



**The Institute of
Chartered Accountants
of Pakistan**

**CA
PAKISTAN**

HEAD OFFICE

Circular No. 04 / 2023

April 6, 2023

ALL MEMBERS OF THE INSTITUTE

Dear Member

External Auditor's Report on Royalty, Franchise and Technical Services (RFT) Fees Agreement, under Paragraph 12 (iii) of Chapter 14 of the Foreign Exchange Manual 2002

The Foreign Exchange Manual 2002 (Chapter 14, paragraph 12 (iv)) requires acknowledgement of RFT agreements by the authorised dealers. For the acknowledgement of RFT agreement, the company/entity (the applicant) has to submit its RFT agreement, Application (specified in Appendix V-52 of the Foreign Exchange Manual) and other documents with the authorized dealer.

In this regard, paragraph 12 (iii) (b) and (e) of Chapter 14 of the Foreign Exchange Manual requires the external auditor of the applicant to:

- a) Verify the information submitted by the applicant in the Application (Appendix V-52);
- b) Verify the basis and actual calculation of the RFT amount payable;
- c) Comment on the value addition through the RFT agreement; and
- d) Certify that the principles of arm's length pricing have been observed, and basis of pricing are transparent and verifiable (this certification is required when the counterparty in the RFT agreement is a related party).

The Institute, in view of the above-noted significant change in the Foreign Exchange Manual relating to the external auditor's role and responsibilities, has developed following documents for the consistent understanding and use by the auditors and other stakeholders:

- Format of assurance report on company's application for acknowledgement of RFT agreement;
- Formats of the applicant's statements (Statement of basis and calculation of RFT, Statement of value addition through RFT, and Statement of arm's length pricing of RFT); and
- A brief explanation of applicant's and auditor's responsibilities under paragraph 12 (iii) b and (e) of Chapter 14 of the Foreign Exchange Manual.

Format of assurance report

The Auditing Standards and Ethics Committee of the Institute has developed the format of the '*Independent Reasonable Assurance Report on the Application for Acknowledgement of Agreement for Royalty/Franchise/Technical Services Fees*', in accordance with the revised International Standard on Assurance Engagements 3000, '*Assurance Engagements other than Audits or Reviews of Historical Financial Statements*' (ISAE 3000) (Revised). The assurance report covers the engagement scope and auditor's opinion on the matters specified in paragraph 12 (iii) (b) and (e) of Chapter 14 of the Foreign Exchange Manual.

The format of the Assurance Report is enclosed as '**Appendix A**' to this Circular.

(Established under the Chartered Accountants Ordinance, 1961 - X of 1961)

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Formats of the applicant's statements

The applicant, in addition to the Application (i.e. Appendix V-52), should also provide information to the auditor related to the calculation of the RFT fee payable, value addition through the RFT agreement, and arm's length pricing for the RFT payable to the related party.

In this regard, formats of following statements have been developed to facilitate the applicants and other stakeholders.

- Statement of Basis and Calculation of Royalty/Franchise/Technical Fee Payable;
- Statement of Value Addition through Royalty/Franchise/Technical Agreement; and
- Statement of Arm's Length Pricing for Royalty/Franchise/Technical Payable to the Related Party (this statement would be required only when RFT is payable to a related party).

The Statements are enclosed as **Appendices B1-B3** to this Circular.

Explanation of applicant's and auditor's responsibilities

A brief paper has also been developed to assist in developing common understanding among applicants and auditors about the requirements and respective responsibilities under paragraph 12 (iii) (b) and (e) of Chapter 14 of the Foreign Exchange Manual. The paper is enclosed as **Appendix C** to this Circular.

Members are advised to take note of the above.

Yours truly

Sohail Malik
Senior Director Technical

Enclosed: as above

INDEPENDENT REASONABLE ASSURANCE REPORT ON 'APPLICATION FOR ACKNOWLEDGEMENT OF AGREEMENT OF ROYALTY / FRANCHISE / TECHNICAL SERVICES FEES'

To the Chief Executive/ Chief Financial Officer of the _____ (*name of Company)

1. Introduction

We have been engaged by the (the Company) to perform a reasonable assurance engagement on the annexed:

- a) Application for the 'Acknowledgement of Agreement for Transfer of Technology' (Royalty/Technical Assistance) executed on _____ (date);
- b) Statement of Calculation of Royalty/Franchise/Technical Fee Payable;
- c) Statement of Value Addition through Royalty/Franchise/Technical Agreement; and
- d) ¹ Statement of Arm's Length Pricing for Royalty/Franchise/Technical Payable to the Related Party.

The above are here-in-after referred to as the Application and Statements.

2. Applicable Criteria

The criteria against which the information contained in the Application and Statements are assessed is specified in paragraph 12 of Chapter 14 '*Commercial Remittances*' of the Foreign Exchange Manual 2002 (the Foreign Exchange Manual). In accordance with paragraph 12(iv) (b) of the Foreign Exchange Manual, for acknowledgement of the RFT Agreement by the authorized dealer, the Company is required to submit to the authorized dealer an Application as per the prescribed format i.e. Appendix V-52 of the Foreign Exchange Manual. The information submitted in the Application has to be verified by the independent external auditor as prescribed in paragraph 12(iii) (b) and (e) of Chapter 14 of the Foreign Exchange Manual.

²In addition to the above criteria, for the purposes of arm's length pricing the criteria against which the information contained in the Statement of Arm's Length Pricing for Royalty/Franchise/Technical (RFT) payable to the Related Party is assessed is specified in the Companies Act, 2017 and the Companies (Related Party Transactions and Maintenance of Related Records) Regulations, 2018.

3. Inherent limitations

All assurance engagements are subject to inherent limitations as selective testing (sampling) may not detect errors, fraud or other irregularities. Non-financial data may be subject to greater inherent uncertainty than financial data, given the nature and methods used for calculating, estimating and determining such data. The selection of different, but acceptable, measurement techniques may result in different quantifications between different entities.

Our assurance relies on the premise that the data and information provided to us by the Company have been provided in good faith. We expressly disclaim any liability or co-responsibility for any decision a person or an entity may make based on this Assurance Report.

4. Management's Responsibility for the Statement/s

Management is responsible for the preparation of the Application in accordance with the applicable criteria and in the form prescribed by the Foreign Exchange Manual.

The management is also responsible for the preparation of the Statement(s) including providing the basis for value creation through RFT payable under the Application, ³ and

where RFT is payable to the related party ensuring compliance with the transparent and verifiable principles of arm's length pricing as per the provisions of the Companies Act, 2017 and the Companies (Related Party Transactions and Maintenance of Related Records) Regulations, 2018.

The above-noted responsibilities also includes maintaining adequate records and internal controls as determined necessary to enable the preparation of the Application and Statements such that they are free from material misstatement, whether due to fraud or error.

5. Our Independence and Quality Control

We have complied with the independence and other ethical requirements of the Code of Ethics for Chartered Accountants issued by the Institute of Chartered Accountants of Pakistan, which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies International Standard on Quality Control 1 "Quality Control for firms that perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements" and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

6. Our responsibility and summary of the work performed

Our responsibility is to carry out an independent reasonable assurance engagement and to express an opinion as to whether the Application and Statements are prepared in accordance with the applicable criteria, based on the procedures we have performed and the evidence we have obtained.

We conducted our reasonable assurance engagement in accordance with International Standard on Assurance Engagements 3000 (Revised), '*Assurance Engagements other than audits or reviews of historical financial statements*' (ISAE 3000 (Revised)) issued by the International Auditing and Assurance Standards Board. That standard requires that we plan and perform this engagement to obtain reasonable level of assurance about whether the information submitted by the Company in the Application and Statements is free from material misstatement.

A reasonable assurance engagement in accordance with ISAE 3000 (Revised) involves performing procedures to obtain evidence about the RFT fee payable, basis of value addition through RFT fee, and application of principles of arm's length pricing for RFT fee payable to related party, and related information in the Application and Statements. The nature, timing and extent of procedures selected depend on the practitioner's judgment, including the assessment of the risks of material misstatement, whether due to fraud or error, in the Application and Statements. In making those risk assessments, we considered internal control relevant to the Company's preparation of the Application and Statements. A reasonable assurance engagement also includes assessing the applicable criteria used and significant estimates made by management, as well as, evaluating the overall presentation of the information contained in the Application and Statements.

We have carried out the procedures considered necessary for the purpose of providing reasonable assurance on the information contained in the Application and Statements.

Our assurance procedures performed included verification of the:

- a) Company's Application for corroborating the information contained therein about RFT with the RFT agreement provided by the management;

- b) Information about amount payable as RFT fee is based on the underlying data and records of the Company, including, the amount for one time lump sum (upfront) royalty/franchisee/technical fee, net sales value (excluding taxes & cost of imported items) / aggregate of customers' billing net of taxes/surcharges on which RFT fee is calculated by the Company, the ceiling specified in paragraph 12 of Chapter 14 of the Foreign Exchange Manual, and the Company's RFT agreement;
- c) Company's information about value addition through RFT agreement for consistency with the underlying records and evidence provided by the management; and
- d) ⁴ Company's basis of arm's length pricing of RFT fee for compliance with the criteria for characterisation as an 'arm's length transaction', including, information and evidence provided by management in this regard.

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

7. Opinion

In our opinion, the Application and Statements, reflect in all material respects, the Company's compliance with paragraph 12 (iii) (b) and (e) of Chapter 14 of the Foreign Exchange Manual.

Modification – If any ⁵

8. Emphasis of Matter paragraph ⁶

9. Restriction on use and distribution

This report is issued in relation to the requirements as stipulated under paragraph 12 of Chapter 14 of Foreign Exchange Manual and is not to be used or distributed for any other purpose. This report is restricted to the facts stated herein and the attachments.

Signature
Chartered Accountants

Date
Place/city

Notes:

* When required, please substitute 'company' as per legal status of the applicant. The format has been developed using the wording 'company', however, it should be used by the auditors of all applicants.

¹ 'Statement of Arm's Length Pricing for RFT payable to the Related Party' to be included in the auditor's report when:

- a) company's counter party for RFT fee payable is a related party, under paragraph 12 (iii)(e) of Chapter 14 of the Foreign Exchange Manual, and
- b) company has prepared and provided the auditor a Statement of Arm's Length Pricing for RFT Payable to the Related Party.

^{2/ 3/ 4} Include the wordings when scope of the engagement includes above-noted 'Statement of Arm's Length Pricing for RFT Payable to the Related Party'.

⁵ Modification/Qualification of opinion, if applicable, shall be in accordance with ISAE 3000 (Revised)

The practitioner shall express a modified conclusion in the following circumstances:

- (a) When, in the practitioner's professional judgment, a scope limitation exists and the effect of the matter could be material. In such cases, the practitioner shall express a qualified conclusion or a disclaimer of conclusion.
- (b) When, in the practitioner's professional judgment, the subject matter information is materially misstated. In such cases, the practitioner shall express a qualified conclusion or adverse conclusion.

⁶ Emphasis of matter paragraph, if applicable, shall be in accordance with ISAE 3000 (Revised)

The practitioner may consider it necessary to include an emphasis of matter paragraph to draw intended users' attention to a matter presented or disclosed in the subject matter information that, in the practitioner's judgment, is of such importance that it is fundamental to intended users' understanding of the subject matter information.

Name of the Company
Statement of Basis and Calculation of Royalty / Franchise / Technical Fee (RFT)
Payable

RFT Agreement between: Name of company and Foreign Collaborator
Address of Foreign Collaborator:
Total Royalty / Franchise and Technical Fee payable:
Mode of Payment:
Period of RFT Agreement Period:

Name of Authorized Dealer/Bank:

The amount of RFT payable in compliance with the requirements of paragraph 12(iii)(b) of FE Manual 2002 is and is calculated hereunder:

Signed by company: CEO & CFO

Name of company
Statement of Value Addition through Royalty/Franchise/Technical (RFT) Agreement

RFT Agreement between: Name of company and the Foreign Collaborator

Address of Foreign Collaborator:.....

Total Royalty/Franchise and Technical Fee payable:.....

Mode of Payment:.....

Period of RFT Agreement Period:.....

Name of Authorized Dealer/Bank:

Description of value addition through RFT payable under the agreement:

Signed by company: CEO & CFO

Name of the Company
Statement of Arm's Length Pricing for Royalty / Franchise / Technical Payable to the Related Party

RFT Agreement between : Name of company and Foreign Collaborator

Address of Foreign Collaborator:.....

Total Royalty / Franchise and Technical Fee payable:.....

Mode of Payment:.....

Period of RFT Agreement Period:.....

Name of Authorized Dealer/Bank:

Name of the related party	Nature of relationship of the company with the related party	Date of RFT agreement	Principal terms and conditions of the RFT agreement	Maximum duration of agreement (including amendments)	Whether RFT is at arm's length basis in compliance with section 208 of the Companies Act 2017 and Regulation 4 of Companies (Related Party Transactions and Maintenance of Related Records) Regulations, 2018	If RFT payable is not at arm's length a brief explanation on deviation from arm's length	Whether the RFT reflects the prevailing market price (Yes/No)	Description of principles / methodology used for arms-length pricing of RFT	Calculation of arm's length pricing based on the relevant principle / method	Remarks

Signed by company: CEO & CFO

Responsibilities of the Applicant and Auditor’s (Practitioner) for Reporting under Paragraph 12 (iii) (b) and (e) of Chapter 14 of the Foreign Exchange Manual 2002

S. No.	Paragraph 12 (iii) (b) and (e) of the Foreign Exchange Manual 2002	Applicant’s responsibilities	Auditor’s responsibilities under ISAE 3000 (Revised)	Auditor’s opinion under ISAE 3000 (Revised)
A.	<p>Paragraph 12(iii) (b) of the Foreign Exchange Manual is reproduced below:</p> <p><i>“The information submitted in the application shall be verified by the external auditor (having satisfactory QCR rating) of the company. The auditor shall verify the basis and actual calculation of the amount payable along with its comments on the value addition.”</i></p>	<p>The applicant has to:</p> <ul style="list-style-type: none"> ▪ Prepare the Application as per the format i.e. Form V-52. ▪ Include information in the Application as per the terms of the RFT agreement. ▪ Calculate RFT as per the rate and benchmarks specified in the Foreign Exchange Manual. ▪ Clearly demonstrate the value addition through RFT as required under paragraph 12 (iii) (a) of the Foreign Exchange Manual. ▪ Maintain and provide complete documentation pertaining to value addition (value addition - right of use, acquisition of knowledge/ technical know-how) for auditor’s verification. <p>For the above applicant would be required to prepare:</p>	<p>The auditor has to obtain from the applicant:</p> <ul style="list-style-type: none"> ▪ Application for the Acknowledgement of Agreement for Transfer of Technology (Royalty/ Technical Assistance). ▪ Statement of Basis and Calculation of RFT Payable; and ▪ Statement of Value Addition through RFT Agreement. <p>The auditor has to:</p> <ol style="list-style-type: none"> 1. Check that the Application is as per the prescribed format i.e. V-52. 2. Verify that the information contained in the application corroborates with the RFT agreement. 3. Verify the Basis of RFT payable. This requires the auditor to verify and conclude that the RFT meets the definitions specified under paragraph 12 (i) of Chapter 14 of the Foreign Exchange Manual. The auditor would verify that the rates and benchmarks 	<p>When the auditor has verified and concluded that applicant has provided the relevant and appropriate information the auditor would report that the Application and the Statements, reflect in all material respects, the applicant’s compliance with paragraph 12 (iii) (b) of Chapter 14 of the Foreign Exchange Manual.</p>

S. No.	Paragraph 12 (iii) (b) and (e) of the Foreign Exchange Manual 2002	Applicant's responsibilities	Auditor's responsibilities under ISAE 3000 (Revised)	Auditor's opinion under ISAE 3000 (Revised)
		a) The Application for the Acknowledgement of Agreement for Transfer of Technology (Royalty / Technical Assistance). b) Statement of Basis and Calculation of RFT Payable; and c) Statement of Value Addition through RFT Agreement.	used for the RFT payable are as per paragraph 12 (ii) of Chapter 14 of the Foreign Exchange Manual. 4. Check the actual calculation of RFT payable. This would require the auditor to re-calculate the information provided by the applicant. 5. Comment on the value addition. This requires the auditor to evaluate the information provided by the applicant regarding value addition through RFT, and also corroborate the information with the RFT agreement.	
B.	Paragraph 12(iii) (e) of the Foreign Exchange Manual is reproduced below: <i>The RFT rate needs to reflect the prevailing market price. In case the counterparty is a related party, external auditor of the applicant shall certify that principles of arms-length pricing has been be observed and the basis of pricing are transparent and verifiable.</i>	The applicant has to: <ul style="list-style-type: none"> ▪ Identify the related party ▪ Ensure that RFT reflects the prevailing market price ▪ Ensure that principles of arm's length are observed and related party transaction can be characterized as 'arm's length transaction' in accordance with the relevant provisions of the Companies Act 2017 and the Companies (Related Party Transactions and Maintenance of 	The auditor has to obtain the Statement of Arm's Length Pricing for RFT Payable to the Related Party from the applicant. The auditor has to obtain evidence that the applicant has appropriately characterized RFT payable to a related party as an 'arm's length transaction' in accordance with the principles of arm's length pricing specified in the relevant provisions of the Companies Act 2017 and underlying Companies (Related Party Transactions and Maintenance of Related Records) Regulations 2018.	When the auditor has verified and concluded that applicant has provided the relevant and appropriate information, the auditor would report that the Statement of Arm's Length Pricing for RFT Payable to the Related Party, reflects in all material respects, the applicant's compliance with paragraph 12 (iii) (e) of Chapter 14 of the

S. No.	Paragraph 12 (iii) (b) and (e) of the Foreign Exchange Manual 2002	Applicant's responsibilities	Auditor's responsibilities under ISAE 3000 (Revised)	Auditor's opinion under ISAE 3000 (Revised)
		<p>Related Records) Regulations 2018. Regulation 4 of the Companies (Related Party Transactions and Maintenance of Related Records) Regulations 2018, specifies following conditions for transactions with related parties to be characterized as "arm's length transactions".</p> <p><i>"Subject to the requirements of section 208 of the Act, a transaction between related parties shall be characterized as an 'arm's length transaction', only if it is carried out in a way, as if-</i></p> <ul style="list-style-type: none"> <i>a) the parties to the transaction were unrelated in any way;</i> <i>b) the parties were free from any undue influence, control or pressure;</i> <i>c) through its relevant decision-makers, each party was sufficiently knowledgeable about the circumstances of the transaction, sufficiently experienced in business and sufficiently well advised to be able to form a sound business judgement as to what was in its interests; and</i> 	<p>For this the auditor would obtain the information and documentary record from the applicant, including applicant's use of methodologies for determining the arm's length pricing. The auditor would evaluate and verify the information provided by management including management's judgment for the selection of the methodologies and working for determining the arm's length pricing.</p>	<p>Foreign Exchange Manual.</p>

S. No.	Paragraph 12 (iii) (b) and (e) of the Foreign Exchange Manual 2002	Applicant's responsibilities	Auditor's responsibilities under ISAE 3000 (Revised)	Auditor's opinion under ISAE 3000 (Revised)
		<p data-bbox="763 341 1167 501"><i>d) each party was concerned only to achieve the best available commercial result for itself in all the circumstances."</i></p> <p data-bbox="763 539 1189 794">For complying with the arm's length principle as-noted above, the applicant would use the arm's length methodologies. There are several internationally accepted methodologies that can be used for the purpose of determining arm's length price. These include:</p> <ul data-bbox="757 831 1167 1086" style="list-style-type: none"> - The comparable uncontrolled-price method - The resale price method - The cost plus method - The profit split method <p data-bbox="763 1123 1167 1283">The applicant would adopt the method that is the most appropriate to the circumstances of each particular case/ transaction.</p> <p data-bbox="763 1319 1189 1378">For independent verification of the auditor, the applicant would make</p>		

S. No.	Paragraph 12 (iii) (b) and (e) of the Foreign Exchange Manual 2002	Applicant's responsibilities	Auditor's responsibilities under ISAE 3000 (Revised)	Auditor's opinion under ISAE 3000 (Revised)
		<p>available information and record regarding the arm's length pricing determined by using the appropriate methodologies.</p> <p>The applicant would provide a 'Statement of Arm's Length Pricing for RFT Payable to the Related Party' to the auditor for his verification and certification.</p>		