Technical Releases (Accounting)

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ACCOUNTING **TR-5**

(Reformatted 2000)

IASC STANDARDS-COUNCIL'S STATEMENT ON APPLICABILITY

THE ISSUE

The Institute has been an Associate Member of the International Accounting Standards Committee (IASC) ever since its existence in 1973. Exposure drafts and accounting standards on various subjects issued by the IASC are being sent to the members regularly. To date, the IASC has issued standards up to IAS 39, out of which the texts of 34 standards have already been circulated to the members.

It has been brought to the notice of the Council that some misunderstanding exists about the applicability of International Accounting Standards (IASs) and the obligations with regard to the compliance with such standards the auditors carry while expressing opinion on published financial statements which have been fully defined in para 5 of the Preface to Statements of International Accounting Standards and para 7 and 9 of the Framework for the Preparation and Presentation of Financial Statements issued by International Accounting Standards Committee[1].

COUNCIL'S DIRECTIVE

The Council wishes to draw the attention of all members to paragraph 4 of the revised Preface of International Accounting Standards which reads as under :-

The members agree to support the objectives of IASC by undertaking the following obligations:

"to support the work of IASC by publishing in their respective countries every International Accounting Standard approved for issue by the Board of IASC and by using their best endeavours:

i) to ensure that published financial statements comply with International Accounting Standards in all material respects and disclose the fact of such compliance;

ii) to persuade Governments and standard-setting bodies that published financial statements should comply with International Accounting Standards in all material respects;

iii) to persuade authorities controlling securities markets and the industrial and business community that published financial statements should comply with International Accounting Standards in all material respects and disclose the fact of such compliance;

iv) to ensure that the auditors satisfy themselves that the financial statements comply with International Accounting Standards in all material respects;

v) to foster acceptance and observance of International Accounting Standards internationally;

The Council desires to direct all members to ensure that in accordance with the obligations undertaken by us as one of the members of IASC, the auditor, while expressing an opinion on published financial statements, should satisfy himself that they do comply with IASs in all material respects and that in the event of any departure from or inconsistency with such standards, the auditors' report should contain suitable qualification. It should however be emphasized that IASs do not override the local statutory provisions under Companies Ordinance, 1984 and the disclosure requirements under the Fourth and Fifth Schedules. Compliance with IASs shall be mandatory in so far as such standards are not inconsistent with local regulations or standards, directives or pronouncements issued by this Institute.

The Council is conscious of the fact that considering practical problems in the set of circumstances prevailing in Pakistan, compliance with some of the standards may be rendered difficult and in view thereof the Council is of the view that compliance with the following standards shall, until notified otherwise, not be deemed to be mandatory:

IAS 15 - Information Reflecting the Effects of Changing Prices

IAS 22 - Business Combinations

IAS 29 - Financial Reporting in Hyperinflationary Economies

This statement is and shall be deemed to be a directive of the Council and shall be applicable to any International Accounting

Standard which may be issued in future unless otherwise specified by the Council. Non-compliance with this directive shall be deemed to be a professional mis-conduct in terms of clause (3) of Part 4 of Schedule I to the Chartered Accountants Ordinance, 1961.

[1] Para 5 of the Preface and para 7 and 9 of the Framework have been reproduced on the next page.

Preface to Statements of International Accounting Standards

Para 5

The term “financial statements” used in paragraphs 2 and 4 covers balance sheets, income statements or profit and loss accounts, statements of changes in financials position, notes and other statements and explanatory material which are identified as being part of the financial statements. Usually; financial statements are made available or published once a year and are the subject of a report by an auditor. International Accounting Standards apply to such financial statements of any commercial, industrial, or business enterprise.

Framework for the Preparation and Presentation of Financial Statements

Scope

Para 7

Financial statements form part of the process of financial reporting. A complete set of financial statements normally includes a balance sheet, an income statement, a statement of changes in financial position (which may be presented in a variety of ways, for example, as a statement of cash flows or a statement of funds flows), and those notes and other statements and explanatory material that are an integral part of the financial statements. They may also include supplementary schedules and information based on or derived from, and expected to be read with, such statements. Such schedules and supplementary information may deal, for example, with financial information about industrial and geographical segments and disclosures about the effects of changing prices. Financial statements do not, however, include such items as reports by directors, statements by the chairman, discussion and analysis by management and similar items that may be included in a financial or annual report.

Users and Their Information Needs

Para 9

The users of financial statements include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. They use financial statements in order to satisfy some of their different needs for information. These needs include the following:

a) ***Investors:*** The providers of risk capital and their advisers are concerned with the risk inherent in, and return provided by, their investments. They need information to help them determine whether they should buy, hold or sell. Shareholders are also interested in information which enables them to assess the ability of the enterprise to pay dividends.

b) ***Employees:*** Employees and their representative groups are interested in information about the stability and profitability of their employers. They are also

interested in information which enables them to assess the ability of the enterprise to provide remuneration, retirement benefits and employment opportunities.

c) ***Lenders:*** Lenders are interested in information that enables them to determine whether their loans, and the interest attaching to them, will be paid when due.

d) ***Suppliers and other trade creditors:*** Suppliers and other creditors are interested in information that enables them to determine whether amounts owing to them will be paid when due. Trade creditors are likely to be interested in an enterprise over a shorter period than lenders unless they are dependent upon the continuation of the enterprise as a major customer.

e) ***Customers:*** Customers have an interest in information about the continuance of an enterprise, especially when they have a long term involvement with, or are dependent on, the enterprise.

f) ***Governments and their agencies:*** Governments and their agencies are interested in the allocation of resources and, therefore, the activities of enterprises. They also

g) require information in order to regulate the activities of enterprises, determine taxation policies and as the basis for national income and similar statistics.

h) ***Public:*** Enterprises affect members of the public in a variety of ways. For example, enterprises may make a substantial contribution to the local economy in many ways including the number of people they employ and their patronage of local suppliers. Financial statements may assist the public by providing information about the trends and recent developments in the prosperity of the enterprise and the range of its activities.

ACCOUNTING **TR-6**
(Reformatted 2000)

FIXED ASSETS INVENTORY AND RECORDS

1. THE ISSUE

Section 230 of the Companies Ordinance, 1984 requires every company to keep proper books of accounts with respect to a number of items which includes all assets of the company. Fixed assets comprise a significant portion of a company's assets. Except for the companies engaged in production, processing, manufacturing or mining activities to which Section 230 (1) (e) applies and which under separate costing rules are required to maintain separate fixed assets records, no guidance is available for other companies. Further following are important aspects for maintenance of proper records and preparation of Financial Statements.

a) Periodic reconciliation of the underlying records of fixed assets with the accounting records (General Ledger).

b) Reconciliation of the periodic physical inventory of fixed assets with fixed assets records.

c) Determination of cost and accumulated depreciation of each item of fixed assets at the time of retirement or disposal.

2. TECHNICAL COMMITTEE RECOMMENDATIONS

2.1 Fixed Assets records

Adequate itemized records of fixed assets should be maintained which at minimum must indicate following particulars:-

FIXED ASSETS INVENTORY AND RECORDS

a) description of each item
b) cost of the item
c) the date of its acquisition
d) classification of the item
e) the location and/or the custodian of the item
f) the rate of depreciation
g) accumulated depreciation
h) depreciation charge for the period
i) the department/cost centre / product to which the depreciation is charged
j) date of revaluation (if any)
k) revalued amount (if any) of the items
l) depreciation on revalued amount

m) accumulated depreciation on the revalued amount

2.2 Physical inventory of fixed assets

Physical verification of fixed assets should be carried out on a cyclical basis (perpetual inventory) according to a formal plan once in five year. The physical inventory should be reconciled with the fixed assets records and adjusted accordingly.

ACCOUNTING **TR-8**
(Reformatted 2000)

CLARIFICATION REGARDING BASIS OF CALCULATION OF WORKERS' PROFITS PARTICIPATION FUND

1. THE ISSUE

Opinion was sought whether Workers' Profit Participation Fund is to be calculated after or before charging it against the profits of the year. For illustration purposes an example is given here under:

a)	Profit of the Company	:	Rs.250.00
	WPPF @ 5% of Rs.250.00	:	Rs. 12.50
b)	Profit of the Company	:	Rs.250.00
	WPPF @ 5/105 of Rs.250.00	:	Rs. 11.90

2. TECHNICAL COMMITTEE RECOMMENDATION

i. Contribution to Workers' Profit Participation Fund is to be made on the basis of provision contained in clause (b) of sub-section (1) of section 3 of Companies Profits (W.P.) Act, 1968. This provides that the amount should be 5% of its profits as per audited accounts. If there are no profits no contribution is payable. Hence, this is in the nature of an appropriation of profits.

ii. Accordingly, method indicated in example (a) is correct and should be followed.

ACCOUNTING TR-10

DEFERRED TAXATION

The question "whether or not any credit on account of depreciation charged in accounts on revised value of revalued assets should be given for computing provision of deferred taxation?" Was considered by the Institute and following opinion was given:

"The Technical Services Committee considered the question referred by the Chairman, Corporate Law Authority on the propriety or otherwise of any credit for deferred taxation in respect of incremental depreciation charged on revaluation of assets and was of the opinion that the answer to the question as framed could only be in the negative as the incremental depreciation charged in accounts does not bring in any tax relief or create any timing difference to necessitate deferred tax accounting. Nevertheless, the question involves other important accounting issues to bring out which the question was divided into three parts as follows:-

(a) Whether following an upward revaluation of fixed assets in excess of cost and consequent increased charge of depreciation against revenue an enterprise is required or permitted to set up a corresponding deferred taxation account?

(b) Whether such deferred tax could be appropriated from surplus on revaluation? and

(c) Whether any credit could be taken against the current tax charge by a claw back from such deferred tax account?

The Committee considered the above questions in great depth in the light of International Accounting Standards, Standard Accounting Practice of the Institute of Chartered Accountants in England & Wales and authoritative literature available on the subject and came to the following conclusions:

(a) An enterprise which carries out a revaluation of its fixed assets in excess of cost is not required or permitted to set up corresponding deferred taxation account unless it is probable that potential tax liability will crystallise. Such a probability can be foreseen only when the enterprise decides to sell the assets and no before.

(b) When the potential tax liability is foreseen deferred tax on such sale could be appropriated from surplus on revaluation.

(c) No credit could be taken against the current tax charge from deferred tax account by way of a claw back because provision for deferred tax for potential tax liability is intended to meet such liability in case of sale only.

Dated: 28-10-1985

ACCOUNTING **TR-11**
(Reformatted 2000)

DEPRECIATION ON IDLE FIXED ASSETS

THE ISSUE

(a) Whether depreciation should be charged on fixed assets which are idle?

(b) Whether on assets used by a company in business or operation of seasonal nature depreciation be charged commensurate with the extent of their use in a season?

TECHNICAL COMMITTEE RECOMMENDATIONS

1. The Committee while examining the above two issues placed reliance on the principles set out in IAS 4 – Depreciation Accounting and was of the opinion that the said IAS lays down comprehensively the principles and standard for depreciation accounting and hence there was no need for a separate standard to deal with the above issues. However, in order to facilitate understanding of the accounting treatment in respect of the above issues, the explanations contained in this Technical Release may provide the necessary guidance.[1]

2. Fixed assets in a business include assets in use and held with reasonable expectation of these being used. Depreciation should, therefore, normally be charged on all fixed assets. Temporarily idle, reserve or stand-by assets should also continue to be depreciated.

DEPRECIATION ON IDLE FIXED ASSETS

3. If the assets are persistently idle, there is a need to review the remaining useful lives of such assets in accordance with IAS 4 – Depreciation Accounting. Paragraph 8 of IAS 4 provides that the useful lives of major depreciable assets or classes of depreciable assets should be reviewed periodically and depreciation rates adjusted for the current and future periods if expectations are significantly different from the previous estimates.[2]

4. With regard to assets used in the operations of seasonal nature, the rates of depreciation determined initially, impliedly take into account the useful lives based on such seasonal operations. The rate and consequently the amount of annual depreciation so determined should thus not be adjusted further to commensurate with the length of seasonal operations in an accounting period.

5. Fixed assets abandoned but not physically disposed off and equipment still owned with no apparent likelihood of resuming operations, if material in amount, should be removed from fixed assets and recorded separately at lower of cost and estimated realizable amount, appropriately explained.

1. Please also see paragraphs 41 to 48 of IAS 16 (Revised 1998)
2. Please also see paragraphs 49 and 50 of IAS 16 (Revised 1998)

ACCOUNTING TR-12

DEBT EXTINGUISHMENT

INTRODUCTION

1. AAPC has considered various issues arising upon extinguishment of a debt. This Technical Release has been developed in order to attain uniformity in accounting treatment of debt extinguishment.

EXPLANATION

2. This Technical Release explains circumstances for an extinguishment of debt, and the reporting of gains and losses on extinguishment.

3. A debtor shall consider debt to be extinguished for financial reporting purposes in the following circumstances:-

   (a) The debtor pays the creditor and is relieved of all its obligations with respect to the debt,

   (b) The debtor is legally released from being the primary obligor under the debt either judicially or by the creditor and that the debtor will not be required to make future payments with respect to the debt under any guarantees.

ACCOUNTING TREATMENT

4. Gains and losses from extinguishment of debt should be included in the determination of net income and, if material, classified as an extraordinary or unusual item. This shall apply whether an extinguishment is early or at scheduled maturity date or late.

5. Gains or losses from extinguishment of debt, if material, should be described sufficiently to enable users of financial statements to evaluate their significance. Accordingly, a description of the extinguishment transaction, including the sources of any funds used to extinguish debt, if it is practicable to identify the sources, shall be disclosed in a single note to the financial statements or adequately cross-referenced if in more than one note.

EFFECTIVE DATE

6. This Technical Release shall be effective for debt extinguishment occurring after December 31, 1991.

ACCOUNTING **TR-14**
(Reformatted 2000)

ACCOUNTING FOR REVALUATION OF FIXED ASSETS

1. THE ISSUE

1.1 The International Accounting Standard 16, Property, Plant, and Equipment (PPE) under the Benchmark and Allowed Alternative Treatments under paragraph 28 & 29 respectively has given option to either carry an item of PPE at its cost less any accumulated depreciation or at re-valued amount.

1.2 Where as asset's carrying amount is increased as a result of revaluation how such increased be recognised in the books of accounts.

1.3 Treatment for adjusted accumulated depreciation at the date of revaluation.

1.4 There is a conflict between IAS 16 and Companies Ordinance, 1984 regarding the treatment of recognising increase in carrying amount of assets.

1.5 The Companies Ordinance, 1984 in sub-section (2) of section 235 requires that except and to the extent actually realised on disposal of the assets which are re-valued, the surplus on revaluation of fixed assets shall not be applied to set off or reduce any deficit or loss, whether part, 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 utilised directly or indirectly by way of dividend or bonus. IAS 16 in paragraph 37 however provides when an assets carrying amount is increased as a result of a revaluation,

ACCOUNTING FOR REVALUATION OF FIXED ASSETS

the increase should be credited directly to equity under the heading of Revaluation Surplus. However a revaluation increase should be recognised as income to the extent that it reverses a revaluation decrease of the same asset previously recognised as an expense.

1.6 IAS 16 in paragraph 33 provides two ways for adjusting accumulated depreciation at the date of revaluation, either to (a) restate proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its re-valued amount or (b) eliminate against the gross carrying amount of the asset and the net amount restated to the re-valued amount of the asset.

2. TECHNICAL COMMITTEE RECOMMENDATIONS

2.1 To recognise increase in assets carrying amount the requirement of Companies Ordinance, 1984 should be followed.

2.2 It is recommended that when an item of PPE is re-valued, any accumulated depreciation at the date of revaluation should be credited to the asset amount.

ACCOUNTING **TR-15**
(Reformatted 2000)

BONUS SHARES - ACCOUNTING TREATMENT

Introduction

- Bonus shares are the shares issued by a company from distributable reserves to its ordinary shareholders, without consideration, by way of either capitalization of its profits or utilization of share premium account.

- Issue of bonus shares is prompted mainly by desire to give the recipient shareholders some separate evidence of part of their respective interests in undistributed profits without distribution of cash which the Board of Directors deem necessary to retain in the business.

THE ISSUE

- How the issue of bonus shares should be accounted for by the Issuer and the Recipient.

TECHNICAL COMMITTEE RECOMMENDATIONS

Accounting by the Issuer

- A bonus issue does not give rise to any change in either the company's assets or its respective shareholders proportionate interests therein. The company issuing bonus shares shall account for such shares by transferring from Reserves to Issued Share Capital an amount equal to the par value of additional shares issued.

- In the first instance, generally the profits are appropriated and transferred to Reserve for Issue of Bonus shares. The Reserve is then utilized for issue of capital on completion of necessary formalities.

Accounting by the Recipient

- Capitalization of accumulated profits by the issue of fully paid bonus shares by a company does not in fact change the net worth of that company and by the same token does not add anything to the assets or income of the recipient shareholder. The correct treatment of bonus shares, therefore, in the hands of the recipient would be merely to add to the number of shares it owns without giving any monetary effect in the accounts either in terms of cost or value thereof as no accretion in fact is taking place in the hands of the recipient.

ACCOUNTING **TR-20**
(Reformatted 2000)

ACCOUNTING FOR EXPENDITURE DURING CONTRUCTION PERIOD

THE ISSUE

How to treat expenditure incurred during construction period up to the date of commencement of commercial production, if an enterprise is devoting substantially all of its efforts in establishing a new project.

Paragraph 17 of IAS 16 (Revised 1998), reproduced below, is not very clear on this issue:-

> " Administration and other general overhead costs are not a component of the cost of property, plant and equipment unless they can be directly attributed to the acquisition of the asset or bringing the asset to its working condition. Similarly, start-up and similar pre-production costs do not form part of the cost of an asset unless they are necessary to bring the asset to its working condition. Initial operating losses incurred prior to an asset achieving planned performance are recognised as an expense."

TECHNICAL COMMITTEE RECOMMENDATIONS

1. Expenditure incurred during project implementation may be grouped under the following broad heads:-

Expenditure	Examples
a) Formation expense	Preliminary expenses, expenses incurred on issue of shares or TFCs including any sums paid by way of commission or brokerage on the issue of shares or TFCs and other formation expenses.
b) Direct project costs	Invoice costs, import duties, clearing expenses, L/C expenses, legal fees, consultant fees, site preparation costs, installation costs including architecture and engineering fees, freight, trial run expenses, site labour costs including supervision, materials used for project construction, insurance design and technical assistance etc.
c) Indirect costs	General and administrative expenses, operation and maintenance, loss on trial runs, depreciation on assets such as vehicle, furniture, etc. Other overheads to the extent that they relate

	to bringing the fixed asset to the location and condition necessary for its intended service.
d) Borrowing costs	Financial charges.

2. Formation expenses shall be written off during a period not exceeding five years commencing from the financial year in which the costs are incurred as provided in paragraph 5(C) of Part II of the Fourth Schedule to the Companies Ordinance, 1984.

3. Direct project costs should be capitalised. Indirect costs, which are not attributable to a specific asset, shall be allocated to buildings and plant and machinery in proportion to their respective costs.

4. Borrowing costs shall be dealt with in accordance with IAS 23 and provisions of the Companies Ordinance, 1984.

5. Any revenues including profit on trial runs earned during construction period shall be set off against expenditure incurred during construction period.

ACCOUNTING **TR-21**
(Reformatted 2000)

DATE OF COMMENCEMENT OF COMMERCIAL PRODUCTION

THE ISSUE

It is extremely important to establish the date, when the project is deemed to commence commercial production as the expenditure of revenue nature which is permissible to be capitalized upto the date of commencement of commercial production, will have to be charged to income after such date.

Large projects usually involve some time lag between the time when the plant is installed and the date when the commercial production commences due to variety of reasons including time required for trial runs. The trial run period is normally brief but in some cases such period may be unusually long as the plant or the process may require adjustments in order to produce products of the required quality in commercial quantities. In such cases, though the plant is installed and has also started production, it may not be considered ready for commercial production unless the required adjustments and test runs are completed. However, once the plant is ready for the production of intended products in commercially feasible quantities, and the company for any reason, delays commercial production, any expenditure during such intervening period has to be treated as revenue expenditure.

TR-20 Accounting for Expenditure During Construction Period issued by the Institute of Chartered Accountants of Pakistan states in its preamble:

How to treat expenditure incurred during construction period upto the date of commencement of commercial production, if an enterprise is devoting substantially all of its efforts in establishing a new project.

This technical release provides guidance to establish date of commencement of commercial production.

TECHNICAL COMMITTEE RECOMMENDATIONS

Date of commencement of commercial production is the date when the plant is ready for the production of intended products in commercially feasible quantities. The cut off date so established is without regard when the plant actually commences commercial production. Where the construction of an asset is completed in parts and each part is capable of being used while construction continues on the other parts, capitalization of costs for each part should cease as it is completed.

ACCOUNTING **TR-22**
(Revised 2002)

BOOK VALUE PER SHARE

THE ISSUE

Different practices and policies are being used for computing book value (commonly known as break-up value in Pakistan) of shares. For instance in some cases all the assets including intangibles, deferred costs and fictitious assets are included in considering the book value without regard to their recoverability. In some other cases, intangibles are excluded from the shareholders' equity. Practices also vary regarding adjustment of contingent and other losses.

TECHNICAL COMMITTEE RECOMMENDATIONS

Book value per share in the equity capital of the company is the amount each share is worth on the basis of carrying value per balance sheet, prepared in accordance with a framework of recognized accounting standards. Such standards provide that:-

(a) An asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.

(b) A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

Computation of Book Value Per Share

Book value per share is computed by dividing shareholders' equity with the number of shares issued. Shareholders' equity includes:-

a) Paid up capital

b) Revenue reserves and retained earnings, (less accumulated losses if any).

c) Capital reserves

Where the auditors have issued a qualified report and the qualification has been quantified in monetary terms, that amount should be deducted from equity.

Where the qualification is not quantified then the members issuing a certificate regarding book value should mention this fact in the certificate.

d) Surplus created as a result of revaluation of fixed assets.

> If the balance sheet of an entity includes balance of surplus on revaluation, the book value per share should be computed separately both, including and excluding such surplus, to enable comparability with those entities where fixed assets have not been revalued.

The book value for any specific purposes in accordance with any statute would have to be computed per requirements or criteria laid down in that respect by the concerned regulatory agency or as set out in the relevant law.

(151st meeting of the Council – April 26-27, 2002)

ACCOUNTING **TR-23**
(REVISED)

ACCOUNTING FOR INVESTMENTS

1.0 This Technical Release supersedes TR-23 Investments Valuation-Application of Lower of Cost and Market Value and shall be called Accounting for Investments.

2.0 Introduction

The TR seeks to explain various aspects of IAS 25, Accounting for Investments.

3.0 Reclassification of Current Investments to Long-Term Investments and Vice Versa and Change in the Basis of Valuation

3.01 Normally, at the time of acquisition, an enterprise should designate whether the investment is a long-term investment or for a trading portfolio i.e., current investment. In exceptional circumstances an investment can be transferred between long-term and current and vice versa if the management's intention as to the purpose of holding an investment changes. However, this should not be done merely to avoid providing for any impairment in the value of investment.

3.02 Moreover, any change in valuation policy of investment by the management should also be looked into thoroughly. For example changing the policy for valuing current investments from say an individual investment basis to aggregate portfolio basis or in the case of long-term investments from cost to revalued amounts etc. and vice versa.

3.03 If the auditor is of the opinion that there is no proper justification for changing an investment from current to long-term (by the time he signs his report, he observes that an investment transferred from current to long-term is still being dealt with as current) and vice versa and for the change in policy for valuation which appears to be done only to avoid provision for the impairment in the value of investments, the attention of members should be drawn in his report. Further the impact of change on profit or loss of the enterprise should also be quantified.

3.04 Provisions of para 37 of IAS 25, reproduced below, should also be kept in view for any transfer of investments:-

> 25.37 Investments re-classified from current to long-term should each be transferred at the lower of cost and market value, or at market value if they were previously stated at that value.

4.0 Conditions Indicating Decline Other Than Temporary in the Value of Long-Term Investments Where Such Investments are Valued at Cost

Besides the parameters indicated in the para 24 of IAS 25, the following conditions may also be kept in view while assessing the loss in value of long-term investments that is other than temporary.

A loss in value of an investment that is other than a temporary decline will sometimes occur, that is, the actual value of the investment to the investor may become lower than the carrying value and the impairment is expected to remain for a prolonged period.

4.01 A decline in market value may be only temporary in nature or may reflect conditions that are more persistent. Declines may be attributable to general market conditions that reflect prospects of the economy as a whole or prospects of a particular industry. Such declines may or may not indicate the likelihood of ultimate recovery of the carrying amount of an investment. A decline in quoted market value below carrying value of an investment with a fixed maturity amount may be considered temporary unless it is anticipated that the investment will be disposed of before it matures or that the carrying value may not be realisable.

4.02 A loss in value of an investment that is other than a temporary decline is obvious in some cases, such as bankruptcy or an agreement to sell an investment at an amount which will result in a loss. In less obvious situations, decline other than temporary in the value of an investment may be indicated by conditions such as:-

(a) a prolonged period during which the quoted market value of the investment is less than its carrying value;
(b) severe losses by the investee in the current year or current and prior years;
(c) continuing losses by the investee for a period of years;
(d) suspension of trading in the securities;
(e) liquidity or going concern problems of the investee;
(f) the current fair value of the investment (an appraisal) is less than its carrying value.

4.03 However, when a condition, indicating that an impairment in value of an investment may have occurred, has persisted for a period of three years after the year in which it occurred, there is general presumption that there has been a loss in value which is other than a temporary decline. This presumption can only be rebutted by persuasive evidence to the contrary.

4.04 Impairment Write Down

Para 23 read with para 32 of IAS 25 firstly requires determination of impairment in the value of long-term investments on individual investment basis and secondly the impairment loss is charged to owners’ equity only when a corresponding revaluation surplus exists, otherwise in all other cases it should be charged to expense. Even if a previous revaluation surplus exists and the impairment is more than the revaluation surplus for

that particular investment then the excess would have to be charged to expense.

5.0 Basis for Determining Carrying Cost at Market Value or at Lower of Cost and Market Value

5.01 The IAS does not specify as to how the market value should be determined. The quoted investments should be valued on average basis but in order for the average to be realistic, the parameters and boundary for working out the average should be limited to the average price obtainable from the sale as quoted on the Stock Exchange in the last week of entity's financial year or middle market price ruling on the balance sheet date.

Note: Middle market price means the average of the highest and the lowest quotation for that day.

5.02 In case of listed securities which have been transferred to the default counter by a Stock Exchange under its listing rules, the determination of impairment loss should be calculated with reference to its last quoted price irrespective of its break-up value as per balance sheet.

5.03 In case of non-listed or private limited companies, the break-up value should be used for determination of the impairment loss.

5.04 It is sometimes difficult for the auditors to establish the intention of the management, whether or not to hold a particular investment for less than a year. Also, there may be changes in the classification of a marketable equity between current and non-current during an accounting period. It is, therefore, recommended that where investments are valued at the lower of cost and market, the carrying amount should be determined on an aggregate portfolio basis in case of current investments and portfolio basis in case of long-term investments.

(Approved by the Council in its 126th meeting held on April 14, 1998)

ACCOUNTING **TR-24**
(Reformatted 2000)

EXCHANGE RISK FEE – ACCOUNTING TREATMENT

THE ISSUE

Whether the exchange risk fee paid on foreign currency loans acquired for capital requirements be capitalized after commencement of commercial production or not.

TECHNICAL COMMITTEE RECOMMENDATIONS

Exchange risk fee is incurred in order to eliminate, or reduce substantially, the risk of loss from changes in exchange rates. This involves use of forward exchange contract to establish the amount required at settlement date of transaction. *The forward rate established under such contract is not an estimate of what the exchange rate will be at the end of the contract but is essentially a function of (a) spot rate at the date the contract is taken out; (b) in the interest rate differential between the currencies of the two countries.* In consideration of providing assurance that a certain amount of foreign currency will be available by a specific date, at a predetermined rate, the banks make a charge to the entity applying for foreign exchange.

International Accounting Standard 23 Borrowing Costs, provides that borrowing costs include exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs. The exchange risk fee is therefore in the nature of borrowing costs and its accounting treatment should be in accordance with IAS 23, Borrowing Costs. Accordingly, exchange risk fee incurred by an entity after commencement of commercial production should be recognized as expense and not be capitalized.

ACCOUNTING **TR-25**
(Reformatted 2000)

PRUDENTIAL REGULATIONS FOR BANKS INSTITUTE'S INTERPRETATION OF PARA IV (I)

THE ISSUE

The State Bank of Pakistan has issued Prudential Regulations for Banks. This Technical Release provides Institute's interpretation of para IV (I) of Prudential Regulations as given below for general guidance of its members.

Para IV (I) of the Prudential Regulation states:

> "While granting any accommodation, banks shall ensure that the total accommodation availed by any borrower from banks / financial institutions does not exceed 10 times of the capital and reserves (free of losses) of the borrower as disclosed in its Audited Accounts. Every bank shall, as a matter of rule, obtain copy of accounts relating to the business of each of its borrower for analysis and record in the following manner: (for the purpose of this Regulation, accommodation shall have the same meaning as in Regulation – I).
>
> | | | |
> |---|---|---|
> | a. | Where the bank's exposure does not exceed Rs.2 million | Accounts duty signed by the borrower |
> | b. | Where the exposure exceeds Rs.2 million but does not exceed Rs.10 million | Accounts duly signed by the borrower and countersigned by the Internal Auditor of the bank or a Chartered Accountant |
> | c. | Where the exposure exceeds Rs.10 million | Accounts duly audited by the practising Chartered Accountants". |

TECHNICAL COMMITTEE INTERPRETATION

Audited Accounts

1. The "audited accounts" referred to in the Regulation need not necessarily mean audited by a chartered accountant. The accounts could be audited by any person in accordance with the statutory requirements applicable to the borrowing entity.

Countersigning the Accounts

2. Only a practising chartered accountant or a chartered accountant in employment of the borrower may countersign the accounts. A non-practising chartered accountant who is an employee of the borrower's entity, while countersigning the

accounts should designate himself as a chartered accountant and disclose his designation in the entity.

3. The countersigning by a chartered accountant involves responsibility of carrying out a limited review to ensure that the total borrowings availed by the borrower do not exceed

   10 times of the capital and reserves of the borrower-entity at the balance sheet date. In such a case the chartered accountant should clearly state the scope of the limited review. For further guidance, members should refer to Circular No.05/2000 dated March 30, 2000.

Full Scope Audit

4. Where the exposure exceeds Rs.10 million, the accounts should be duly audited by a practising chartered accountant. Such audit involves a full scope audit which is carried out with the objective of expression of an opinion on the financial statements in accordance with International Standards on Auditing.

Acceptance of Assignment

5. A practising member (both in case of companies and other entities) may not accept the audit assignment of an entity covering the same period on which the regular auditor of the entity has already been appointed to issue audit report.

Applicability of TR to Prudential Regulations for NBFIs

6. The guidance provided in this TR is also applicable to Prudential Regulations for NBFIs.

ACCOUNTING **TR-27**

IAS-12, AACOUTING FOR TAXES ON INCOME

APPLICABILITY IN PAKISTAN

IAS-12, Accounting for Taxes on Income issued by IASC has been adopted by ICAP, but it is felt that guidance is required on the applicability of deferred taxation where the companies in Pakistan are assessed to Income Tax under Section 80C, 80CC and 80D of the Income Tax Ordinance 1979 and have brought forward tax losses. It is, therefore, proposed to issue the following as a guidance to the members on the applicability of IAS 12 in Pakistan in relation to these Sections.

1.0 DEFERRED TAXATION APPLICABILITY OF SECTION 80C, 80CC, AND 80D

1.1 The deferred tax accounting does not apply to those companies whose entire sales are covered under Section 80C or 80CC, as there will be no timing differences. However, the difficulty arises in the case of those companies which have sales covered under both sections 80C and 80CC and sales which are not so covered. Timing differences are likely to arise on that portion of profit, which represents non-supplies. If the ratio between supplies and non-supplies remains the same year after year, it would be easy to calculate effect of timing differences but since this ratio cannot be expected to be the same year after year, effect of timing differences cannot be calculated with accuracy.

1.2 In cases where an entity has sales covered under both Sections 80C and 80CC and those which attract normal provisions of the Income Tax Ordinance, 1979, a reasonable estimate for sales relating to non-supplies be made for future years and the deferred tax provided accordingly. However, if it is not practicable to develop a reasonable estimate for calculation of deferred tax liability, the fact should be disclosed in the accounts stating the difficulties in quantifying.

1.3 A practical example on the application of Section 80C is enclosed on assumption that the ratio between non-supplies and supplies is 4:6.

1.4 In case in a particular year, current tax liability is calculated under provisions of Section 80D due to taxable loss the effect of timing differences should be calculated and deferred tax liability provided, if necessary.

2.0 TAX LOSSES

2.1 In Pakistan, normally the tax losses are assessed months or even years after the date of balance sheet date, so while ascertaining the potential tax saving on the balance sheet date, the loss for the current year should be based on the

estimated amount of loss which is likely to be assessed by the tax authorities. The fact should be distinctly disclosed.

2.2 The potential tax saving relating to a tax loss carry forward may be included in determination of net income for the period of the loss if there is assurance beyond any reasonable doubt that future taxable income will be sufficient to allow the benefit of the loss to be realized.

However, due to applicability of Section 80D of the Income Tax Ordinance, 1979 it is difficult to ascertain the amount of tax saving relating to loss. In this regard, tax saving should only be considered if a reasonable estimate of the turnover for the foreseeable future can be made, otherwise, it would be prudent not to set up deferred tax asset for recognizing tax saving.

3.0 EXAMPLE

Equipment costing Rs.2,000,000 was purchased during 19A . Capital expenditure budget reflects following additions:

19B	700,000
19C	800,000
19D	900,000
19E	1,000,000

Entity's revenue include 60% sales covered under Section 80C and 80CC.

Tax Rate	45%
Tax Depreciation	25% WDV
Life	10 Years
Depreciation Policy	Straight Line

ACCOUNTING NBV

YEAR	COST			DEPRECIATION			NBV
	BEGINNING OF YEAR	ADDITIONS	END OF YEAR	BEGINNING OF YEAR	FOR THE YEAR	END OF YEAR	
19A	2,000,000		2000,000		200,000	200,000	1,800,000
19B	2,000,000	700,000	2700,000	200,000	270,000	470,000	2,230,000
19C	2,700,000	800,000	3500,000	470,000	350,000	820,000	2680,000
19D	3,500,000	900,000	4400,000	820,000	440,000	1,260,000	3140,000
19E	4400,000	1000,000	5400,000	1260,000	540,000	1,800,000	3600,000

DEPRECIATION PER ACCOUNTS

YEAR	ON ORIGINAL COST	ON ADDITIONS 19B	ON ADDITIONS 19C	ON ADDITIONS 19D	ON ADDITIONS 19E	TOTAL
	2000,000	700,000	800,000	900,000	1000,000	5,400,000
19A	200,000					200,000
19B	200,000	70,000				270,000
19C	200,000	70,000	80,000			350,000
19D	200,000	70,000	80,000	90,000		440,000
19E	200,000	70,000	80,000	90,000	100,000	540,000

TAX WDV

YEAR	COST			DEPRECIATION			NBV
	BEGINNING OF YEAR	ADDITION	END OF YEAR	BEGINNING OF YEAR	FOR THE YEAR	END OF YEAR	
19A	2,000,000		2,000,000		500,000	500,000	1,500,000
19B	2,000,000	700,000	2,700,000	500,000	550,000	1,050,000	1,650,000
19C	2,700,000	800,000	3,500,000	1,050,000	612,500	1,662,500	1,837,500
19D	3,500,000	900,000	4,400,000	1,662,500	684,375	2,346,875	2,053,125
19E	4,400,000	1,000,000	5,400,000	2,346,875	763,281	3,110,156	2,289,844

TAX DEPRECIATION

YEAR	ON ORIGINAL COST	ON ADDITIONS 19B	ON ADDITIONS 19C	ON ADDITIONS 19D	ON ADDITIONS 19E	TOTAL
	2,000,000	700,000	800,000	900,000	1,000,000	5,400,000
19A	500,000					500,000
19B	375,000	175,000				550,000
19C	281,250	131,250	200,000			612,500
19D	210,938	98,437	150,000	225,000		684,375
19E	158,203	73,828	112,500	168,750	250,000	763,281

TIMING DIFFERENCES

YEAR	NBV PER ACCOUNTS	TAX WDV	CUMULATIVE TIMING DIFFERENCE	INCREASE IN TIMING DIFFERENCE
19A	1,800,000	1,500,000	300,000	
19B	2,230,000	1,650,000	580,000	280,000

19C	2,680,000	1,837,500	842,500	262,500
19D	3,140,000	2,053,125	1,086,875	244,375
19E	3,600,000	2,289,844	1,310,156	223,281

The above table reflects that cumulative timing differences are increasing and no reversals have taken place. Accordingly, no provision for deferred taxation is required. In contrast, under the full liability method, a provision of Rs.54,000 would be required at the end of 19A being 45% of 40% Rs.300,000.

It is to be noted that had timing differences were expected to have fallen bellow that level of Rs.300,000 a provision equal to the timing differences would have been necessary at the applicable tax rate. For example had all the figures in the cumulative timing differences column in the above example been the same except that the originating difference at end of 19A be Rs.700,000 instead of Rs.300,000 then a provision of Rs.54,000 would be necessary.

Originating timing differences	700,000
Timing difference at end of 19B	580,000
Reversal	120,000
Tax rate	45%
Provision	54,000
40% thereof	21,600

The provision should be made at applicable tax rate on the timing difference between current level and lowest level over foreseeable future years.

(115th meeting of the Council – April 26, 1996)

ACCOUNTING **TR-28**

GOLDEN HANDSHAKE – ACCOUNTING FOR

1. To restructure the organisations, a number of banks, financial institutions and public and private sector corporations and companies are offering golden handshake to their employees. Large amounts are involved in the golden handshake incentives. A question has arisen whether the entire amount of golden handshake be accounted for as a period cost or be treated as a deferred cost.

2. It is stated that the objectives of these restructuring are to rationalise the personnel strength so as to reduce the surplus staff and its associated costs resulting in increase efficiency, the future benefits of which are likely to accrue to the organisation in the shape of improved profits.

3. The matter has been examined by the Council of the Institute and it has been decided to issue following guidance in this respect:

   (a) In case the organisation is being closed down, all such expenses will have to be treated as period cost.

   (b) In case the purpose of golden handshake is downsizing / right-sizing, the management of the organisation concerned may treat such expenses as period cost or deferred cost in the manner provided below.

   (c) In case such expenses are treated as period cost then these should be shown separately as line item in the profit and loss account with appropriate disclosure in the notes to the accounts.

   (d) Such expenses may be treated as deferred cost only when it is probable that future economic benefits associated with the scheme will flow to the enterprise and:-

      (i) those benefits can be quantified as far as possible;

      (ii) the period in which these benefits will flow can also be determined reasonably; and

      (iii) the Golden Handshake scheme showing the above elements has been approved by the board of directors.

   (e) These deferred expenses should be amortised over the period the benefits are expected to accrue restricted to a maximum period of five years including, the year in which these are incurred and complete disclosure about such treatment should be made in the notes to the financial statements, until such time the deferred cost is fully amortised.

(f) Subject to the limit of 5 years amortisation as stated in the preceding paragraph, the carrying amount of deferred cost should be reviewed at every balance sheet date and approved by the board of directors in order to assess whether the future economic benefits as envisaged in the original scheme, approved by the board of directors, are still available tot he enterprise. When a decline has occurred the carrying amount should be reduced to the recoverable amount, which should be amortised over the balance period. Hence, the amount of reduction should be recognised as an expense immediately.

4. The auditor while reporting on the financial statements which contain the treatment of golden handshake expenses in either way should consider para 30 of IAS 13 *The Auditor's Report on Financial Statements*, which is reproduced below:

> In certain circumstances, an auditor's report may be modified by adding an emphasis of matter paragraph to highlight a matter affecting the financial statements which is included in a note to the financial statements that more extensively discusses the matter. The addition of such an emphasis of matter paragraph does not affect the auditor's opinion. The paragraph would preferably be included after the opinion paragraph and would ordinarily refer tot he fat that auditor's opinion is not qualified in this respect.

5. EXPLANATION

Expenses mean the liability relating to golden handshake offer accepted by the employees or the mandatory golden handshake announced by the management as on the close of financial year.

(Approved by the Council through circulation on March 13, 1998 under CA Bye-Law 55)

ACCOUNTING TR-29

CARRY-OVER-TRANSACTIONS (COT)

THE ISSUE

The Karachi Stock Exchange (Guarantee) Limited (KSE) had enforced Carry-Over Transactions Regulations ("the Regulations") with effect from 11 January 1993. These regulations were introduced to enhance the stock market liquidity and parallel regulations were also enforced by the other stock exchanges of the country. Following paragraphs summarise the mechanism of COT along with its accounting treatment generally being followed.a

1. Carry over transaction, as defined in section 2(e) of the Regulations, means the combination of two transactions taking place simultaneously and settled in two clearings in sequence. According to section 4(iii) of the regulations, the buyer of shares in current clearing period ("the first transaction") would become seller of the same shares in the immediate next clearing period ("the second transaction") and the seller of shares in current clearing period ("the first transaction") would become buyer of the same shares in the immediate next clearing period ("the second transaction").

2. Buyer / Seller enters into the first transaction on Friday after normal trading hours and its settlement takes place on succeeding Wednesday through Clearing House of KSE along with settlements of normal transactions. Simultaneously, seller / buyer enters into the second transaction on the same Friday and its settlement takes place through Clearing House but on succeeding second Wednesday. However, the contract ticket of the second transaction (which is prepared on Friday) bears the date of succeeding Monday, not of Friday. Share Price of the second transaction is marked-up and generally does not match with the prevailing market quotes of the succeeding Monday. The marking-up of second transaction is dependent on demand and supply of funds in the Carry-Over Market.

3. Paragraph 10 of International Accounting Standard 39 "Financial Instruments: Recognition and Measurement" defines *"repurchase agreement (Repo) as an agreement to transfer a financial asset to another party in exchange for cash or other consideration and a concurrent obligation to reacquire the financial asset at a future date for an amount equal to the cash or other consideration exchanged plus interest"*. If we consider the series of above two Carry-Over-Transactions as a whole, its commercial effect takes form of a Repo in which lending / borrowing of funds against pledge of shares takes place for one week i.e. from Wednesday to Wednesday.

4. Paragraph 13 of the IAS 18 "Revenue" states that the "*revenue recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole"*. Paragraph 13 further gives an example of *an enterprise that may sell goods and at the same time enter into a separate*

agreement to repurchase the goods at a later date thus negating the substantive effect of the transaction; in such a case the two transactions are dealt with together". However, dealing with first and second transactions separately, revenue / expense from COT is generally accounted for as capital gain / loss and not as interest income / expense.

5. Paragraph 27 of IAS 39 states that "*an enterprise should recognise a financial asset or financial liability on its balance sheet when, and only when, it becomes a party to the contractual provisions of the instrument*". In the case of first transaction COT, generally the buyer recognises purchase of shares as investment in its balance sheet (and not recognise a lending) without considering the second transaction. However, simultaneousness of the second transaction of COT does not constitute the buyer in substance a party to the contractual provisions of the equity instrument.

6. Paragraph 35 of IAS 39 states that "an enterprise should derecognise a financial asset or a portion of a financial asset when, and only when, the enterprise loses control of the contractual rights that comprise the financial asset (or a portion of the financial asset)." Further, paragraphs 38 & 39 state that a transferor has not lost control of a transferred financial asset and, therefore the asset is not derecognised if the transferor has the right to reacquire the transferred asset unless either (i) the asset is readily obtainable in the market or (ii) the reacquisition price is fair value at the time of reacquisition. In the case of first transaction of COT, generally the seller de-recognises the investment in shares from its balance sheet (and not recognising a borrowing) without considering the second transaction. However, simultaneousness of the second transaction of COT gives the seller a right to repurchase the shares at a fixed price. Further, the respective shares are not readily obtainable in the market on succeeding Monday because their prices are fixed in advance i.e. on Friday.

Keeping in view the above practise and the form as well as substance of COT a question has arisen whether COT is a Repo or not?

TECHNICAL COMMITTEE RECOMMENDATIONS

The appropriate Committee of the Institute has examined all aspects of the query regarding Carry-Over-Transactions (COT) and is of the opinion that a Carry-Over-Transaction is a Repo transaction as the substance of the transaction and not its form should be considered and accordingly it should be treated as a financing transaction. in the books of accounts.

The aforesaid clarification provides the accounting treatment for Carry-Over-Transactions under International Accounting Standards. However for the purposes of other statutes, the transaction would have the effect according to the relevant provisions of that law.

(152nd meeting of the Council - July 19-20, 2002)