Corporate Governance and Accounting Practices in Pakistan

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CORPORATE GOVERNANCE AND ACCOUNTING PRACTICES IN PAKISTAN

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Abstract

Providing transparency in terms of financial accounting information is one of the objectives of corporate governance. Good accounting practices would result in accounting information that would be very useful to the stakeholders, hence good governance. Employment of effective accounting standards, such as IFRSs can be considered as a better accounting practice that are claimed to produce better disclosure and comparability of accounting information.

This study was made to determine whether the companies listed in Pakistan complied with the requirements of IFRS, and whether the financial statements of those companies were harmonized. Thorough document analysis of the selected 51 companies was performed for the selected IFRSs. To determine the degree of harmonization of accounting practices among the companies in Pakistan C index was used. To test for the level of harmonization Chi square test was used.

We concluded that, across the board, companies in Pakistan pursue and comply with the requirements of International financial reporting standards (IFRS). This is not the same for the degree of harmonization. Although for most of the IFRS selected degree of harmonization was positively tested there were a few exceptions. The implication is that the users of financial statements should first make adjustments for these items and then compare any aspect of financial condition or performances of the companies in Pakistan.

INTRODUCTION

1.1   Corporate Governance

Corporate governance includes all methods, systems, procedures and rules which are made to reduce conflict of interest among the prime stakeholders of a business (Berk and DeMarzo, 2007, p.900). The core activities within the corporate governance system would make sure that:

   I.   All of the stakeholders are treated fairly.
  II.   Organization comply with all of the internal and external policies and regulations
 III.   Assets of the business are used for the interest of the stakeholders
 IV.   Adequate level of financial transparency is achieved.

1.2   Financial Accounting

The objective of financial accounting is to produce information to a diversified group of stakeholders. The production of information is only possible because of a rigorous process called accounting process. It includes activities from recording of business transactions to their ultimate summarization called financial statements. The information produced through accounting process is disseminated to the stakeholders in the form of financial statements (Horngren, Harrison and Robinson, 1995, p.4). This lengthy and complex process, called accounting process, is subject to many principles, rules, assumptions and alternatives. To achieve quality in the employment of given principles, rules, alternatives and assumptions accounting standards are developed. Needless to say better accounting standards would result in quality accounting information, implying that corporate governance is achieved if quality accounting standards are employed.

1.3   Financial Accounting and Corporate Governance

One of the prime factors in a corporate governance system is effective financial disclosure. An accounting system would provide a platform to achieve effective financial disclosure. This is why good accounting practices are believed to result in effective corporate governance system (Sloan, 2002, p.2). Accounting profession has evolved itself in terms of principles, standards, and empirical practices. The creation of strong standards and their effective implementation has enhanced the value driven from the practices of accounting departments. Almost every country in the world has an organized accounting environment supported and promoted directly or directly by a professional body. Among other activities such professional bodies usually certify candidates to perform specified accounting functions for individual and corporate form of businesses. These bodies also play an important role in setting or adopting applicable accounting standards.

The evolution in accounting profession has crossed borders as well. This has resulted from the growth in multinational form of business and to some extent other forms of international business transactions. The need to prepare consolidated financial statements and compare businesses in an international setting has prompted individual professional accounting bodies to cooperate and co-ordinate. The international accounting standards board was such an attempt from accounting bodies. The board was established to harmonize accounting practices among the various countries in the world. The board would issue accounting standards, specific to an accounting dimension, to be adopted by the member countries. The adoption meant that the accountant of the member countries would now follow the adopted accounting in preparing the financial statements of specific forms of business.

1.4   International Financial Reporting Standards

1.4.1   Composition of IFRS

The now existing IFRS came into being in 2001 by replacing the then IAS. The existing number of IASs were taken and adopted by IFRS in their original form. Any new standard released afterwards was identified by the name of IFRS. They are composed of:
International Financial Reporting Standards (IFRS)
International Accounting Standards (IAS)
Standing Interpretations Committee (SIC)
Conceptual Frameworks for the Financial Statements
Underlying assumptions

1.4.2   Accounting Models to Implement IFRS

IFRS authorize two basic accounting models:

1.   Historical cost accounting during periods of low level changes in price index.
2.   Constant rupee Purchasing Power Accounting approach during periods of low level changes in price index.

1.4.3   Underlying Assumptions in IFRS

The following are the four underlying assumptions as narrated by in IFRS:

1. Accrual basis: the expenses and revenues are recorded when they are earned or accrued and not when cash is received or paid.

2. Going concern: It is assumed that the business will continue its operations for an indefinite period of time unless otherwise expected.

3. Stable measuring unit assumption: The value of financial statements components to be reported in nominal monetary units or traditional Historical cost accounting. The accountants continue employing stable measuring unit assumption unless there is at least 26% change in the value of the currency for three years in a row.

4. Units of constant purchasing power: Based on these alternatives accountant report the adjusted values of assets and liabilities based on the current price index during low inflation and deflation.

1.5   Adoption of IFRS

IFRS are used in many parts of the world such as Europe, BRIC countries, most of the Asian and Latin American countries and many African countries. Presently about 125 countries in the world require or allow IFRS adoption. The benefits of IFRS are globally recognized from the perspective of the investors and other stakeholders. They reduce the costs of comparison and increase the meaningfulness of information. The Companies, too, benefit from implementing IFRS because of the transparency. This is certainly the case for multinational companies. IFRS have been critized as well because they provide flexibility of alternative accounting treatment. Also if the implementation is weak that would also negate effective comparability. In Pakistan all publicly listed companies must adhere to all issued IAS/IFRS except IAS 39, 40 and IFRS-9. Adoption of the first two of these is not required for financial institutes. Whereas the adoption of IFRS-9 is under the preview of ICAP and should be in effect from January 2013.

1.6   Financial Statements

Financial statements are general purpose financial reports which are sent to the stakeholders for their analysis and information. Needless to say these reports are the result of the entire accounting process which has its foundation structured on IFRS. The financial statements comprise of Income statement, Balance sheet, cash flows statements and statement of changes in stockholders equities (Porter and Norton, 2001, p.8).

1.6.1   Qualitative characteristics of financial statements:

Financial statements are prepared by companies and sent to the shareholders and other stakeholders to let them appreciate the financial dynamics of the business. To prepare financial statements various accounting principles are followed. These principles translate into certain approaches or methods. In most cases the principles allow alternative treatments. But if the shareholders and the investors have to have any chance of comparing the financial position and the performance of the company across time and across the industry these principles should be universally applied and applied using the same alternatives. Therefore this study is being made to explore the quality of accounting practices in Pakistan in terms of appropriate application of the relevant IFRS.

1.6.2   Understandability, Reliability, Relevance and Comparability

Users of financial statements should understand them easily and financial information is reliable if it is subject to the reliability and accuracy of accounting processes (Porter and Norton, p.49). The two main culprits of financial statement inaccuracy are dishonest and incompetent behavior of accountants. The mechanisms to tackle these culprits are auditing and internal control systems. All firms have internal controls and regular audits it is only the quality that matters. Financial statements should contain information that is helpful for decision making. This means that information should be prospective in nature. Also to be relevant information should come at the right time and be timely. This means that the financial statements of similar companies should be prepared using similar principles and format so that the readers can compare the performance and condition of business of different companies.

1.7   Objective of the Research

The major objective of this study is to measure the quality of accounting practices (corporate governance) terms of in private sector non-financial organization. The quality here means:
1. Compliance with the requirements of IFRS.
2. Level of high degree of harmonization in accounting practices

1.8   Scope of the Study

Only the listed companies are considered in this study. The private limited companies and other forms of business are beyond the scope of this study. Also, the quality of accounting practices is measured in terms of the International financial reporting standards applicable in Pakistan.

1.9   Limitation of the Study

I have accounted for all of the IFRS which have been adopted by the securities and exchange commission of Pakistan. To date there are 43 IFRS which have been adopted by SECP.

Chapter 2   Literature Review

2.1   IFRS-Comparability and Uniformity

Across the countries competition and collaboration would increase if the companies are able to compare and measure the performance of each other. This is only possible through complete and unambiguous disclosure. Shankaraiah and Rao (2004a) reports that such a disclosure would be greatly enhanced if it comes with the help of strong and effective accounting standards. Therefore, he went on to explain that development and application of effective accounting standards is an important aspect of effective corporate governance. Application of effective and similar accounting standards creates transparency and provides for comparability. Adoption of IFRS is one step in this direction. Ball (2006) reports that uniformity in accounting standards is desirable, in fact, necessary in the world which has increasingly become global world. The profession of accounting in Pakistan has greatly evolved over the last few decades. This development in accounting has to do with the establishment of effective corporate codes, the role of regulatory agencies and the adoption of international accounting standards. Ashraf and Ghani (2005) have investigated accounting environment in Pakistan existing in various time bands and reported that the quality of accounting practices in Pakistan owes to factors such as: lack of investor protection, weak legal system and enforcement mechanisms.

2.2   Politics and Accounting

Politics also has it share in the accounting environment of an emerging country such as Pakistan. The political connection of the directors creates agency conflict and also reduces accounting conservatism. Mohammed, Ahmed & Ji (2011) report that political affiliations of the directors have negative impact on corporate governance, which in turn compromises the quality of financial reporting.

2.3   Accounting-A Good Mechanism to Address Corporate Governance

Ineffective accounting practices lead to opaqueness in financial reporting. Needless to say it results in undervaluation or overvaluation of securities. Shankaraiah and Rao (2004a) opine that the growth India is hampered because the accounting malpractices of companies do not allow fair valuation of securities offered by these companies. Lack of good governess in accounting practices hampers growth in another way; it restricts comparison of performance of companies across sectors and economies. In the words of Shil (2008) accounting is a mechanism to address good corporate governance, if the world adopts a universal accounting standard this will lead to easy comparison of companies in the same industry from different countries.

Several corporate governess weaknesses could be the cause of the misstatement of financial statements components. These could be the dependence of internal auditors, expertise of auditors and directors and involvement of external auditors in consultation assignments. But according to Agrawal & Chadha (2005) these factors are not as important as are financial expert in the audit committee or the presence of CEO who comes from the founding members. Existence of strong accounting standards affords transparency and comparability of accounting practices and financial statements. In other words strong accounting standards enhance corporate governance. Shankaraiah and Rao (2004b) investigate the effective role that good accounting standards play in meaningful disclosure and hence good corporate governance. According to them this phenomenon boosts the confidence and trust level of the prime stakeholders, whereas bad governance leads to financial dissatisfaction. So, mere quantity of disclosure is not enough rather it is the meaningfulness of the disclosure that is important. Report UN Conference (2004) suggests meaningful disclosures in the financial statements so as to provide a clear advantage to the stakeholders. It also states that domestic regulations and norms of the industry give shape to the accounting environment of an economy. The organizations follow the accounting practices which are dictated by the regulations and the norms. Similarly Sapovadia (2007) states that the accounting standards must be assessed to deliver in the contemporary environment. He further added that the standards should eliminate the adoption of alternative practices so as to guarantee accurate disclosure of business information.

As mentioned already good corporate governance promote harmony of interest between various stakeholders of the company. Effective accounting practices are very important, as it imply meaningful disclosure and better corporate governance system. So according to Shafi and K Shankaraiah (2000) the employment of effective accounting standards is an important factor to implement effective corporate governance in the highly complex modern business environment to create fundamental business values.

2.4   IFRS Adoption-Advantages and Disadvantages

Literature is also divided about the general benefits of IFRS to developed versus developing countries. While comparability and international convergence is given as the most common benefit for IFRS, researcher in USA generally disagree. They cite loss of discretion and monoplization as the common demerits of IFRS. They also think that easy adoption for IFRS creates an incentive for developing country such as Pakistan to go for it even when it is not ready. As Ball (2006) state that countries can opt for IFRS irrespective of their capability to effectively implement and legalize them, leading the standards to lose their importance in effectively presenting the financial condition and performance of the business.

Christopher (2011) reports that among various countries there are prominent financial reporting variations. He further states that the IASB's aim is to reduce variations in practice by amending the regulations but for most of the financial statements components, there is no economic rationale available as an explanation to go with the alternatives employed. But should there be an absolute harmonization of accounting treatments? What about difference in operating characteristics and the environment? Should not firm in different industries adopt difference accounting treatments? On the same footings Aziz and Stuart argue that harmonization will occur when firms operating in the same industry go for the same accounting treatments not when firms across countries are uniform in accounting treatments. The logistic regression on empirical data used by the authors revealed lack of harmonization as industry differences were outweighed by country differences.

2.5   Harmonization of Accounting Practices

2.5.1   Benefits of Harmonization

Harmonization is regarded as a process whereby all countries adhere to uniform accounting standards for financial reporting purposes" (Nobes et.al 1981). It is the process of blending and combining various practices into an orderly structure, which produces a synergistic result" (Samuels et.al. 1985). As the growing magnitude of financial globalization was increasing, the need for establishing a single set of accounting standards that would be authoritative in the international arena was becoming essential.

The aim of the international harmonization is to reduce or overcome differences across world, in order to bring a better international comparability of financial statements (Choi et al. 2002). Several authors assert that diversity in

accounting information leads to difficulties in operational productivity particularly in multinational firms. While for many investors, accounting diversity is barrier to make decisions. In fact harmonization can be characterized from two aspects: material and formal harmonization.

2.5.2   Disadvantages of Harmonization

Harmonization of accounting practices in the international setting is frequently cited as one of the strong reasons for the development of world financial markets. But contrasting viewpoints also exist. The literature frequently sees researchers discussing the merits of openness and free choice in terms of the adoption of accounting standards. They cite cost reduction, development in accounting theory, development in accounting practice and dissolution of power as the benefits of allowing free choice in the adoption. As an example Shyam Sunder (2011) states that just like any other market accounting standards should not be operating as a monopoly. The firms should be free to select the alternative most suitable to their situation. He further added that the competition among the suppliers of the standards would pave way to the development of better accounting standards and practices.

2.5.3   Mixing Care with Harmonization

Similarly Ball (2006) advises that in seeking harmonization of accounting practices through internationalization of standards require care. He adds that such a move would create incentive of creativity for the preparers and make IASB a bureaucratic and a politicized institution.
When firms adopt similar definitions and rules to communicate their financial accounting information, then they can increase the effectiveness of this with lessening essentially the cost, this assumption results to pressure for harmonizing of accounting information across all firms and making this a desirable device. However some authors have voiced cautiousness for achieving International accounting harmonization. Through formulating standards and setting limits to dissimilarity among financial reports it is generated a mean not only of achieving the harmonization but it is also an object of harmonization themselves (Van der Tas 1988).

Chapter 3   Research Methodology

3.1   Population

The population is the number of public limited companies operating in Pakistan. The number of companies listed with the Karachi stock exchange was 592 as on September 1, 2012.

3.2   Sampling Method

3.2.1   Selection of Companies

Cluster sampling would be used to obtain a sample of 51 companies. The Karachi stock exchange has grouped the 592 listed companies grouped into 38 sectors. For my research these are considered as clusters. This total includes 5 sectors from finance sectors and 15 sectors which have less than 5 companies. Out of these 18 clusters, 6 sectors were selected based on a simple random sampling technique. From each sector a quota of 8-12 companies was applied to each cluster.

3.2.2   Selection of Accounting Standards

Out of the total adopted 33 IFRS, 10 were selected based on the convenience and judgement of the researcher:

3.3   Research Technique

Thorough document analysis of the annual reports was applied. The annual reports of the selected 51 companies were obtained. The application of the relevant accounting standards was ascertained by focusing the relevant portions of the annual reports. The data about the employment of accounting approaches, assumptions, methods, and

level of disclosures specific to all of the adopted IFRS was scratched from the annual reports and presented in a tabular format. The information so obtained determined the level of IFRS compliance by the listed companies in Pakistan. To determine the degree of harmonization of accounting practices among the companies in Pakistan C index was used. Three years data was used to determine the improvement in the degree of harmonization. To test for the level of harmonization Chi square test was used.

Chapter: 4 Data Collection and Analysis

4.1   Introduction

We perused the annual reports of 51 companies in terms of the compliance with the 10 selected IFRS. The perusal resulted in the identification of the status of the compliance of the IFRSs selection of the alternative methods, approaches and assumptions used by the companies in their bid to comply with the IFRSs.

The researcher made a separate table for each of the 10 IFRSs selected for this study. Each table contains columns for the selected accounting alternatives and the rows for the sectors of companies selected. The table also exhibit C index and Chi square value to test for the level of harmonization achieved for each of the three years.

4.2   Document Analysis

Table 1:   Accounting for Costing of Inventory

	2009			2010			2011			Total
	FIFO	WA	Oth	FIFO	WA	Oth	FIFO	WA	OTH	
Raw Materials										
Textile	3	9		2	10		1	11		
Cement	0	9		0	9		0	9		
Power										
Fertilizer	0	8		0	8		0	8		
Sugar	2	6		1	7		0	8		
Oil and Gas	0	4		0	4		0	4		
Total	5	36	0	3	38	0	1	40	0	
C Index	0.7805			0.8610			0.9512			
Chi Square	23.4390			29.8780			37.0976			
Work In Process										
Textile	0	12		0	12		0	12		
Cement	0	9		0	9		0	9		
Power										
Fertilizer	0	8		0	8		0	8		
Sugar	0	8		0	8		0	8		
Oil and Gas	0	4		0	4		0	4		
Total	0	41	0	0	41		0	41	0	
C Index	1.00			1.00			1.00			
Chi Square										
Finished Goods										
Textile	0	12		0	12		0	12		
Cement	0	9		0	9		0	9		
Power										
Fertilizer	0	8		0	8		0	8		
Sugar	0	8		0	8		0	8		
Oil and Gas	0	4		0	4		0	4		
Total	0	41		0	41	0	0	41	0	
C Index	1.00			1.00			1.00			
Chi Square										

We the   have
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below-mentioned hypothesis to test for the degree of harmonization in the usage of inventory costing methods in Pakistan.

HA1: Inventory costing methods employed by companies in Pakistan are significantly different.

We have identified two methods for costing inventories which the listed companies in Pakistan are required to follow in order to comply with the requirements of IFRS and SECP. These methods are FIFO method and WA method. In 2009 out of 41 companies 36 employed WA and 5 employed FIFO. In 2010 38 employed WA and 3 employed FIFO. The number of companies which employed WA and FIFO was 40 and 1 respectively.

The sector-wise analysis exhibits that out of the 12 companies selected to represent textile sector 9 Employed WA and 3 employed FIFO in 2009, 10 employed WA and 2 employed FIFO in 2010 and 40 employed WA and 1 employed WA in 2011. For the sugar sector out of the 8 companies selected 6 employed WA and 2 employed FIFO in 2009, 7 employed WA and 1 employed FIFO in 2010 and all 8 employed WA in 2011. The other sectors: cement, fertilizer, oil and Gas employed WA consistently through the period of 2009-11. The C indices calculated for the three periods are: 0.7805 for 2009, 0.8610 for 2010 and 0.9512 for 2011. The calculated value of chi square from 2009 to 2011 is: 23.4390, 29.8780 and 37.0976. At these values null hypothesis is rejected.

Table 2:   **Accounting Practices for Inventory Valuation**

	2009			2010			2011			Total
	Cost	NRV	Oth	Cost	NRV	Oth	Cost	NRV	OTH	
Raw Materials										
Textile	0	12		0	12		0	12		
Cement	0	9		0	9		0	9		
Power										
Fertilizer	0	8		0	8		0	8		
Sugar	0	8		0	8		0	8		
Oil and Gas	0	4		0	4		0	4		
Total	0	41	0	0	41	0	0	41	0	
C Index	1.0000			1.0000			1.0000			
Chi Square										
Work In Process										
Textile	0	12		0	12		0	12		
Cement	0	9		0	9		0	9		
Power										
Fertilizer	0	8		0	8		0	8		
Sugar	0	8		0	8		0	8		
Oil and Gas	0	4		0	4		0	4		
Total	0	41	0	0	41		0	41	0	
C Index	1.0000			1.0000			1.0000			
Chi Square										
Finished Goods										
Textile	0	12		0	12		0	12		
Cement	0	9		0	9		0	9		
Power										
Fertilizer	0	8		0	8		0	8		
Sugar	0	8		0	8		0	8		
Oil and Gas	0	4		0	4		0	4		
Total	0	41		0	41	0	0	41	0	
C Index	1.0000			1.0000			1.0000			
Chi Square										

We have the below-mentioned hypothesis to test for the degree of harmonization in the usage of inventory valuation methods in Pakistan.

HA1: Inventory valuation methods employed by companies in Pakistan are significantly different.

We have identified two methods for valuing inventories which the listed companies in Pakistan are required to follow in order to comply with the requirements of IFRS and SECP. These methods are cost method and NRV method. From 2009 to 2011 all of 41 companies employed NRV method for each of the inventory category.

The sector-wise analysis exhibits that out of the 12 companies selected to represent textile sector all 12 Employed NRV throughout the three years period. For the sugar sector out of the 8 companies selected all employed NRV throughout the three years period. The other sectors, too, employed NRV throughout the three years period. The C indices calculated for the three periods are: remained at 1.00.

Table 3:   Accounting Practices for Borrowing Costs During Construction

	2009		2010		2011		Total
	Capitalization	Expensing	Capitalization	Expensing	Capitalization	Expensing	
Textile	12	0	12	0	12	0	
Cement	9	0	9	0	9	0	
Power	7	0	7	0	7	0	
Fertilizer	8	0	8	0	8	0	
Sugar	8	0	8	0	8	0	
Oil and Gas	7	0	7	0	7	0	
Total	51	0	51	0	51	0	
C Index	1.00		1.00		1.00		
Chi Square							

We have the below-mentioned hypothesis to test for the degree of harmonization in the treatment of borrowing costs incurred for capital work in progress.

HA1: Accounting treatment employed for borrowing costs by the companies in Pakistan differs significantly.

We have identified two treatments borrowing costs incurred for capital work in progress. One of the treatments is prescribed by IFRS and listed companies in Pakistan are required to follow in order to comply with the requirements of IFRS and SECP. This treatment requires the companies to capitalize borrowing cost for incurred for capital work in progress. In 2009 annual reports of all 51 companies indicated their policy of capitalizing borrowing cost during capital work in progress. The position remained the same during 2010 and 2011. The entirety of the situation also means that C index remained at the level of 1.00 throughout the three year period.

The calculated value of chi square from 2009 to 2011 is: 23.4390, 29.8780 and 37.0976. At these values null hypothesis is rejected.

Table 4:   Accounting For Cash Flow Treatment of Finance Cost

	2009			2010			2011			Total
	Operating Activities	Financing Activities	NA	Operating Activities	Financing Activities	NA	Operating Activities	Financing Activities	NA	

Textile	6	5	1	6	5	1	6	4	1	
Cement	5	5		4	6		3	6		
Power	5	3		6	1		6	1		
Fertilizer	5	3		6	2		7	1		
Sugar	4	4		5	3		5	3		
Oil and Gas	4	2	1	4	2	1	4	2	1	
Total	27	22	2	30	19	2	31	18	2	
C Index	0.4740			0.4945			0.5205			
Chi Square	0.5102			2.4694			3.45			

We have the below-mentioned hypothesis to test the degree of harmonization for the cash flow statement treatment of finance costs followed by the companies in Pakistan.

HA1: Cash flow statement's treatment of finance cost employed by companies in Pakistan are significantly different.

We have identified approaches to incorporating finance costs in the cash flow statement prepared by the companies in Pakistan. These are the approaches recognized by the IFRS and therefore the companies can only choose one of them. Based on these approaches the companies can either include finance costs in the operating activities section or the financing activities section. In 2009 out of 27 companies treated finance costs in operating activities section and 22 treated them in financing activities section. In 2010 30 used operating activities section and 19 used financing activities section. In 2011 31 treated them in operating activities section and 18 treated them in the financing activities section.

The C indices calculated for the three periods are: 0.4740 for 2009, 0.4945 for 2010 and 0.5205 for 2011.

The calculated value of chi square from 2009 to 2011 is: 0.5102, 2.4694 and 3.45.

Table 5:   Accounting Practices for Cash Flow Treatment of Financing Income

Cash Flow Treatment of Financing Income										
	2009			2010			2011			
	Operating Activities	Investing Activities	N A	Operating Activities	Investing Activities	N A	Operating Activities	Investing Activities	N A	Total
Textile	8	4	2	8	2	2	8	2	2	
Cement	3	6		3	6		4	5		
Power	6	1		6	1		6	1		
Fertilizer	7	1		7	1		7	1		
Sugar	6	2		6	2		6	2		
Oil and Gas	4	2	1	4	2	1	5	1	1	
Total	34	14	3	34	14	3	36	12	3	
C Index	0.5779			0.5779			0.6170			
Chi Square	8.3333			8.3333			12.0000			

We have the below-mentioned hypothesis to test the degree of harmonization for the cash flow statement treatment of financing income followed by the companies in Pakistan.

HA1: Cash flow statement's treatment of financing income employed by companies in Pakistan are significantly different.

We have identified approaches to incorporating financing income in the cash flow statement prepared by the companies in Pakistan. These are the approaches recognized by the IFRS and therefore the companies can only choose one of them. Based on these approaches the companies can either include finance costs in the operating activities section or the investing activities section. In 2009 out of 34 companies treated finance costs in operating activities section and 14 treated them in investing activities section. In 2010 too, 34 used operating activities section and 14 used investing activities section. In 2011 36 treated them in operating activities section and 12 treated them in the investing activities section.

Table 6:   **Accounting Practices for Depreciation**

	2009			2010			2011			Total
	SLM	RBM	Oth	SLM	RBM	Oth	SLM	RBM	Oth	
Raw Materials										
Textile	2	10		3	9		4	8		
Cement	4	5		4	5		4	5		
Power	7	0		7	0		7	0		
Fertilizer	8	0		8	0		8	0		
Sugar	0	8		0	8		1	7		
Oil and Gas	6	1		7	0		7	0		
Total	27	24	0	29	22	0	31	20	0	
C Index	0.4918			0.4996			0.5137			
Chi Square	0.5102			1.6531			3.4490			

We have the below-mentioned hypothesis to test for the degree of harmonization in the usage of methods for charging depreciation in Pakistan.

HA1: Methods of depreciation employed by companies in Pakistan are significantly different.

We have identified two methods for charging depreciation which the listed companies in Pakistan are required to follow in order to comply with the requirements of IFRS and SECP. These methods are straight line method (SLM) and reducing balance method (RBM). In 2009 out of 51 companies 27 employed SLM and 24 employed RBM. In 2010 29 employed SLM and 22 employed RBM. The number of companies which employed SLM and RBM was 31 and 20 respectively.

The sector-wise analysis exhibits that out of the 12 companies selected to represent textile sector 2 employed SLM and 10 employed RBM in 2009, 3 employed SLM and 9 employed RBM in 2010 and 4 employed SLM and 8 employed RBM in 2011. For the cement sector out of the 9 companies selected 4 employed SLM and 5 employed RBM throughout the three year period of 2009 to 2011. The power and the fertilizer sector used SLM throughout the period while the sugar sector used RBM throughout. Out of the seven companies in the oil and gas sector 6 used SLM and 1 used RBM in 2009, while in both 2010 and 2011 all seven companies used SLM.

The C indices calculated for the three periods are: 0.4918 for 2009, 0.4996 for 2010 and 0.5137 for 2011.

The calculated value of chi square from 2009 to 2011 is: 0.5102, 1.6531 and 3.4490. At these values null hypothesis is rejected.

Table 7:   Accounting Practices for Financial Statements Presentation

	2009					2010					2011					
	A	B	C	D	E	A	B	C	D	E	A	B	C	D	E	Total
	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	
Textile	9	9	9	9	9	9	9	9	9	9	9	9	9	9	9	
Cement	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	
Power	8	8	8	8	8	8	8	8	8	8	8	8	8	8	8	
Fertilizer	8	8	8	8	8	8	8	8	8	8	8	8	8	8	8	
Sugar	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	
Oil and Gas	51	51	51	51	51	51	51	51	51	51	51	51	51	51	51	
Total																
C Index	1.00					1.00					1.00					
Chi Square																

A: Financial statements are clearly identified.
B: Financial statements comprise of balance sheet, income statement, cash flow statement and changes in stockholders' equity.
C: Notes provide important information specific to the financial statements.
D: Summary of significant accounting policies is given.
E: Assets and liabilities are properly classified.

We have the below-mentioned hypothesis to test for the degree of harmonization for the various aspects of implementation of IFRS specific to financial statements presentation.
HA1: Financial statement presentation practices among the companies in Pakistan do not differ significantly.
We have identified several key financial statements presentation practices which the listed companies in Pakistan are required to follow in order to comply with the requirements of IFRS and SECP. These practices are numbered from A to F. The document analysis of the annual reports of the 51 companies indicates that all of the companies employ financial statements presentations practices which are in compliance with IFRS.
The C indices, as a result, remained 1.000 throughout the period of 2009 to 2011.

Table 8:   Accounting Practices for Impairment of Assets

Impairment of Assets										
	2009			2010			2011			
	A	B	C	A	B	C	A	B	C	Total
Textile	12	12	12	12	12	12	12	12	12	
Cement	9	9	9	9	9	9	9	9	9	
Power	7	7	7	7	7	7	7	7	7	
Fertilizer	8	8	8	8	8	8	8	8	8	
Sugar	8	8	8	8	8	8	8	8	8	
Oil and Gas	7	7	7	7	7	7	7	7	7	
Total	51	51	51	51	51	51	51	51	51	
C Index	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	
Chi Square										

A: The Company makes an annual assessment of impairment.

B: The recoverable amount of considered by the company is the higher of its fair value less costs of disposal and its value in use.

C: If the recoverable amount is less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. That loss, an impairment loss, is recognized in profit or loss.

We have the below-mentioned hypothesis to test for the degree of harmonization in the usage of inventory costing methods in Pakistan.

HA1: The impairment policies implemented by companies in Pakistan are significantly different.

We have identified three factors which the listed companies in Pakistan are required to have in their assets impairment policy so as to comply with the requirements of IFRS and SECP. These factors are listed above and named as a, b, c and d. All of the 51 sampled companies have these factors in their impairment policy throughout the period of 2009 to 2011. Naturally the C indices calculated for the entire three periods stand at 1.00.

Table 9:   Accounting Practices for Lease Transactions

Accounting for Leasing										
	2009			2010			2011			
	Finance Lease	Operating Lease	Both	Finance Lease	Operating	Both	Finance Lease	Operating Lease	Both	
Textile	8	1	3	8	1	3	9	0	3	
Cement	6	0	1	6	0	1	6	0	1	
Power	6	0	1	6	0	1	7	0	0	
Fertilizer	8	0	0	8	0	0	8	0	0	
Sugar	4	1	1	4	1	1	5	1	1	
Oil and Gas	5	0	2	5	0	2	5	0	2	
Total	37	2	7	37	2	7	40	1	6	
C Index	0.6647			0.6647			0.7686			
Chi Square	25.13			25.13			34.78			

We have the below-mentioned hypothesis to test for the degree of harmonization in the usage of methods for recording leasing transactions in Pakistan.
HA1: Lease accounting methods employed by companies in Pakistan are significantly different.
We have identified two lease accounting which the listed companies in Pakistan are required to follow in order to comply with the requirements of IFRS and SECP. These methods are finance lease method and operating lease method. In 2009 out of 46 companies 37 employed finance lease method, 2 employed operating lease method and 7 employed both the methods. In 2010 the figures remained the same. The number of companies which employed finance lease was 40, operating lease 1 and the number of companies which employed both finance lease and operating lease was 6.

The sector-wise analysis exhibits that out of the 12 companies selected to represent textile sector in 2009 and 2010, 8 Employed finance lease, 1 employed operating lease and 3 employed both the methods. In 2011, 9 employed finance lease and 3 employed both the methods. For cement sector 6 companies employed finance lease and 1 employed both the method throughout the three years period. For fertilizer all of the 8 companies employed operating lease throughout the three years period. For sugar 4 companies employed operating lease, 1 company employed finance lease and 1 company employed both the methods in 2009 and 2010, whereas for 2011 one

additional company opted for operating lease method. For oil and gas sector 5 companies employed operating lease method and 2 companies employed finance lease throughout the three years period.

The C indices calculated for the three periods are: 0.6647 for 2009 and 2010, and 0.7686 for 2011. The calculated value of chi square from 2009 to 2011 is: 25.13, 25.13 and 34.78. At these values null hypothesis is rejected.

Table 10:   **Accounting Practices for Pension Benefit Obligation**

Accounting for Pension- Disclosure on Pension Benefit Obligation													
	2009				2010				2011				
	Break up	Disc. Rate	Salary Growth	Emp Age	Break Up	Disc Rate	Salary Growth	Emp Age	Break Up	Disc. Rate	Salary Growth	Emp Age	
	Y N	Y N	Y N	Y N	Y N	Y N	Y N	Y N	Y N	Y N	Y N	Y N	
Textile	8 1	7 2	7 2	6 3	8 1	7 2	7 2	6 3	8 1	7 2	7 2	6 3	
Cement	7 1	7 1	6 2	6 2	7 1	7 1	6 2	6 2	7 1	7 1	6 2	6 2	
Power	7 0	7 0	7 0	7 0	7 0	7 0	7 0	7 0	7 0	7 0	7 0	7 0	
Fertilizer	8 0	6 2	6 2	6 2	8 0	6 2	6 2	6 2	8 0	7 1	7 1	7 1	
Sugar	5 2	5 2	4 3	4 3	5 2	6 1	6 1	5 2	6 1	6 1	6 1	6 1	
Oil and Gas	7 0	7 0	7 0	7 0	7 0	7 0	7 0	7 0	7 0	7 0	7 0	7 0	
Total	42,4	39,7	37,9	36,10	42,4	40, 6	39,7	37,9	43,3	41,5	40,6	39,7	
C Index	0.84	0.74	0.67	0.65	0.84	0.76	0.74	0.67	0.88	0.80	0.76	0.74	
Chi square	31.4	22.3	17.0	14.7	31.4	25.1	22.3	17.0	34.8	28.2	25.1	22.3	

We have identified several aspects of disclosures specific to pension benefits obligations which the listed companies in Pakistan are required to follow in order to comply with the requirements of IFRS and SECP. The above table shows the values of C index and Chi squares for all othese aspects over a period of three years.

Table 11:   **Accounting Practices for Deferred Tax Method**

Accounting for Taxes-Deferred Tax Method									
	2009			2010			2011		Total
	BS Liability	IS Liability	NA	BS Liability	IS Liability	NA	BS Liability	IS Liability	NA	
Textile	9	3	0	11	1	0	12	0	0	
Cement	9	0	0	9	0	0	9	0	0	
Power	1	0	6	1	0	6	1	0	6	
Fertilizer	7	1	0	8	0	0	8	0	0	
Sugar	8	0	0	8	0	0	8	0	0	
Oil and Gas	6	1	0	6	1	0	6	1	0	
Total	40	5	6	43	2	6	44	1	6	
C Index	0.7980			0.9131			0.9556			
Chi Square	27.2222			37.3556			41.0889			

We have the below-mentioned hypothesis to test for the degree of harmonization in the usage of deferred taxation methods in Pakistan.

HA1: Deferred taxation methods employed by companies in Pakistan are significantly different.

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We have identified two methods for measuring deferred tax which the listed companies in Pakistan are required to follow in order to comply with the requirements of IFRS and SECP. These methods are income statement liability and balance sheet liability method. In 2009 out of 45 companies 40 employed balance sheet liability method and 5 employed income statement liability method. In 2010 43 employed income statement liability method and 2 employed balance sheet liability method. The number of companies which employed income statement liability method and balance sheet liability method was 44 and 1 respectively.

The sector-wise analysis exhibits that out of the 12 companies selected to represent textile sector 9 Employed IS liability method and 3 employed BS liability method in 2009, 11 employed Is liability method and 1 employed BS liability method in 2010 and 40 employed WA and all 12 employed IS liability method in 2011. Mostly all of the companies in other sectors, except power sector, employed BS liability method consistently. Out of the seven companies in power sector six were found exempt from taxation, the remaining company employed BS liability method consistently.

The C indices calculated for the three periods are: 0.7980 for 2009, 0.9131 for 2010 and 0.9556 for 2011. The calculated value of chi square from 2009 to 2011 is: 27.2222, 37.3556 and 41.0889. At these values null hypothesis is rejected.

Table 12:   Accounting Practices for Recognition of Deferred Tax Items

Accounting for Taxes-Basis of Recognition										
	2009			2010			2011			Total
	All TD Recog	Tax Losses, Credits Recog.	Future Profits Recog.	All TD Recog.	Tax losses, Credits Recog.	Future Profits Recog.	All TD Recog.	Tax losses, Credits Recog.	Future Profits Recog.	
Textile	9 3	12 0	12 0	11 1	12 0	12 0	12 0	12 0	12 0	
Cement	9 0	9 0	9 0	9 0	9 0	9 0	9 0	9 0	9 0	
Power	1 0	1 0	1 0	1 0	1 0	1 0	1 0	1 0	1 0	
Fertilizer	7 1	8 0	8 0	8 0	8 0	8 0	8 0	8 0	8 0	
Sugar	8 0	8 0	8 0	8 0	8 0	8 0	8 0	8 0	8 0	
Oil and Gas	6 1	7 0	7 0	6 1	7 0	7 0	6 1	7 0	7 0	
Total	40 5	45 0	45 0	43 2	45 0	45 0	44 1	45 0	45 0	
C Index	0.79	1.00	1.00	0.91	1.00	1.00	0.96	1.00	1.00	
Chi Square	27.22			37.36			41.09			

We have the below-mentioned hypothesis to test for the degree of harmonization in the usage of deferred taxation methods in Pakistan.

HA1: Deferred taxation methods employed by companies in Pakistan are significantly different.

We have identified three attributes of the deferred tax policy which the listed companies in Pakistan are required to follow in order to comply with the requirements of IFRS and SECP. These attributes are (a) recognition of all temporary items (b) recognition of tax losses and credits and (c) the recognition of the reversibility of temporary

items. In 2009 out of 45 companies 40 recognized all temporary difference where 5 did not do so. For the other two attributes all of the 45 companies exhibited full compliance throughout the three year period. The C indices calculated for the first attribute for the three periods are: 0.79 for 2009, 0.91 for 2010 and 0.96 for 2011. The calculated value of chi square for the attribute from 2009 to 2011 is: 27.22, 37.36 and 41.09. At these values null hypothesis is rejected. The C index, as the companies exhibited full compliance, stood at 1.00 for the three periods.

Chapter 5   Findings

5.1   Accounting Practices for Costing of Inventory

The companies in Pakistan are strictly following the requirements of IFRS in terms of the selection of inventory methods, as they are either employing WA or FIFO method. The degree of harmonizationas measured through C index has also improved significantly over the three periods. The harmonization is also positively tested by chi square which means that although the companies in Pakistan has alternative options available nevertheless majority of the companies are employing the same inventory costing method

5.2   Accounting Practices for Valuation of Inventory

The companies in Pakistan are strictly following the requirements of IFRS in terms of the selection of inventory valuation methods, as all of them are only applying NRV method. The degree of harmonization as measured through C index is perfect at the level of 1.00. So, in terms of inventory valuation the companies in Pakistan are in full compliance and in perfect accounting harmony.

5.3   Accounting Practices for Borrowing Costs During Construction

The companies in Pakistan are strictly following the requirements of IFRS in terms of the borrowing costs, as they charge borrowing costs to profit and loss normally. Moreover borrowing costs incurred for capital work in progress is capitalized. The degree of harmonization as measured through C index remained at 100% throughout the period of 2009 to 2011.

5.4   Accounting Practices for Cash Flow Treatment of Finance Cost

The companies in Pakistan are strictly following the requirements of IFRS in terms of the treatment of the finance costs in the cash flow statements, as they are either treating them in operating activities section or financing activities section. The degree of harmonization as measured through C index has also improved significantly over the three periods. The harmonization is not positively tested by chi square over the period. This means that the companies in Pakistan are making use of the alternative options available to treat finance costs in the cash flow statements and their cash flow statements are not comparable because of finance costs.

5.5   Accounting Practices for Depreciation Methods

The companies in Pakistan are strictly following the requirements of IFRS in terms of the selection of methods for charging depreciation, as they are either employing SLM or RBM. The degree of harmonization as measured through C index is low and improving only slightly. The harmonization is also not tested positively by chi square which means that the availability of alternative options is causing most of the companies to not use the same method for charging depreciation.

5.6   Accounting Practices for Presentation of Financial Statements

The companies in Pakistan are strictly following the requirements of IFRS in terms of the presentation of financial statements. The degree of harmonization as measured through C index has remained 1.00 over the entire period.

5.7   Accounting Practices for Impairment of Assets

The companies in Pakistan are strictly following the requirements of IFRS in terms of the impairment policy for its assets. Their impairment policy is characterized by annual review, define recoverable amount as higher of fair value less cost of sell and value to use and recognizes impairment when recoverable amount is less than carrying amount. For all of these aspects of impairment policy the degree of harmonization as measured through C index is perfect.

5.8   Accounting Practices for Leasing Methods

The companies in Pakistan are strictly following the requirements of IFRS in terms of the selection of lease accounting methods, as they are either employing finance lease method or operating lease method. The degree of harmonization as measured through C index has also improved significantly over the three periods. The harmonization is also positively tested by chi square which means that although the companies in Pakistan has alternative options available nevertheless majority of the companies are employing the same lease accounting method.

5.9   Accounting Practices of Pension Benefits Obligations

The companies in Pakistan are strictly following the requirements of IFRS in terms of the disclosures specific to the pension benefits obligations. The degree of harmonization as measured through C index has also improved significantly over the three periods for all of the aspects of the disclosures. The harmonization is also positively tested by chi square.

5.10   Accounting Practices for Deferred Tax Methods

The companies in Pakistan are strictly following the requirements of IFRS in terms of the selection of methods for measuring deferred tax, as they are either employing income statement liability method or balance sheet liability method. The degree of harmonization as measured through C index has also improved significantly over the three periods. The harmonization is also positively tested by chi square which means that although the companies in Pakistan has alternative options available nevertheless majority of the companies are employing the same method for measuring deferred tax.

5.11   Accounting Practices for Recognition of Deferred Tax Components

The companies in Pakistan are strictly following the requirements of IFRS in terms of the three important attributes identified for deferred tax measurement. The degree of harmonization for the first attribute has significantly improved over the three years period from 0.79 to 0.96. The degree of harmonization, as measured by C index, for the other two attributes remained at 1.00 throughout the three years period. The harmonization for the first attribute is positively tested by chi square which means that although the companies in Pakistan has alternative options available nevertheless majority of the companies have the same attributes in their deferred tax measurement methodology.

Chapter 6   Conclusion and Recommendation

6.1   Conclusion

Financial accounting is a means of providing transparency to the stakeholders. The information that is produced through the accounting process is disseminated to the stakeholder by way of financial statements. The financial statements are prepared using accounting principles, assumptions, and alternative approaches. This necessitates that accounting reports, that is, financial statements be prepared using principles and alternative approaches which are sound in nature and afford comparability.

This study was made to understand whether companies in Pakistani pursue good accounting practices and whether these practices allow comparability. IFRS were considered as representing proxy for the good accounting practices. The comparability among the companies was determined through the degree of harmonization as measured by C index and tested by Chi square. We concluded that, across the board, companies in Pakistan pursue and comply with the requirements of International financial reporting standards (IFRS). This is not the same for the degree of harmonization. Although for most of the IFRS selected degree of harmonization was positively tested there were a few exceptions.

For cases such as costing of inventory, valuation of inventory, borrowing costs, cash flow, presentations of financial statements, lease methods, recognition of deferred tax items the degree of harmonization remained perfect throughout the three year period of 2009 to 2011. For other cases such as inventory costing, cash flow treatment of financing income, deferred tax methods and disclosures on pension benefit obligations the degree of harmonization was found strong but not perfect. The degree of harmonization over the period of time for these items either remained stable or improved. For the last category of items the degree of harmonization as measured through C index remained low and did not improve significantly over the three years period. The Chi square did not test them positively for the harmonization. The items were depreciation methods and cash flow treatment of finance costs.

Table: 14   Degree of Harmonization

Perfect Harmonization	Strong Harmonization	Weak Harmonization
Borrowing Costs	Inventory Valuation	Cash Flow Treatment of Finance Costs
Financial Statements Presentation	Cash Flow Treatment of Finance Income	Depreciation Methods
Impairment of Assets	Lease Transactions	
	Disclosures of Pension Benefits Obligations	
	Deferred Tax Methods	
	Recognition of Deferred Tax Items	

The above table shows the strength of degree of harmonization among Pakistani companies in terms of the implementation of selected IFRS. The table suggests that degree of harmonization across the board is strong. In fact, as the preceding individual tables shows, the degree of harmonization has progressively improved for all of them selected treatments. But it is very important to note that the degree of harmonization for methods of depreciation and cash flow treatment of finance cost is weak. This is alarming because these are very important financial statements items and influence the two or all of the financial statements. The implication is that the users of financial statements should first make adjustments for these items and then compare any aspect of financial condition or performances of the companies in Pakistan.

6.2   Recommendations

The chief regulator for companies in Pakistan, Securities and Exchange Commission, should make relevant changes in the regulations addressing IFRS. The change should be such that would eliminate the option of selecting alternative accounting methods or approaches available to the companies. The elimination of the options can be relaxed considering only the special circumstances facing the company.

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