



The Institute of
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Local News Brief

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IFAC/IAASB NEWS

Exposure Draft on Proposed Amendments to IFRS 7 (Improving Disclosures about Financial Instruments) (Comments Due Date: 15 December 2008)

IFRS 7 Financial Instruments: Disclosures was issued in 2005. This exposure draft aims to enhance disclosures about fair value measurements and the liquidity risk of financial instruments. In light of present market conditions, the view is that such disclosures are necessary.

The exposure draft proposes amendments to disclosure requirements that are based on a three level fair value hierarchy (similar to that used in SFAS 157). The amendments would apply to financial instruments and require disclosures about:

- (a) the level of the fair value hierarchy into which fair value measurements are categorised in their entirety. This requirement would apply both for fair values included in the statement of financial position and for other fair values that are disclosed but not included in that statement.
- (b) the fair value measurements resulting from the use of significant unobservable inputs to valuation techniques. For these measurements, the disclosures include a reconciliation from the beginning balances to the ending balances.
- (c) the movements between different levels of the fair value hierarchy, and the reasons for those movements.

After IFRS 7 was applied in 2007, the Board was informed that some of the disclosure requirements about the nature and extent of liquidity risk were unclear and difficult to apply and did not always result in useful information for users of financial statements.

This exposure draft proposes amendments to IFRS 7 that would:

- (a) clarify that liquidity risk disclosures are required only for financial liabilities that will result in the outflow of cash or another financial asset.
- (b) require entities to provide quantitative disclosures based on how they manage liquidity risk for derivative financial liabilities.
- (c) require entities to disclose the remaining expected maturities of non-derivative financial liabilities if they manage liquidity risk on the basis of expected maturities.
- (d) strengthen the relationship between qualitative and quantitative disclosures about liquidity risk.

Fair Value Audit Practice Alert Released

IFAC's International Auditing and Assurance Standards Board (IAASB) staff has released a practice alert, **Challenges in Auditing Fair Value Accounting Estimates in the Current Market Environment**. The alert highlights areas within the ISAs that are particularly relevant to fair value audits. The practice alert, may be downloaded free-of-charge from the IAASB section of the IFAC website (www.ifac.org/iaasb).

IFAC Supports Single Set of Auditing Standards

IFAC has issued a policy paper titled **IFAC's Support for a Single Set of Auditing Standards: Implications for Audits of Small and Medium-sized Entities**. The paper explains IFAC's position that International Standards on Auditing (ISAs) are designed to be applicable to the audits of entities of all sizes. All policy positions may be downloaded from the IFAC website by going to <http://www.ifac.org/Store/>.

IASB Update

Discussion Paper: Preliminary Views on Financial Statement Presentation (Comments Due Date: 14 April 2009)

The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) initiated the joint project on financial statement presentation to address users' concerns that existing requirements permit too many alternative types of presentation and that information in financial statements is highly aggregated and inconsistently presented, making it difficult to fully understand the relationship between the financial statements and the financial results of an entity.

This discussion paper invites comment on the boards' preliminary views on a proposed model for presenting information in the financial statements. The model is designed to make an entity's financial statements more useful by requiring entities to provide detailed information organised in a manner that clearly communicates an integrated (cohesive) financial picture of an entity.

Should members wish to comment on the above listed exposure draft and discussion paper, the same may be forwarded to Director Technical Services (shahid.hussain@icap.org.pk) before the due date. Appropriate CPD credit will be given for research articles provided.

Strategy for Global Financial Crisis

- The IASB and FASB announced further steps they plan to take for dealing with reporting issues, namely:
 - Rapid appointment of a high level advisory group
 - Public roundtables in Asia, Europe and North America
 - Common long term solutions to reporting of financial instruments

Educational Guidance on the Application of Fair Value Measurement when Market becomes Inactive

The IASB has published through a press release the educational guidance on the application of fair value measurement when markets become inactive. The educational guidance takes the form of a summary document prepared by IASB staff and the final report of the expert advisory panel established to consider the issue.

The main points of the report are as follows:

- Fair value means a quoted market price in an active market for an identical asset/liability.
- Inactive market means a significant decline in the volume and level of trading, quoted prices vary significantly or prices are not current. Significant judgment is involved to determine how regular trading is.
- Whichever valuation technique is used, appropriate risk adjustments for credit and liquidity must be made.
- Forced transactions are not orderly transactions and cannot form part of a fair value measurement. Judgment is required to determine whether a transaction is forced.
- If observable market data does not exist, fair values are determined using a valuation technique based on management's internal assumptions about cash flow and discount rates. Credit and liquidity risk adjustments should be included.
- If markets are inactive, brokers rely on models with inputs based on information only available to the broker. When considering a broker quote an entity should place less reliance on quotes that do not reflect the result of market transactions.

Full documents can be viewed/downloaded from the following links.

Press Release

<http://www.iasb.org/News/Press+Releases/IASB+publishes+educational+guidance+on+the+application+of+fair+value+measurement+when+markets+become.htm>

IASB Staff Summary

<http://www.iasb.org/Current+Projects/IASB+Projects/Fair+Value+Measurement/Fair+value+of+financial+instruments+in+markets+that+are+no+longer+active.htm>

Final Report of the Expert Advisory Panel

<http://www.iasb.org/Current+Projects/IASB+Projects/Fair+Value+Measurement/Fair+value+of+financial+instruments+in+markets+that+are+no+longer+active.htm>

Reclassification of Financial Assets: Amendment to IAS 39 and IFRS 7

The objective of the amendment in IAS 39 is to align IFRS with US GAAP. It permits loans and receivables to be reclassified if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity. Other non-derivative financial assets classified as trading can be reclassified in rare circumstances.

The amendments permit an entity to reclassify any non-derivative financial asset, other than those designated at fair value through profit or loss upon initial recognition, out of the trading category (and hence out of the fair value through profit or loss category) if it is no longer held for the purpose of being sold or repurchased in the near term. Financial assets classified as AFS and if they can be classified as loans and receivables can be reclassified effective 1 July 2008. Assets in AFS classification which need to be reclassified as HTM would need to be classified at fair value on the date of classification as this reclassification is not covered in the amendment and was already allowed before the amendment.

The effective date for the amendments is 1 July 2008 and reclassifications of a financial asset cannot be applied retrospectively to any date or any reporting period prior to 1 July 2008. The amendments state that any reclassification of a financial asset in periods beginning on or after 1 November 2008 takes effect prospectively from the date it is made and therefore cannot be applied retrospectively.

In Pakistan generally loans and receivables are not classified as held for trading or available for sale - therefore the amendment has limited effect of ability to classify equity securities classified as held for trading which can now be classified as available for sale, if the intention has changed.

Full document can be viewed/ downloaded from the following link:

<http://www.iasb.org/News/Press+Releases/IASB+amendments+permit+reclassification+of+financial+instruments.htm>

SECP Update

- Approved various amendments in the following 4 Regulations of the Exchange:
 - (i) Regulations Governing Risk Management
 - (ii) Regulations Governing Deliverable Futures Contract (DFC)
 - (iii) Regulations Governing Stock Cash-Settled Futures Contract (CSF)
 - (iv) Regulations Governing Stock Index Futures Contract (SIFC)
- Further details may be obtained from www.kse.com.pk
- Imposition of Additional VaR based Cash Margins in Deliverable Futures Market as follows:
 - 25% additional VaR based cash margins will be applied with effect from December 2008 Futures Contract.
 - 50% additional VaR based cash margins will be applied with effect from January 2009 Futures Contract.
- Issues findings of Occupational Savings Schemes Survey 2007-08.
- Directives issued to fixed income mutual funds to revalue Term Finance Certificates (TFC) downward by 5-30 per cent based on their respective ratings (Circular 26 dated 5 November 2008).
- Chief Executive of the company responsible for making dividend payment within a period of thirty days of declaring the same.

SBP Update

- To facilitate the ongoing efforts of stakeholders for development of the capital market, the **Prudential Regulations** will be amended as follows:
 - 1) Limit on total investment in shares will be increased to 30% of their equity (Islamic Banks/DFIs up to 45%) provided that investment in future contracts shall not exceed 10% of their equity.
 - 2) Minimum margin requirement on exposure against shares: Banks/DFIs are allowed to continue to maintain a minimum margin of 30% on their lending against shares, however they should not give a margin call until the margin reaches to the level of 25%.

Amendments come into effect from 27 October 2008.

- SBP issues strategic plan for Islamic Banking Industry of Pakistan.
- SBP issued Fair Debt Collection Guidelines to set standards to be observed by banks and DFIs for recovery of their debt.
- Advances to Deposit Ratio (ADR) shall not exceed 70% at any time: Advances defined as all loans/advances (on net basis) less refinance availed from SBP under Export Refinance and Long Term Financing Facility (LTFF) Schemes, lending for commodity operations, lending for power generation and distribution and lending to other banks. Deposits defined as all types including demand, savings and time deposits plus Tier 1 Capital less deposits/placements from other banks.
- SBP increased interest rate on November 13, 2008 by two per cent to 15 per cent.
- **Cash Reserve Requirements (CRR)** to be amended as follows:

From 15 November 2008, weekly average of 5% (subject to daily minimum of 4%) of Total Demand Liabilities (including Time Deposit with tenor of less than 1 year); time liabilities (including Time Deposit with tenor of 1 year and above) will not require any cash reserve.

- **Islamic Financial Services Board (IFSB)** approved two exposure drafts of Capital Adequacy Requirements for Sukuk Securitisation and Real Estate Investments and Guiding Principles on Governance of Islamic Collective Investment Schemes.
- In order to facilitate banks to provide financing to the exporters, it has been decided to amend the **Export Finance Scheme (EFS)** as under:
 - i) State Bank will henceforth provide 100% refinancing to banks against export finance provided by them to exporters under Part-I of EFS subject to fulfillment of the requirements of the Scheme. However, banks will continue to provide 30% of finance under Part-II from their own sources.
 - ii) Export finance already provided by banks under Part-I of EFS from own sources at the ratio of 30 percent and outstanding as on 31st October, 2008 shall be refinanced by the State Bank, for the remaining period of individual loan. For this purpose, the banks will have to approach the respective field offices of the SBP BSC.
 - iii) The limit of each bank under EFS for the FY 2008-09 will be revised on quarterly basis and conveyed to banks individually.

FBR Update

- The provisions of the Convention for the avoidance of double taxation and the Prevention of Fiscal Evasion, which was signed with the Government of Japan, will come into effect from 9 November 2008.
- Labour and Manpower Division (WWF Wing) agreed that the status quo be maintained I PTR cases and demand of WWF for the tax years 2007 and 2008 may not be created. However, the issue has been removed by the Finance Act, 2008, therefore levy of WWF may be pressed, wherever eligible in the Tax Year 2009.

Technical Advisory Committee Opinions

Treatment of Incremental Depreciation Arising Out of Revaluation of Fixed Assets

Enquiry

If a Company in its financial statements has disclosed that it has revalued its fixed assets 3 months before the year end. The said revaluation has resulted in surplus amounting to Rs.900 million in certain items of plant and machinery and deficit of amounting to Rs.600 million in case of certain other items leading to net surplus of Rs.300 million which was reported in the balance sheet as net Surplus on Revaluation of Fixed Assets Account.

Depreciation rates for plant and machinery items were in the range of 6% to 20%. While computing incremental depreciation on plant and machinery items it was noticed that those items which have resulted in deficit were charged with higher rate of depreciation and thus resulted in reduction in depreciation charge for the year amounted to Rs. 9 million.

If we assume following results:

Depreciation	Rs. <u>In million</u>	Applicable <u>Dep. Rate</u>	Incremental <u>Rs. in millions</u>
Plant A – Surplus on revaluation	900	9% Avg	81
Plant B – Deficit on revaluation	<u>(600)</u>	15% Avg	<u>(90)</u>
Net result (Surplus)	<u>300</u>		<u>(9)</u>

It can also be understood as following:

Depreciation

	<u>Cost</u>	Surplus/ <u>deficit</u>	Revalued <u>Amount</u>	Dep <u>Rate</u>	Before <u>Revalue</u>	After <u>Revalue</u>	Incremental <u>Depreciation</u>
Plant A	1000	900	1900	9%	90	171	81
Plant B	1000	(600)	400	15%	150	60	<u>(90)</u>
							<u>(9)</u>

Accounting Treatment adopted by the Company:

The depreciation charge for the current year was reduced by Rs.9 million due to major impact of depreciation on deficit items and no adjustment has been made to the value of surplus on revaluation of fixed assets.

In pursuance of section 235 of the Companies Ordinance, 1984 which provides that

Quote “(1) Where a company revalues its fixed assets, the increase in, or sums added by writing up of, the value of such assets as appearing in the books of accounts of the company shall be transferred to an account to be called “Surplus on revaluation of Fixed Assets Account” and shown in the balance-sheet of the company after Capital and Reserves.

(2) Except and to the extent actually realized on disposal of the assets which are revalued, the surplus on revaluation of fixed assets shall not be applied to set off or reduce any deficit or loss, whether past, current or future, or in any manner applied, adjusted or treated so as to add to the income, profit or surplus of the company, or utilized directly or indirectly by way of dividend or bonus:

Provided that the surplus on revaluation of fixed assets may be applied by the company in setting off or in diminution of any deficit arising from the revaluation of any other fixed asset of the company:

Provided further that incremental depreciation arising out of revaluation of fixed assets may be charged to surplus on revaluation of fixed assets account “ **Unquote**

Items which have resulted in deficit on revaluation, had an impact of reduction in the depreciation charge for the year in Profit and Loss Accounts and thus increased the amount of profit made available for distribution to the shareholders just because of revaluation of fixed assets.

The accounting treatment adopted by the Company appears to be in violation of the requirement of the Ordinance and IAS-16 as no adjustment with surplus on revaluation of fixed assets has been accounted for.

Committee's Views

The Committee noted that the issue has arisen because Section 235 of the Companies Ordinance allows companies to set-off revaluation of surplus of fixed assets against the deficit of any other fixed assets (which may have different useful life/depreciation rate) which IAS 16 does not permit. Paragraph 40 of IAS 16 states that:

If an asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus. (underlining is ours).

However, notwithstanding the above the Committee deliberated the matter and is of the view that the accounting treatment adopted by the company is in accordance with Section 235 of the Companies Ordinance, 1984 read with SRO 45(I)/2003 dated January 13, 2003 except that the company should also transfer each year an amount, equal to the decrease in depreciation charge, from the retained earnings/unappropriated profit to the surplus on revaluation account. .

Local News Brief

- The Central Depository Company of Pakistan Limited (CDC) made amendments in its regulations with the approval of the SECP, prohibiting deposit of registered-form eligible securities into its Central Depository System (CDS) where such securities are not already registered in the name of the relevant account holder or sub account holder.
- KSE clarified the procedures for Selling Out Market at KSE. The session is not any routine selling out session, but will only be triggered when a particular member would fail to pay his money and /or margins obligations to the National Clearing Company or the KSE.
- KSE and Singapore Exchange Limited (SGX) signed an MoU to assist each other with the development of the financial services industry.