



The Institute of
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of Pakistan

e Technical Update

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Contents

IFAC/IAASB News
IAASB Released 7 Revised & Redrafted ISAs

New IAASB Audit Practice
Alert Focuses on Fair
Value Accounting
Estimates

IASB Update
Exposure Draft of
Proposed
Improvements to IFRSs

Exposure Draft on
Simplifying Earnings per
Share – Proposed
Amendments to IAS 33

Exposure Draft on
Additional Exemptions for
First Time Adopters –
Proposed Amendments to
IFRS 1

Exposure Draft on
Discontinued Operations –
Proposed Amendments to
IFRS 5

IASB Announced Four
Planned 'Credit Crisis'
Steps

SECP Update

SBP Update

FBR Update

Technical Advisory
Committee Opinions

Local News Brief

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IFAC/IAASB NEWS

IAASB Released 7 Revised & Redrafted ISAs

In 2007 the IAASB commenced their review of the International Standards on Auditing (ISAs) with a view to improving the clarity, removing existing ambiguity and encouraging consistent application. Post review seven Revised and Redrafted Standards have been released as outlined below. The standards will provide further momentum towards achieving convergence and contribute to enhancing understanding of the purpose and scope of audits, and their effective conduct.

ISA 200 (Revised and Redrafted), *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, which is the overarching Standard to all other ISAs. In addition to ISA 200 (Revised and Redrafted), the IAASB also released:

- ISA 320 (Revised and Redrafted), *Materiality in Planning and Performing an Audit*,
- ISA 450 (Revised and Redrafted), *Evaluation of Misstatements Identified during the Audit*,
- ISA 530 (Redrafted), *Audit Sampling*;
- ISA 610 (Redrafted), *Using the Work of Internal Auditors*;
- ISA 705 (Revised and Redrafted), *Modifications to the Opinion in the Independent Auditor's Report*; and
- ISA 706 (Revised and Redrafted), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*.

All clarified ISAs will be effective from a single date, for audits of financial statements for periods beginning on or after December 15, 2009.

New IAASB Audit Practice Alert Focuses on Fair Value Accounting Estimates

(New York/October 6, 2008) - To assist auditors in addressing the challenges of auditing fair value accounting estimates, the staff of the IAASB, an independent standard-setting board under the auspices of the International Federation of Accountants (IFAC), today released an audit practice alert. The alert was developed following consultation with the IAASB's Task Force on Fair Value Auditing Guidance, which is considering the need for new or modified guidance in light of current marketplace issues.

The purpose of the alert is to highlight areas within the ISAs that are particularly relevant in the audit of fair value accounting estimates in times of market uncertainty. The practice alert, *Challenges in Auditing Fair Value Accounting Estimates in the Current Market Environment*, may be downloaded free of charge from the IFAC website (www.ifac.org).

IASB Update

Exposure Draft of Proposed Improvements to IFRSs (Comments Due Date 7 November 2008)

IFRS	Proposed Amendment
IFRS 2	Scope of IFRS 2 and Revised IFRS 3
IFRS 5	Disclosure of non current assets classified as held for sale or discontinued operations
IFRS 8	Disclosure of information about segment assets
IAS 7	Classification of expenditure on unrecognized assets
IAS 18	Determining whether an entity is acting as a principal or as an agent
IAS 36	Unit of accounting for goodwill impairment test
IAS 38	Additional consequential amendments arising from revised IFRS 3 Measuring the fair value of an intangible asset acquired in a business combination
IAS 39	Scope exemption for business combination contracts Application of the fair value option Cash flow hedge accounting Bifurcation of an embedded foreign currency derivative

Exposure Draft on Simplifying Earnings per Share – Proposed Amendments to IAS 33 (Comments Due Date 5 December 2008)

This exposure draft aims to prescribe principles for the determination and presentation of earnings per share so as to improve performance comparisons between entities.

Exposure Draft on Additional Exemptions for First Time Adopters – Proposed Amendments to IFRS 1 (Comments Due Date 23 January 2009)

In this exposure draft the IASB proposes to amend IFRS 1 First-time Adoption of International Financial Reporting Standards to address potential challenges for jurisdictions adopting IFRSs in the near future.

Exposure Draft on Discontinued Operations – Proposed Amendments to IFRS 5 (Comments Due Date 23 January 2009)

This exposure draft contains proposals by the IASB to amend IFRS 5 Non-current Assets Held for Sale and Discontinued Operations to revise the definition of discontinued operations and require additional disclosure related to components of an entity that have been (or will be) disposed of.

Should members wish to comment on the above listed exposure drafts, 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.

IASB Announced Four Planned ‘Credit Crisis’ Steps

The IASB has announced the current status of its response to the credit crisis and the next steps it expects to take. In its announcement, the IASB indicated that it ‘is closely monitoring developments in the United States and other jurisdictions to avoid unnecessary inconsistencies in accounting treatments under IFRSs and US generally accepted accounting principles (GAAP)’.

The IASB's next steps will be in the following areas:

1. Ensure consistency of fair value measurement guidance between IFRSs and US GAAP
2. Consider the possible impact of the US Emergency Economic Stabilization Act of 2008 and other similar programmes internationally on the valuation of assets and liabilities
3. Immediately consider the ability to reclassify financial instruments.

US GAAP permits entities, in rare circumstances, to reclassify financial instruments that are in the form of securities from their trading portfolio (measured at fair value with changes through the income statement) to 'held to maturity' (measured at amortised cost and subject to testing for impairment). Also US GAAP permits some loans that are not securities to be transferred from Held for Sale (measured at lower of cost or market with changes through the income statement) to Held for Investment (measured at amortised cost and subject to testing for impairment). IAS 39 does not currently permit such transfers. The IASB intends to assess (at its October 2008 Board meeting) any inconsistencies in how IAS 39 and US GAAP practice address the issue of reclassifications and decide whether to eliminate any differences.

The IASB on 13 October issued amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures that would permit the reclassification of some financial instruments.

The amendments to IAS 39 introduce the possibility of reclassifications for companies applying International Financial Reporting Standards (IFRSs), which were already permitted under US generally accepted accounting principles (GAAP) in rare circumstances.

The deterioration of the world's financial markets that has occurred during the third quarter of this year is a possible example of rare circumstances cited in these IFRS amendments and therefore justifies their immediate publication. Today's action enables companies reporting according to IFRSs to use the reclassification amendments, if they so wish, from 1 July 2008.

The amendments address the desire to reduce differences between IFRSs and US GAAP in a manner that produces high quality financial information for investors across the global capital markets.

Sir David Tweedie, Chairman of the IASB, said:

In addressing the rare circumstances of the current credit crisis, the IASB is committed to taking urgent action to ensure that transparency and confidence are restored to financial markets. The IASB has acted quickly to address the concerns raised by EU leaders and others regarding the issue of reclassification. Our response is consistent with the request made by European leaders and finance ministers; it is important that these amendments are permitted for use rapidly and without modification.

For more information about the IASB's response to the credit crisis, see <http://www.iasb.org/credit+crisis.htm>.

4. Be willing to participate in any study on the impact of accounting in the credit crisis

SECP Update

- Requested Exchange to enquire from all listed companies regarding the compliance of Section 204-A of Companies Ordinance 1984 relating to the appointment of Independent Share Registrar
- Issued draft Group Companies Registration Regulations 2008 to provide a framework for companies intending to avail tax relief from FBR. Further details may be obtained from www.secp.gov.pk/DraftAmendments/.pdf
- Members of the Exchange are required to submit bi-annually a certificate from a practicing Chartered Accountant confirming their Net Capital Balance as on June 30 and December 31 by September 30 and March 31 respectively.
- NBFCs engaged in brokerage business will be required to form a separate company to conduct stock brokerage operations w.e.f. 21 November 2008
- Draft Non-Banking Finance Companies and Notified Entities Regulations 2008 issued for comment www.secp.gov.pk/DraftAmendments/NBFC_NE_2008.pdf
- SECP issues Listed Companies (Substantial Acquisition of Voting Shares and Takeovers) Regulations 2008
- Insurance and Takaful Companies under section 41 of the Insurance Ordinance 2000 are required to maintain at all times such reinsurance arrangements which in the opinion of the directors are adequate to ensure continuing compliance of the solvent related provisions of the Ordinance by their respective companies

SBP Update

- Draft Guidelines on Islamic Financing for Agriculture issued (www.sbp.org.pk)
- All Exchange Companies shall submit a certificate by 31 October 2008 signed by the CEO and all Directors confirming that the company management is satisfied with the compliance status of each of its business locations
- Rs 6.522 bn was raised through the sale of three year Ijara Sukuk in the first ever auction of an Islamic Paper in the domestic market
- Shariah Advisor of an Islamic Banking Institution shall not work in any other banking institution in any capacity whatsoever, shall not approve transactions from both sides representing two financial institutions and shall not hold any executive/non-executive position in any other financial institution except for working as a member of the Shariah Board/Committee in that financial institution

FBR Update

- Regulatory duty equivalent to the Price Differential Claims (PDC), in Rupees per litre, of High Speed Diesel (HSD) and Superior Kerosene Oil (SKO) as notified by the Ministry of Petroleum & Natural Resources
- Customs – duty drawback rates on export of engineering/metal and allied products allowed
- Duty drawback rates on export of miscellaneous products such as packing materials, edible products, plastic products etc. allowed
- Sales Tax – notification for SRO 601 (I)/2000 dated 28 August 2000 rescinded

Technical Advisory Committee Opinions

Inquiry 1

A company is expanding its production capacity by adding a new line. The financing arrangement of this expansion project (qualifying asset) has been a mix of debt and equity. The project has been kicked off and equity (through rights issue) has been raised up front and been utilized for the project payments. The equity funds are in the bank accounts and the company is earning income on these funds.

What will be accounting treatment of the income earned on equity raised specifically for the qualifying asset (If company had taken decision not to expand then the company would not have raised this equity)? Can it be capitalized in the CWIP or it will be charged to the Profit and Loss account?

Opinion

We reproduce the following paragraphs from IAS-16 Property, Plant and Equipment:

- 21 Some operations occur in connection with the construction or development of an item of property, plant and equipment, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities. For example, income may be earned through using a building site as a car park until construction starts. Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in profit or loss and included in their respective classifications of income and expense.

In view of the above, the Committee is of the opinion that interest income earned on the temporary investment of funds raised through equity are in the nature of earnings from incidental operations as referred to in the above paragraph of IAS-16 and hence should be recognized in the profit and loss account in the period in which such income is earned.

Inquiry 2

Reference is made to Para 62 of IAS 16 which is reproduced hereunder:

- 62 A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. Straight-line depreciation results in a constant charge over the useful life if the asset's residual value does not change. The diminishing balance method results in a decreasing charge over the useful life. The units of production method results in a charge based on the expected use or output. The entity selects the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits.

In the light of above, it can be validly concluded that there is no binding as regards to application of any particular method for providing depreciation in the accounts. In the hotel industry depreciation in respect of “crockery, cutlery and linen” is being provided on replacement cost method whereby initially an asset is recorded at cost and subsequent purchases thereof is charged to profit and loss account however, an exercise is carried out every year in order to assess that whether the amount recorded at historical cost without providing any depreciation should not be materially differ as compared to inventory of crockery, cutlery and linen in hand.

Is the above method allowed, especially for the hotel industry, in relation to assets classified under crockery, cutlery and linen in the light of IAS and related guidelines?

Opinion

The Committee would like to draw your attention to the following requirements of IAS-16 “Property, Plant and Equipment”

50 - The depreciable amount of an asset shall be allocated on a systematic basis over its useful life

60 - The depreciation method should reflect the pattern in which the asset’s future economic benefits are expected to be consumed by the entity.

The Committee has considered that replacement cost method does not result in systematic allocation of depreciable amount of an asset over its useful life and hence is not a proper method of depreciation. Therefore, for the purpose of charging depreciation in respect of assets in the hotel industry such as crockery, cutlery and linen, an appropriate depreciation method should be selected that reflects the expected pattern of consumption of future economic benefits embodied in such assets through their usage.

The Committee also recognizes that in view of the nature of the above referred assets, the estimation of their useful life may involve a significant amount of judgment. However, in this regard the management should consider factors such as physical wear and tear, commercial obsolescence, asset management policy of an entity that may involve replacement of such assets after a specified period etc. Accordingly, the useful life of each item should be estimated separately. While determining the useful life of an asset the factors that have been given in paragraph 56 of IAS 16 should be taken into account.

The depreciation charge as determined above, should be recognized in the profit and loss account on a systematic basis over the useful life of the asset.

Local News Brief

- ❖ Pakistan set to float Government Commercial Paper (GCP), bonds to attract FDI
- ❖ Amended Anti Money Laundering Ordinance 2007 will empower the Financial Monitoring Unit (FMU) of SBP to collect necessary records and information from any person relating to transactions for suspicious currency transactions. The penalty for the same has been raised from Rs 1m to Rs 5m
- ❖ SBP to host five Islamic Financial Services Awareness Programmes in Karachi from 27-31 October 2008 under the auspices of the Islamic Financial Services Board (IFSB)
- ❖ E Banking transactions grew 32% to Rs13.9 Tln in FY08
- ❖ Central Depository Company (CDC) will seek listing on three stock exchanges in January 2009
- ❖ IMF to assist the Government in the finalization of new five year macroeconomic policy framework
- ❖ KSE and Al Meezan Investment Management Ltd signed an MOU to launch Pakistan’s First Co Branded Islamic Index (KMI)
- ❖ National Commodities Exchange Ltd (NCEL) has launched mini gold futures contract for buying and selling pure 10 grams gold to increase the participation of small investors