

POLICY NOTE TO THE SECP TO ASSIST IN DEVELOPING THE NEW FRAMEWORK FOR COST ACCOUNTING INFORMATION SHARING

I. Background

The Competition Commission of Pakistan (hereinafter the “CCP”) took notice of the Press Release on the website of the Securities and Exchange Commission of Pakistan¹ (the “SECP”), and the news items appearing in the national press (‘Pakistan Today’, August 23, 2011, ‘The News’ and ‘Daily Times’ of August 24, 2011), wherein it was mentioned that the SECP has withdrawn the Companies Cost Accounting Records (General Order), 2008 (the “General Order”) dated 26th September, 2008. It is also mentioned that the said order was devoid of specific reporting formats/guidelines, therefore the industries, each having a unique nature of cost components and reporting structure, were facing practical difficulties in complying with the requirements of the said order. We note from the Press Release that the SECP is actively involved in consultation to develop industry-specific guidelines/reporting format, and that it will issue special orders for certain specific industries.

2. The General Order stated that it shall apply from the financial year commencing on or after October 1, 2008, to companies engaged in production, processing, manufacturing or mining activities, in the fertilizer, thermal energy, petroleum refining, natural gas, and polyester fiber industries. Further to this, companies engaged in cement, vegetable ghee and sugar industries were also required to comply with the above-mentioned General Order. SECP had earlier issued a special order for these sectors. The General Order stated that the companies were required to maintain cost accounting records, have a cost audit, and circulate and distribute the cost auditor’s reports. Later on, the SECP deferred the applicability of the General Order vide its SRO 371(I)/2011, dated May 9, 2011, to the companies engaged in fertilizer, thermal energy, petroleum refining, natural gas, and polyester fibre industries till July 1, 2011. However, as per the General Order, this deferment did not affect special cost orders issued by the SECP for cement, vegetable ghee and sugar industries.

3. Through this Policy Note, the CCP intends to provide its input into the new cost orders of the SECP that may have implications for competition in the industries concerned.

II. Competition Concerns

4. The CCP has been established inter alia to provide for free competition in all spheres of commercial and economic activity to enhance economic efficiency and to protect consumers from anti-competitive behavior. According to Section 29 of the Competition Act, 2010 (the “Act”), its duties include but are not limited to:

¹ http://www.secp.gov.pk/news/PDF/News_11/PR-Aug23-2011.pdf

(a) reviewing policy frameworks for fostering competition;

(b) engaging in competition advocacy, and taking all other actions as may be necessary for carrying out the purposes of this Act.

5. It is CCP's mandate to promote competition norms through advocacy and persuading economic agents including government agencies/ regulators to act in accordance with the Act. CCP holds the view that the requirement of circulating and distributing cost audit reports amongst shareholders as prescribed in Clause 4 of the withdrawn General Order was inconsistent with the overall spirit of Chapter II of the Act, as discussed below. The said Clause 4 is reproduced below:

“4. **Circulation and distribution of reports:-** (1) Each company that falls within the industries specified in paragraph 1(3) above shall be required to circulate the cost auditor's report to Directors prescribed in sub-rule (3) of rule 4 of the Companies (Audit of Cost Accounts) Rules, 1998 together with the Reconciliation stipulated in 3(b) above within six months of the close of the financial year to members, directors and **shareholders of the company**, the Commission and the Registrar concerned. **Such reports may be disseminated to its shareholders by posting the same on the company's website** within six months of the close of the financial year. The cost audit report shall not be required to be printed and it shall be permissible to circulate photo-copies thereof.” (Emphasis added)

6. CCP observes that the maintenance of cost accounting records and cost audits may contribute towards enhancing competitiveness of the sectors. However, in Pakistan, where the concept and practice of enterprise governance is developing, enterprises may not be inclined to self-regulate and conduct cost audits. This is despite the fact that they may benefit, for instance, by using results to improve their competitiveness through various measures. In any case, it is understandable that the SECP would want to foster self-disciplinary mechanisms by instituting a cost accounting system that collects and collates cost data.

7. CCP views cost audits as instruments that promote efficiency as they may identify processes and activities where improvements can be made to enhance productivity and reduce/eliminate wastage of resources. In this sense, cost accounting reports are a part of the corporate support system that is for internal use, providing cost information to the management for decision making and control. Generally, companies are not inclined to share detailed cost data, **except with management and regulators**; its availability to other market players may harm their competitive advantage. The said General Order required companies to circulate the cost auditor's report amongst shareholders and/or to publish the report on their websites. In case said order was implemented, this particular requirement would have resulted in making commercially sensitive information available in the public domain. This may affect the independence with which companies make their production and pricing decisions, thus, negatively affecting competition. Therefore, we consider that commercially sensitive cost information should be kept confidential. This spirit is embodied in the Cost Audit Rules in Pakistan, which confine the disclosure of the cost auditor's report to the SECP and the directors of the company.

8. We consider that sharing detailed cost data may be problematic in a competitive business environment. The data, once shared, becomes public information, and information exchange on cost may provide patronage and facilitate companies in their coordination and monitoring of anti-competitive practices, be it dividing the markets allocating quotas, or fixing prices and hence may facilitate collusion amongst independent economic agents. Such practices are universally recognized as having detrimental effects on competition, eradicating or seriously reducing the benefits that competitive markets deliver for consumers. When asymmetric costs are private information, this hinders cartel activity. Sharing these costs may facilitate collusion. It may create a public record on which collusive schemes may be based. This outcome is more likely when shared information is disaggregated and detailed, possibly helping companies detect deviations from collusive schemes. Hence, the outcome of publicizing detailed cost data is harmful for competition.

III. Recommendation

9. In view of the foregoing CCP is of the considered view that a competition issue arises when there is a requirement to place sensitive cost data in the public domain. CCP, therefore, considers that circulating the cost audit reports in a manner that was earlier prescribed by the SECP would negatively affect competition and may facilitate anti-competitive practices. CCP fully appreciates and acknowledges SECP's significant role as a pre-eminent regulatory institution, however, having appreciated the scheme of law under the Companies Ordinance 1984, the legal framework does not envisage any such requirement, whereas, imposition of any such requirement by SECP will result in conflict with the provisions of section 4 of the Act. To the contrary, it is a scheme of Companies Ordinance 1984 that access to business information and data is open to specified stakeholders.

10. Accordingly, CCP issues this Policy Note under Section 29 of the Act to assist SECP in ensuring that the new framework dispenses with the requirement of placing cost audit reports on companies' websites or otherwise available as public information.