Chapter 4

Taxation and Financial Reporting Obligation

# Introduction

Taxation and financial reporting obligations are crucial aspects of managing and regulating businesses, organizations, and individuals' financial activities. They serve as the foundation for ensuring compliance with legal requirements, fostering transparency, and maintaining trust within the economic ecosystem. Below is a brief introduction to these two interconnected areas:

# Taxation

Taxation refers to the system by which governments levy financial charges on individuals, businesses, or other entities to fund public services, infrastructure, and other government activities. Taxes come in various forms, such as income tax, corporate tax, value-added tax (VAT), and property tax.

Key points:

Purpose: Taxes are used to fund government operations and provide essential services, such as education, healthcare, and security.

Obligations: Taxpayers are required to calculate, report, and pay their taxes accurately and on time. Non-compliance can lead to penalties, interest charges, or legal consequences.

Tax Laws and Regulations: Tax systems vary across Jurisdictions, requiring taxpayers to understand local, national, and sometimes international tax laws.

## Financial Reporting Obligations

Financial reporting obligations involve the preparation and presentation of financial statements to ensure transparency and accountability. These reports provide stakeholders with insights into the financial health and performance of an entity.

### Key points:

Purpose: Financial reporting helps investors, creditors, regulators, and other stakeholders make informed decisions .

Standards: Entities must comply with accounting standards such as Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS),

Components: Financial reports typically include income statements, balance sheets, cash flow statements, and notes to the accounts.

Deadlines: Businesses are often required to file financial reports periodically (e.g., quarterly or annually) with relevant regulatory bodies.

## Interrelation

Taxation and financial reporting are interconnected because financial reports often serve as the basis for determining taxable income and calculating tax liabilities. Proper financial reporting ensures compliance with tax laws and helps avoid disputes with tax authorities.

In summary, taxation and financial reporting obligations are essential for compliance, transparency, and fostering trust in economic systems.

## Tax Reporting and Business Strategy

Globalization and technological development over the last decade, together with an increasing need for rationalizing costs, have led companies to focus on their core businesses, transferring resources from accessory activities. Outsourcing of administrative and financial functions including finance & accounting, payroll, tax management and other administrative tasks is not always an easy decision since it requires a partner that can provide efficient and reliable support. A good cost benefit rationale is also the key for the success of such decision.

## Financial Reporting Requirements for Pakistani Companies

As a business owner in Pakistan, you are required to comply with financial reporting standards to operate legally and transparently. The Securities and Exchange Commission of Pakistan (SECP) has outlined detailed procedures for preparing and filing financial statements to ensure consistency and accuracy in reporting. Following the SECP guidelines properly is critical for maintaining your business license and investor confidence. This article provides a step-by-step overview of the financial reporting requirements for companies registered in Pakistan to help you fulfill your obligations efficiently and avoid penalties or legal trouble. With the right systems and processes in place, financial reporting does not have to be an arduous task and can provide valuable insights into your business's performance.

## Applicable Laws and Regulations

As a public limited company in Pakistan, your organization is required to comply with several laws and regulations regarding financial reporting. The two primary acts are:

The Companies Act, 2017, which requires all public and private companies to:

Maintain proper books of accounts and financial records. Prepare annual financial statements, including a balance sheet and profit and loss account.

Appoint an auditor to audit the financial statements.

File the annual financial statements and auditor's report with the Securities and Exchange Commission of Pakistan (SECP).

The Securities Act, 2015 regulates the governance and issuance of securities. Under this act, public listed companies must:

Disclose prescribed information to the public including financial results, prospectuses, and notices.

Comply with the SECP's Code of Corporate Governance

Submit quarterly and annual financial statements and other reports to the SECP and stock exchanges.

To summarize, the key financial reporting requirements for your company are:

* Maintain accurate accounting records.
* Prepare annual financial statements according to IFRS
* Appoint an independent auditor to audit the financials.
* File reports with the SECP and stock exchanges.
* Follow good corporate governance practices.

By understanding and properly implementing these financial reporting laws and regulations, your company can build trust and transparency for investors and stakeholders. The team at Usman Rasheed & Co. Chartered Accountants has extensive experience helping organizations like yours meet their compliance obligations. Please contact us if you need any assistance.

## Appointment of Auditors

As a public limited company in Pakistan, you are required to appoint an independent auditor to audit your annual financial statements and report on their fairness and compliance with approved accounting standards. The following steps outline the process for appointing auditors:

The Board of Directors nominates an audit firm as auditors for the approval of shareholders in the annual general meeting (AGM). The firm should be registered with the Institute of Chartered Accountants of Pakistan (ICAP) and not have any relationship with the company that could impair their independence.

Shareholders approve the appointment of the auditors in the AGM for the conduct of the audit of that financial year. Approval requires an ordinary resolution, meaning a simple majority of the votes cast.

The Board fixes the remuneration of the auditors in consultation with the audit committee. The remuneration should be reasonable to ensure high audit quality.

The appointment of auditors is valid only for one financial year. The auditors can be reappointed in the next AGM. There are no term limits on reappointment, but rotation of auditors periodically, such as every 5 years, is considered good practice.

The auditors have the right to access company records and information to conduct the audit. They should be provided unrestricted access to financial and non-financial information.

The auditors submit an audit report with their opinion on the financial statements. The report is presented to shareholders in the next AGM along with the audited financial statements.

Following these steps will ensure you remain compliant with the financial reporting requirements in Pakistan. Usman Rasheed & Co Chartered Accountants has extensive experience guiding companies through the financial reporting and audit process. Please contact us if you need any assistance.

## Preparation of Financial Statements

### Collecting Financial Information

To prepare financial statements for your company, you must first gather all relevant financial information from the past fiscal year. This includes records of:

### Sales and revenues

* Expenses (operating, administrative, cost of goods sold)
* Assets (current, fixed, intangible)
* Liabilities (current, long-term)
* Shareholder equity
* Cash flow (operating, investing, financing activities)

Review all transactions thoroughly to ensure no information has been omitted or recorded incorrectly. Verify that revenues and expenses have been properly matched to the fiscal year they apply to.

### Preparing the Statements

Once you have organized all financial information, you can begin drafting the core financial statements:

### Income Statement

Summarizes revenues and expenses to show the company's profit or loss over the fiscal year. Calculate revenue, cost of goods sold, gross profit, and net income.

### Balance Sheet:

It provides a snapshot of the company's assets, liabilities, and shareholder equity at the end of the fiscal year. Assets must equal liabilities plus equity.

### Cash Flow Statement

Shows the flow of cash in and out of the company over the fiscal year from operating, investing, and financing activities Helps assess liquidity and solvency.

### Statement of Changes in Equity

It outlines the changes in shareholder equity over the fiscal year including profits, dividends, and share issues.

### Review and Audit

Carefully review all financial statements to ensure there are no errors or omissions before distributing to shareholders and filing with regulatory bodies. Consider having statements audited by an independent external auditor to provide assurance of their accuracy and compliance with accounting standards. Audited statements may be required for public companies and when seeking investment or loans.

Following these steps will allow you to properly prepare and disseminate your company's mandatory financial statements, providing transparency to shareholders and meeting regulatory requirements. Be sure to stay up-to-date with current accounting standards to guarantee full compliance.

### Filing of Financial Statements

As a public limited company in Pakistan, you are required to file annual financial statements with the Securities and Exchange Commission of Pakistan (SECP) and the registrar of companies. This includes:

### Balance Sheet

A balance sheet provides a snapshot of your company's financial position at the end of the financial year. It lists your assets, liabilities, and equity. Your balance sheet must follow the SECP's prescribed format.

### Profit and Loss Account

Your profit and loss account, also known as an income statement, shows your company's revenue, expenses, and profits for the financial year. It must also follow the SECP's standard format.

### Cash Flow Statement

The cash flow statement shows your company's cash inflows and outflows from operating, investing and financing activities. It provides important information about your company's liquidity and solvency.

### Notes to the Accounts

The notes provide additional information about the items listed in your balance sheet, profit and loss account, and cash flow statement. They give context to help readers understand your company's financial results and position. The notes must include information such as accounting policies, contingent liabilities, and related party transactions.

### Directors' Report

The directors' report provides an overview of your company's operations and financial performance for the year. It highlights important events that occurred and their impact on the financial statements. The report must be approved and signed by at least two directors.

### Auditors' Report

The auditors' report contains the auditors' opinion on whether your company's financial statements give a true and fair view of its financial position and performance. The auditors' report must be prepared by independent auditors who are registered with the SECP.

Filing complete and accurate financial statements on time is crucial to maintaining your company's compliance. Usman Rasheed & Co Chartered Accountants can help you prepare financial statements that meet all SECP requirements. Our experienced team stays up-to-date with the latest accounting standards and corporate regulations in Pakistan.

### Penalties for Non-Compliance

As a public limited company in Pakistan, strict penalties apply for failing to comply with financial reporting quirements. ###Late Filing Penalties

Failure to file annual financial statements within the stipulated time period results in late filing penalties. For public listed companies, the penalty is Rs. 10,000 per day of default, to a maximum of Rs. 500,000. Private limited companies lace a penalty of Rs. 2,000 per day up to Rs. 100,000.

### Fines for Inaccurate Reporting

The SECP can impose hefty fines if material misstatements or omissions are identified in the audited financial statements The quantum of the penalty depends on the nature and significance of the violation but can be up to Rs. 5 million. The responsible directors and executives may also face legal prosecution in serious cases of fraudulent financial reporting

### Restrictions and Suspensions

Repeated or willful non-compliance with financial reporting requirements can lead to stringent actions like:

* Restriction, from raising further capital from the public.
* Suspension of trading of the company's securities on the stock exchange.
* Cancelation of the company's listing on the stock exchange.

The SECP has the authority to restrict or suspend the voting rights and dividend rights of shareholders in case of non-compliance.

As a last resort, the SECP can petition the court to wind up the operations of the company for failure to comply with regulations.

### Remedial Actions

To avoid stringent penalties and repercussions, companies should take prompt remedial actions upon identification of any non-compliance. This includes:

Immediately notify the SECP about the violation and submit a compliance plan.

Rectify the non-compliance like restating and re-filing inaccurate financial statements.

Strengthen internal controls and compliance mechanisms to prevent future violations.

Seek professional advice from financial experts on corrective actions needed.

With stringent monitoring and enforcement by the SECP compliance with financial reporting requirements is non-negotiable for Pakistani companies. Usman Rasheed & Co can provide guidance on SECP regulations and help strengthen your compliance mechanisms.

The financial reporting requirements for public companies in Pakistan are quite comprehensive and regulated. By following the step-by-step process outlined, you can ensure your company remains compliant with the relevant laws and regulations, While the reporting requirements may seem complex, taking it one step at a time and leveraging the resources available will help make the process manageable. By providing transparent and accurate financial reports, your company can build trust and credibility with shareholders and regulators. Though compliance comes with responsibilities, the benefits to your company's reputation and governance far outweigh the efforts required. With diligence and persistence, you can achieve rewarding results.

## Summary

Establishing an enterprise in Pakistan involves complying with several regulatory requirements. Here's a summary of the key steps and regulations:

1. Business Registration: Sole Proprietorship: Register with the Federal Board of Revenue (FBR) for a National Tax Number (NTN).

Partnership Firm: Register under the Partnership Act, 1932, with the Registrar of Firms.

Private/Public Limited Company: Incorporate under the Companies Act, 2017, through the Securities and Exchange Commission of Pakistan (SECP).

2. Tax Registration: Obtain an NTN from the FBR for income tax purposes.

Register for Sales Tax if the business involves taxable goods or services.

File for Professional Tax with provincial revenue authorities, if applicable.

3. Industry-Specific Licensing: Depending on the nature of the business, specific licenses may be required, such as:

Manufacturing: Environmental Protection Agency (EPA) approval.

Banking/Finance: Licensing by the State Bank of Pakistan.

Healthcare: Approvals from the Drug Regulatory Authority of Pakistan (DRAP).

4. Regulatory Approvals: Import/Export: Obtain a membership from a relevant chamber of commerce and an Importer/Exporter Code (IEC).

Construction/Real Estate: Approval from local development authorities.

5. Labor and Employment Compliance: Register employees with Employees Old-Age Benefits Institution (EOBI) and Social Security Institutions.

Comply with labor laws regarding wages, working conditions, and benefits.

6. Intellectual Property Protection: Register trademarks, patents, or copyrights with the Intellectual Property Organization of Pakistan (IPO-Pakistan).

7. Additional Compliance: Follow local municipal regulations for trade licenses.

Adhere to environmental and safety standards as per industry requirements.

8. Foreign Investment Regulations: For foreign investors:

Register with the Board of Investment (BOI) for special permissions or incentives.

Comply with foreign exchange regulations as per the State Bank of Pakistan.

9. Bank Account and Capital Requirements: Open a corporate bank account in the business name. Deposit the required capital, as stipulated for specific business types.

10. Annual Filings and Maintenance: File annual tax returns with the FBR.

Submit annual accounts and compliance reports to the SECP for companies.

Understanding these requirements and engaging legal or consultancy services can simplify the process of setting up an enterprise in Pakistan.