

1. **First phase of reforms**

The successful completion of the first phase of reforms has resulted in significant improvement in the capital market and its healthy impact is being noticed both within and outside the country. The key indicator is a visible revival of investor confidence.

SEC has fairly and effectively dealt with issues of stock market integrity (proper price discovery and effective settlement of transactions), stock broker integrity and stock exchange governance.

SEC has constituted a consultative group comprising of professional bankers and capital market experts in order to have an independent and professional feedback for consolidation of key policy measures and improved monitoring of stock market. The group that acts as a think tank and a sounding board to the Chairman SEC discussed wide ranging capital market issues during its first meeting held in Karachi last week.

2. **Present focus**

In addition to enhancing its surveillance, monitoring and enforcement capacity, the SEC is now concentrating on improving corporate governance, transparent accounting practices and reliable disclosure through audits. Timely availability of correct and material information is the key to effective regulation and bringing back investor confidence. Sound reporting of corporate financials is a key element of disclosure and transparency. The entire system critically depends upon it.

To achieve this, the Commission is not only committed to strengthening the accounting profession but is also ensuring maximum transparency and minimizing conflict of interest. Collapse of US energy giant Enron, which led to the highest bankruptcy in world history, involving about \$200 billion, occurred mainly due to misleading accounts and shady auditing resulting from crony alliances between corporate managers and auditors. This financial scam along with several other similar incidents in the recent past has brought the performance and responsibility of the accounting profession into question all over the world.

In Pakistan, accounting profession has significant strengths. We have within the profession a large number of very competent accountants and auditors - perhaps world class. But the profession also has significant weaknesses. There are a few that may well have succumbed to the growing apathy and erosion in moral values we have been afflicted with in recent years. In particular, a minimalist approach has been taken in complying with international accounting standards, consistency is sometimes non-existent, disclosure levels are weak and the attempt is to avoid liability rather than inform, and there is a noticeable reluctance to submit to quality control reviews. There has been no shortage of accounting scandals and failures in Pakistan in recent years. It is high time the profession gears up and takes decisive steps to visibly enhance its quality as well as image.

There is considerable intellectual ferment that is calling for major reform in several areas:

First, it is increasingly being argued that self-regulation is not enough to maintain standards. It is felt that the profession must be regulated by a tough, statutorily independent body under the direct aegis of the Securities Commission (or a part of it) - the agency must have teeth to fine or ban erring auditors;

Second, conflicts of interest in accounting firms need to be properly addressed. It is simply inappropriate for an auditor to also provide consulting services. Even if there isn't any conflict, the perception of it is enough to undermine confidence.

Third, it is improper, almost insensible, for the same auditor or audit firm to continue to audit books of a client for years and years. There must be mandatory rotation after 3-4 years.

Fourth, staff of external audit firms should not be hired by their clients as internal auditors, managers etc.

We will have to decisively address these areas and others calling for improvement, as this is a very important area for Pakistan to effectively tackle if we are to engender investor confidence and attract investment.

3. Measures for better disclosure

SEC has already taken some initial measures by issuing directives to stock exchanges about accounting and auditing of listed companies. These are:

Firstly, the Commission has directed listed companies to facilitate the QCR process by requiring them to authorize their auditors to make available all audit working papers and other information for this purpose.

Secondly, no listed company would be allowed to retain or hire an auditor found guilty of professional misconduct for a period up to 3 years as may be determined by the Commission.

Thirdly, the SEC has directed that listed companies must not hire their auditors as consultants or advisors or for the provision of other services. This is a basic rule albeit we may make some exceptions in respect of services that are a natural to auditing and are not in conflict with the external audit function.

Fourthly, the Code of Corporate Governance that is being finalized will stipulate provisions with respect to rotation of auditors, banning auditors and their families from investing in shares of their audit clients, instituting audit committees and the internal audit function, and requiring the appointment of only those firms as auditors that have gone through the QCR process.

4. Investors' confidence in capital market

The Commission needs to strengthen its enforcement, improve standards for corporate governance and enhance the quality of audit.

In addition to the directive to listed companies about hiring services of auditors, the Commission has issued a directive today to the stock exchanges to fund their Investor Protection and Clearing House Protection Fund. These steps will help restore investor confidence and will allow stock exchanges to play their due role in the development of the country.

There has been significant interest from international investors including non-resident Pakistanis, to invest in stocks. That has also been reflected in the recent market upsurge. The key areas that have given confidence to investors are improved governance of stock exchanges, better monitoring by the SEC and commitment to continue and consolidate these reforms