



File No: 52/Cost Audit/SY/CCP/2020/  
**COMPETITION COMMISSION OF PAKISTAN**  
**GOVERNMENT OF PAKISTAN**

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## **POLICY NOTE**

**SUBJECT: REINSTATEMENT OF REQUIREMENT FOR COST AUDIT UNDER COMPANIES ACT 2017**

The Competition Commission of Pakistan (hereinafter the ‘**Commission**’) has been entrusted with the exclusive statutory mandate of providing free competition in all spheres of commercial and economic activity, to enhance economic efficiency and protect consumers from anti-competitive practices. Under clause (b) of Section 29 of the Competition Act, 2010 (hereinafter the ‘**Act**’) the Commission is also empowered by the legislature to review the laws and policy frameworks, and to make suitable recommendations to the Federal or Provincial Governments to make new or amend the existing laws to foster competition.

2. This policy note recommends that the Securities & Exchange Commission of Pakistan (‘SECP’), reinstate the requirement of cost audit for **Cement, Sugar, Vegetable Ghee/Cooking Oil, Fertilizer, Wheat flour industries, and any other sector when and where deemed necessary** for the purpose of facilitating policy interventions in a fair, transparent, and independent manner.

3. The Commission is of the view that any limitation placed on cost audits may promote anti-competitive practices that in their very essence are detrimental to public interest.

## **BACKGROUND**

### **TREATMENT OF COST AUDIT UNDER DEFUNCT COMPANIES ORDINANCE, 1984**

4. Under Section 258 of the Companies Ordinance, 1984 ('CO, 1984), the Federal Government had the power to direct companies to carry out audit of their cost accounts. Under Section 43 of the Securities and Exchange Commission of Pakistan Act, 1997, SECP was vested with all the powers exercisable by Federal Government under any provision(s) of CO, 1984, thereby making the terms 'Federal Government' and the 'SECP' synonymous for the purpose of CO, 1984.

5. Once a company or several companies were required to include in their books of accounts particulars referred to in Section 230(1)(e) of CO, 1984, through a general or special order invoked under Section 246 of the said Ordinance, the requirement to carry out a cost audit was explicitly stated in the same order.

6. SECP, through general orders, such as 'Companies Cost Accounting Records (General Order), 2008'<sup>1</sup>, as well as special orders, required companies included in various sectors to carry out audit of their cost accounts on an annual basis. These cost audits followed professional standards specified in Companies (Audit of Cost Accounts) Rules, 1998<sup>2</sup>. Typical industries in this regard are listed herein below.

- a. Fertilizer,
- b. Thermal energy,
- c. Petroleum refining
- d. Natural gas, and
- e. Polyester fiber
- f. Sugar
- g. Cement

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<sup>1</sup> [https://www.secp.gov.pk/wp-content/uploads/2016/05/cca\\_records.pdf](https://www.secp.gov.pk/wp-content/uploads/2016/05/cca_records.pdf)

<sup>2</sup> <https://www.secp.gov.pk/document/the-companies-cost-accounting-records-general-order-2008/?wpdmdl=13494&refresh=5ea6ac6b5db3a1587981419>

- h. Vegetable Ghee, and
- i. Pharmaceuticals

## **TREATMENT OF COST AUDIT UNDER COMPANIES ACT, 2017**

7. Come 2017, the CO, 1984 was replaced with the Companies Act, 2017 ('CA, 2017). Section 220 of CA, 2017 was effectively a reproduction of Section 230 of CO, 1984, except for now, the requirement of issuing a general or special order in this regard has been omitted. Section 220 of CA, 2017 is being provided below for reference:

***“220. Books of account, to be kept by company. (1) Every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statements for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any:***

***Provided that in the case of a company engaged in production, processing, manufacturing or mining activities, such particulars relating to utilisation of material or labour or the other inputs or items of cost as may be specified, shall also be maintained”.***

8. Furthermore, While SECP had the unconditional power to direct companies to carry out audit of their cost accounts, in terms of Section 258 of CO, 1984, the corresponding Section of CA, 2017 i.e. Section 250, made it such that now the aforesaid power could only be exercised subject to recommendation made by the regulator of the relevant sector or an entity therein. Section 250 is being reproduced below for ready reference:

***Section 250. Audit of cost accounts.- (1)Where any company or class of companies is required under first proviso of sub-section (1) of section 220 to include in its books of account the particulars referred to therein, the Commission may direct that an audit of cost accounts of the company shall be conducted in such manner and with such stipulations as may be specified***

*in the order by an auditor who is a chartered accountant within the meaning of the Chartered Accountants Ordinance, 1961 (X of 1961), or a cost and management accountant within the meaning of the Cost and Management Accountants Act, 1966 (XIV of 1966); and such auditor shall have the same powers, duties and liabilities as an auditor of a company and such other powers, duties and liabilities as may be specified.*

**(2) The audit of cost accounts of the company under sub-section (1) shall be directed by the Commission subject to the recommendation of the regulatory authority supervising the business of relevant sector or any entity of the sector.”**

## **BROADER IMPLICATIONS OF THE DEPARTURE IN CA, 2017 CONCERNING THE REQUIREMENT FOR COST AUDIT**

9. The **major departures** regarding the requirement for cost audit in the CA, 2017 are:
- a. Omission of SECP’s authority to issue general and/or special orders requiring yearly cost audits in specified industries

While keeping the provision for directing/requiring cost audit from firms, making it subject to **recommendation from a sector regulator** in this regard.

10. Broadly speaking the **implications** of the above are:
- a. Almost all the sectors that have historically been required by SECP to carry out cost audit of accounts, under CO, 1984, do not have a sector specific regulator, thus making the provision for directing cost audit under CA, 2017 **ineffectual for all practical purposes**.
  - b. In lieu of the aforementioned, various government bodies, that may require readily available and credible cost information, may have to rely

on industry players or their associations, instead of an independent third party, with no inherent conflict of interest. Not only could this negatively impact Government decisions, but also public interest at large.

- c. The absence of audited cost accounts in any sector and the reliance on industry associations for information, could lead to exchange of commercially sensitive information at the association's platform, impacting competition and hurting consumer welfare.
- d. In putting such reliance, not only does the Government inadvertently legitimize such exchange at the association's level, but also risk usage of an association's platform to enter into prohibited agreements, such as price fixing, a behavior universally considered to be very harmful to competition, and against public interest.

## **COMPETITION CONCERNS**

### **Main Competition Concerns**

#### **Potential for Exchange of Commercially sensitive information**

When Associations are relied upon for costing information as against an independent third party fully equipped with carrying out such an audit, there is very high likelihood of sharing of commercially sensitive information between potential competitors, such that factors that give competitive edge to firms, and are best kept a secret, are freely shared between them potentially generating ideas for collective welfare as against individual edge required in a competitive market.

#### **Possibility of cartelization**

Potential loss of competitive edge through sharing of commercially sensitive information, can raise the possibility of agreements geared at collective welfare of firms, at the cost of general consumer welfare ensured by firms competing in terms of economically efficient measures.

## **Obfuscation/Concealment of information due to vested Interests**

There is every possibility for Associations that are nothing but a body essentially comprising competing members firms, to manipulate or conceal information, to serve their own interests as against promoting overall sector competitiveness.

## **Problems in Enforcement under the Competition Act, 2010**

11. Section 4 of Competition the Act prohibits, agreements between undertakings and decisions by associations that have the impact of restricting, lessening, or preventing competition in a given sector or relevant market

As highlighted above, when associations are relied upon for information, the authenticity of such data would always be doubtful in identifying any patterns of pricing that can potentially raise a red flag in terms of ‘price fixing’ or other hard core violations treated as ‘prohibited agreements’ in contravention of Section 4 of the Act.

12. Section 3 of the Act prohibits any legal entity to abuse its dominant position. One instance of such abuse is when an undertaking that is dominant in its relevant market, leverages that position to carry out an ‘unreasonable increase in price’ of its products or services.

- a. While evaluating the above is one of the most challenging of tasks faced by Competition agencies world over, an inconclusive but important component of all such analysis is ‘accounting comparators’. One of the most important accounting comparators is the relationship between the price and cost of a product or service being offered by a dominant entity in a given market. For this analysis to be of any significance, information pertaining to the cost or expenses incurred by a dominant undertaking need to be credible to the core, which cannot be guaranteed, unless an independent third party with no vested interest at any level of supply chain and professional competence is engaged.

## **Policy Tools provided for in the Act vis-a-vis Government regulated Sectors**

13. In addition to the aforementioned enforcement actions, the Act also empowers the Commission to issue policy note or Opinions addressing competition concerns prevalent in Government regulated sectors or otherwise

- a. The essence of Competition law, is promotion of a free market economy. However, it is a reality that Governments do identify and intervene in certain sectors deemed to be providing absolute essentials for the masses. These could include essential commodities such as sugar, wheat/wheat flour, ghee/cooking oil, but also in some instances, and in relatively poor countries, drugs falling in the lifesaving category.
- b. While the Act by no means advocates Government intervention in terms of price or other such matters of commercially sensitive nature, When the Government does regulate such sectors, the Commission, through its policy tools, has been actively involved in identifying inefficiencies in such sectors and suggesting ways in which the various stages of supply chain could be made more efficient, in contributing to overall competitiveness of a sector.
- c. Sectors of the nature mentioned above, are subject to multiple government interventions which inter alia include subsidies, support price and price controls. Having costing accounts of companies, audited, does not only provide credible costing data to pertinent Government departments for making informed and independent decisions, but also equips the Commission to identify areas of economic efficiency, so that a regulated sector can at least closely emulate a market, marked by competition.
- d. Readily available costing information, verified by an independent third party, as against information provided by industry stakeholders,

addresses the conflict of interest inherent in the need to obtain such data from industry stake holders or their associations.

- e. Time and again through its orders and policy tools, the Commission has discouraged usage of an association's platform to agree on matters of a commercially sensitive nature, and the legitimization of the same, by any Government body. While obtaining information from an association may be the most convenient way of obtaining information, it may lead to obfuscation or concealment of information in addition to empowering an association to facilitate among its members, price fixing, output restriction, behavior universally recognized as extremely detrimental to competition, at the cost of consumers' welfare.

## **CONCLUSION/RECOMMENDATIONS**

14. To sum up the foregoing, reinstating cost audit would ensure transparency and make access to readily available and credible cost information for any pertinent government bodies to make informed and independent decisions in the wider interest of public.

15. From the competition stand point, availability of audited cost data would promote consumer welfare through:

- a. Facilitation of Enforcement measures and
- b. Policy interventions provided for in the Act,
- c. Resolution of conflict of interest through independent access to information,
- d. Curbing/prevention of harmful anti-competitive practices such as
  - i. Exchange of commercially sensitive information leading to
  - ii. Coordinated action/cartelization at the associations' platform

16. In view of the aforementioned, the foremost recommendation of the Commission is that SECP may reinstate the practice of conducting cost audit, through any



means that it may deem fit/appropriate particularly in sectors that do not have specific regulators, are recipients of subsidies, and/or support price, and/or any other special incentives in terms of resource allocation or cost advantage. The Commission recommends cost audit for the following sectors at the very minimum:

- a. Cement
- b. sugar,
- c. vegetable ghee/cooking oil,
- d. fertilizer and
- e. wheat flour

17. The SECP may direct cost audits in these sectors, on an annual basis, as per any pertinent accounting rules prevalent at the time, as may be specified in CA, 2017.

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**Islamabad the 8<sup>th</sup> day of May, 2020**