

PRACTICAL IMPLEMENTATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS IN PAKISTAN

By Asad Ali Shah
The Institute of Chartered Accountants of Pakistan

Agenda

- **Introduction**
- **Regulatory framework and enforcement**
- **Capacity building**
- **Lessons learned**
- **Conclusions**

I. Introduction

- ICAP has been adopting IASs / IFRSs issued by the IASB, and International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Boards for over 20 years.
- ICAP's Council is committed to work with the SECP and the SBP in achieving compliance with full set of IFRSs by 2009 for public interest entities.
- Various impediments in achieving such compliance are being addressed

I. Introduction (Contd.)

A brief background:

- An overview of economic indicators
- Requirements relating to IFRSs implementation
- Council's strategy for IFRS
- Due process for adoption of IFRSs
- Current adoption status
- The three-tier Structure and SME standards
- Impediments and problems in implementing IFRSs
- Compliance gaps between IFRSs and local statute

Overview of Economic indicators

- Last five years performance indicates Pakistan' is one of the fastest growing economies in Asian region along with China, India and Vietnam.
- FDI in Pakistan US \$ 6 billion in FY 2007
- International investors call for comparable financial information from countries competing for foreign investments.
- This requires the corporate sector in Pakistan to comply with internationally acceptable standards on financial reporting

Requirements Relating to IFRS Implementation

- The SECP is empowered under Section 234 of the Companies Ordinance, 1984 to prescribe the appropriate International Accounting Standards (IASs) & International Financial Reporting Standards (IFRSs).
- SECP notifies the accounting standards based on the recommendation of ICAP.
- The requirements of Companies Ordinance, 1984 or the requirements of the said directives take precedence in case of difference in requirements with the Standards

Council's Strategy for IFRS

- ICAP will work together with SECP and SBP to ensure that Pakistan GAAP becomes full IFRS compliant by the end of 2009.
- Professional Standards and Technical Advisory Committee (PS&TAC) has formed a Committee to carry out a detailed gap analysis,.

Due Process for Adoption of IFRSs

Following is the ICAP procedure for adoption:

- Committees set up to carry out review of the IFRSs
- Dissemination of exposure drafts to corporate sector and its members and carry out consultation with the stakeholders
- Recommendation to Council for adoption of a particular standard
- Recommendation to SECP by the Council for notification of a particular standard
- SECP notification of adoption after undergoing its internal deliberations and review process.

Current Adoption Status

- The Council of the Institute has adopted all IASs/ IFRSs except IFRS 1, 4.
- Strategies and action plans decided by the Institute for the two IFRSs are as follows :

IFRS 1 – It would be adopted once all other IAS/IFRS were adopted.

IFRS 4 –The Insurance Committee of the ICAP is actively deliberating on the adoption of this standard.

Current Adoption Status (Contd.)

IAS/ IFRSs still awaiting for notification by SECP are:

- IAS 29 - Financial Reporting in Hyper-Inflationary Economies
- IFRS 7 - Financial Instruments : Disclosures
- IFRS 8 - Operating Segments

The Three-Tier Structure and SME Standards

- ICAP is cognizant of the difficulties faced by small and medium entities (SMEs) in complying with full set of IFRSs.
- ICAP has developed two SME standards namely:
 - Accounting and Financial Reporting Standard for Medium Size Entities (MSEs)
 - Accounting and Financial Reporting Standard for Small Size Entities (SSEs).

The Three-Tier Structure and SME Standards (Contd.)

Three Tier Structure

Tier 1	Publicly Interest Entities (Listed entities that have public accountability and are of considerably large size)	Complete set of IFRS that are approved by the Council of the Institute and notified by the SECP shall be applicable to these entities.
Tier 2	Medium-Sized Entities (These are entities that are neither PIEs nor SSEs)	MSE Standards issued by the Institute are applicable to these entities.
Tier 3	Small Sized Entities (Small entities that have turnover and paid up capital below specified threshold)	SSE Standards issued by the Institute are applicable to these entities.

The Three-Tier Structure and SME Standards (Contd.)

Notification of MSE & SSE Standards

- Approved by the Council in its meeting held on July 28, 2006
- SECP notified the Accounting and Financial Reporting Standards for SMEs without any modification or alteration
- SECP has revised Fifth Schedule after deliberations with the ICAP

Impediments and Problems in Implementing IFRS

- Significant time required to persuade regulators about the removal of inconsistencies existed between Companies Ordinance, 1984 and IFRSs.
- Preparers require more time in implementing complex standards i.e. IAS 39, IAS 19, IFRS 3 etc.
- Resistance from stakeholders (Banks & DFIs) may further delay full implementation of IFRS.
- Shortage of faculty for training and continuing education on IFRS.

Compliance Gaps Between IFRS and Local Statutes

Companies Ordinance, 1984	IAS/IFRS
Surplus on Revaluation of Fixed Assets shown in the balance-sheet after Capital and Reserves.	Credited directly to equity under the heading of revaluation surplus. (IAS 16.37)
A statement of changes in equity and cash flow statement is a part of the balance sheet and P&L in case of a listed company only. (sec 234(3))	As per IAS 1, a complete set of financial statements comprise of balance sheet, income statement, statement of changes in equity, cash flow statement and notes to accounts.

Compliance Gaps Between IFRS and Local Statutes (Contd.)

Companies Ordinance, 1984	IAS/IFRS
Definition of Subsidiary	A <i>subsidiary</i> is an entity, including unincorporated entity such as partnership, that is controlled by another entity (known as the parent)-----
Definition of Associates	An entity including an unincorporated entity such as partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in joint venture

Compliance Gaps Between IFRS and Local Statutes (Contd.)

SECP Directive	IAS/IFRS
The Listed companies carrying deferred cost as on July 5, 2004 are allowed to treat such cost as per superseded Fourth Schedule. However, after July 5, 2004, any further deferral of costs will not be allowed.	The concept of deferred cost does not exist in the IAS/IFRS anymore.

- Prudential Regulations issued by the SBP include certain requirements that are in conflict with IAS 39.

II. Regulatory framework and enforcement

The significant regulatory bodies and framework in Pakistan are:

- Securities and Exchange Commission of Pakistan
- Non-Banking Financial Companies are regulated by NBFC Department of SECP
- The Monitoring and Enforcement Department of SECP (EMD)
- The Insurance Division of SECP
- The Companies Ordinance, 1984

II. Regulatory framework and enforcement (contd.)

- The Insurance Ordinance of 2000
- State Bank of Pakistan
- The Banking Companies Ordinance, 1962 and the Role of SBP in Monitoring and Enforcement of standards
- Banking Inspection Department (BID)
- Off-Site Supervision & Enforcement Department (OSED)
- The Institute of Chartered of Accountants of Pakistan

ICAP's Role as a Regulator of Accountancy Profession

- **Members of the ICAP are required to follow the Code of Ethics.**

The Institute is currently deliberating adoption of the revised IFAC Code of Ethics issued in June 2005.

- **Members of ICAP are required to ensure compliance with IFRS**

- **ICAP's disciplinary process**

The Directorate of Corporate Affairs and Investigation works in conjunction with the Institutes *Investigation Committee* formed by the Council to investigate breaches.

ICAP's Role as a Regulator of Accountancy Profession(Contd.)

Quality Control Review (QCR)

The salient features of the revised QCR Framework:

- QCR of a practicing firm now to be carried out after two and half years
- A QCR must cover at least 25% of audit partners of a practicing firm.
- Issuing the QCR report on a whole firm basis instead of branch wise.

ICAP's Role as a Regulator of Accountancy Profession(Contd.)

- Review of additional files in case one file is assessed to be "not-in-accordance" with the International Standards of Auditing applicable in Pakistan.
- Process of short listing of files before the review has been done away with.

ICAP's Role as a Regulator of Accountancy Profession(Contd.)

Quality Assurance Board (QAB)

- The Quality Assurance Board (QAB) monitors QCR program of the Institute
- The QAB is currently in the process of incorporating *International Standard on Quality Control 1* into the QCR program of ICAP

III. Capacity building

The Role of ICAP in Creating Awareness of IFRS:

- Facilitating Regulators
- Guidance
- Awareness Programs
- Members Information and Education Series

III. Capacity building (Contd.)

- **Disclosure checklist**
- **Training Workshops for Small and Medium Practices**
- **IFAC's seven statements of membership obligations (SMOs)**
- **Enhancing Continuing Professional Education (CPD)**

III. Capacity building (Contd.)

- **Upgrading the Licensing Procedure of Professional Accountants and Auditors:**
 - Audit of listed companies is only performed by the firm having a satisfactory QCR rating
 - International Education Standard (IES 5) – Practical Experience Requirement.
 - Networking of Audit firms

III. Capacity building (Contd.)

- **Simplified SME Reporting Tools** - developing illustrative financial statements and disclosure checklists for SMEs.
- **Adoption of Interpretations issued by IFRIC**
- **Pakistan Accounting Research Foundation**
- **Guidelines on Governance and Accounting for NGOs and NPOs**

IV. Lessons learned

- Verbatim adoption of IFRS to bring the regulatory requirements in line with IFRS
- Staying at par with revisions / amendments to IFRS
- Implementation of certain requirements of IFRSs is a gradual process: Transition time for gradual implementation of standards required.

IV. Lessons learned (Contd.)

- Addressing differences in IFRSs and law
 - Changes in law as per the accounting requirements
 - Making a particular accounting requirement inapplicable to a sector of economy (e.g. deferment of IFRIC -4 upto 2009)
- Development of standards for SME's
- Involvement of Stakeholders in the adoption and implementation process
- Role of QAB in improving Standard of Auditing and Financial Reporting
- Investment in Training and Education of IFRS

V. Conclusion

With all the three factors i.e. implementation, regulatory framework and quality assurance moving in the right direction, Pakistan is on track and not too far away from achieving full IFRS Implementation and compliance by the end of December 2009

THANK YOU