legislation to include responsibilities of CEO & CFO for certification of Financial Statements (like Sarbanes Oxley Act).**
- **Stringent penalties for fraudulent financial statements / maintaining double books of account. Section 230 / 234 provide same penalties for misstatements due to error and fraud.**
- **Strengthen the Institute of Corporate Governance for education of directors / audit committee members.**
- **More requirements on Ethical Principles, their disclosure and compliance, specifically to prohibit corruption / bribery etc.**
- **Strengthen stock exchanges to transform them into effective SROs for regulating the securities market.**
  - **Demutualization / integration of stock exchanges etc.**