The Institute of
Chartered Accountants
of Pakistan

HEAD OFFICE

CA\DTS\IASB-2002

September 16, 2002

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom.

EXPOSURE DRAFT OF PROPOSED IMPROVEMENTS TO INTERNATIONAL ACCOUNTING STANDARDS.

Dear Sir,

The Accounting and Auditing Standards Committees of the Institute of Chartered Accountants of Pakistan have reviewed the exposure draft of proposed improvements to International Accounting Standards issued by IASB and are pleased to forward the enclosed comments.

These comments are also being e-mailed to you.

Thanking you

Yours truly

Syed Sajid Ali
Director Technical Services

Encl: as above

E:\IASC\ED on improvements to IAS.doc

IAS-1, *Presentation of Financial Statements*

Question 1

Do you agree with the proposed approach regarding departure from a requirement of an International Financial Reporting Standard or an Interpretation of an International Financial Reporting Standard to achieve a fair presentation (see proposed paragraphs 13-16)?

Answer

Agreed. The effect of noncompliance should be quantified.

Question 2

Do you agree with prohibiting the presentation of items of income and expense as 'extraordinary items' in the income statement and the notes (see proposed paragraphs 78 and 79)?

Answer

Prohibition of presentations of items of income and expense as extra ordinary items will affect the comparability of the financial statements. Even if the argument that" items treated as extraordinary result from the normal business risks faced by an entity" is accepted, we cannot ignore the existence of certain events that do not form part of the entity's normal business activities and are non recurring in nature. Such events, if not disclosed separately will impede the users understanding of the entity's financial performance and in turn may influence their decision made on the basis of the information provided in the financial statements. Perhaps unusual item classification should be added and extra-ordinary item eliminated.

Question 3

Do you agree that a long-term financial liability due to be settled within twelve months of the balance sheet date should be classified as a current liability, even if an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue (see proposed paragraph 60)?

Answer

Disagreed. Events that provide evidence of conditions that existed at the balance sheet date are defined as adjusting events in IAS 10. In our view, completion of an agreement to refinance, or to reschedule payments on a long-term basis after the balance sheet date and before the financial statements are authorized for issue provides evidence of conditions existed at the balance sheet date hence should be treated as an adjusting event and the relating liability should be classified as long term liability.

Further, its classification as current would not present the economic reality of the transaction. By achieving a refinancing subsequent to year-end the entity has demonstrated that its working capital was not affected. Its classification as current would distort the working capital at the current date and subsequent year as when it is refinanced it would be classified as long term. Perhaps better argument could be when it is refinanced for a long term only then reclassification as a long term liability should be accepted.

Question 4

Do you agree that:

(a) a long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date, even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach (see proposed paragraph 62)?

(b) if a lender was entitled to demand immediate repayment of a loan because the entity breached a condition of its loan agreement, but agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during that time the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of the loan agreement, at least twelve months after the balance sheet date and:

  (i) the entity rectifies the breach within the period of grace; or

  (ii) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified (see proposed paragraphs 63 and 64)?

Answer

(a) Disagreed. Refer to 3 above.

(b) Disagreed. Refer to 3 above. The treatment suggested contradicts with the arguments of the instances discussed in question 3 and 4(a) above.

Question 5

Do you agree that an entity should disclose the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements (see proposed paragraphs 108 and 109)?

Answer

Agreed. However, parameters should be clearly defined, as the term "most significant effect on the amounts of items recognized in the financial statements" is very generic and subjective for the management to decide whether the judgments made are significant enough to be disclosed under paragraph 108 and 109 or not.

Question 6

Do you agree that an entity should disclose key assumptions about the future, and other sources of measurement uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year (see proposed paragraphs 110-115)?

Answer

Disagreed. Until detailed guidelines could be developed this would result in insufficient information.

IAS-2, *Inventories*

Question 1

Do you agree with eliminating the allowed alternative of using the last-in, first-out (LIFO) method for determining the cost of inventories under paragraphs 23 and 24 of IAS 2?

Answer

Agreed.

Question 2

IAS 2 requires reversal of write-downs of inventories when the circumstances that previously caused inventories to be written down below cost no longer exist (paragraph 30). IAS 2 also requires the amount of any reversal of any write-down of inventories to be recognised in profit or loss (paragraph 31).

Do you agree with retaining those requirements?

Answer

Agreed.

IAS – 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies

Question 1

Do you agree that the allowed alternative treatment should be eliminated for voluntary changes in accounting policies and corrections of errors, meaning that those changes and corrections should be accounted for retrospectively as if the new accounting policy had always been in use or the error had never occurred (see paragraphs 20, 21, 32 and 33)?

Answer

Agreed.

Question 2

Do you agree with eliminating the distinction between fundamental errors and other material errors (see paragraphs 32 and 33)?

Answer

We agree that the distinction between fundamental error and other material errors should be eliminated but misstatement is a wider term and refers to intentional errors therefore in our view, misstatements and fraud should be excluded from the definition of error and a requirement should be included to disclose these separately.

Further, the criteria for identifying a material error that needs a prior period adjustment should be included in the proposed definition of error (defined in the original IAS 8 as "The error causes the financial statements of one or more prior periods no longer to be considered to have been reliable").

IAS - 10, *Event After the Balance Sheet Date*

Summary of Main Changes

The main change proposed is to revise paragraphs 11 and 12 to indicate that if dividends are declared after the balance sheet date, an entity should not recognise those dividends as a liability at the balance sheet date.

A Basis for Conclusions for this change is not included in this Exposure Draft, given that the reason for this change is indicated in paragraph 12.

Comment

The above changes are inconsistent with the proposed paragraph 62, 63 and 64 of IAS 1 "Presentation f Financial Statements".

IAS-16, *Property, Plant and Equipment*

Question 1

Do you agree that all exchanges of items of property, plant and equipment should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably (see paragraphs 21 and 21A)?

Answer

Agreed, carrying value of asset given up at times does not reflect the fair value of asset given up/acquired asset.

Question 2

Do you agree that all exchanges of intangible assets should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably? (See the amendments in paragraphs 34-34B of IAS 38, Intangible Assets, proposed as a consequence of the proposal described in Question 1.)

(Note that the Board has decided not to amend, at this time, the prohibition in IAS 18, Revenue, on recognizing revenue from exchanges or swaps of goods or services of a similar nature and value. The Board will review that policy later in the context of a future project on the Recognition of Revenue.)

Answer

The committee is of the view that the above referred matter does not fall under the ambit of IAS 16 and should be dealt separately with the revision of IAS 38.

Question 3

Do you agree that depreciation of an item of property, plant and equipment should not cease when it becomes temporarily idle or is retired from active use and held for disposal (see paragraph 59)?

Answer

Agreed. The depreciation of an item of Property, Plant and Equipment should not cease only on the ground that the item has become temporarily idle or is retired from active use and held for disposal. Physical wear and tear of such items continues even if the asset is not in use although not at the same rate as during its active use. This aspect is adequately dealt in the Exposure Draft for the improvement of IAS 16, which now requires to review the useful life and depreciation method at each balance sheet date. This will ensure that the idle assets are depreciated on a basis that is more reflective of the pattern in which the future economic benefits from such assets are expected to be consumed by the entity.

IAS-17, *Leases*

Question 1

Do you agree that when classifying a lease of land and buildings, the lease should be split into two elements—a lease of land and a lease of buildings?

The land element is generally classified as an operating lease under paragraph 11 of IAS 17, Leases, and the buildings element is classified as an operating or finance lease by applying the conditions in paragraphs 3-10 of IAS 17.

Answer

Agreed.

Question 2

Do you agree that when a lessor incurs initial direct costs in negotiating a lease, those costs should be capitalised and allocated over the lease term?

Do you agree that only incremental costs that are directly attributable to the lease transaction should be capitalised in this way and that they should include those internal costs that are incremental and directly attributable?

Answer

Agreed.

IAS-21, *The Effect of Changes in Foreign Exchange Rates*

Question 1

Do you agree with the proposed definition of functional currency as "the currency of the primary economic environment in which the entity operates" and the guidance proposed in paragraphs 7-12 on how to determine what is an entity's functional currency?

Answer

Agreed.

Question 2

Do you agree that a reporting entity (whether a group or a stand-alone entity) should be permitted to present its financial statements in any currency (or currencies) that it chooses?

Answer

Agreed. Many foreign operations present their financial statements in more than one currency, one in their functional currency and the other denominated in the reporting entity's currency or local framework's required currency. Therefore, an entity should be allowed to present its financial statements in any currency (or currencies) that it chooses.

Question 3

Do you agree that all entities should translate their financial statements into the presentation currency (or currencies) using the same method as is required for translating a foreign operation for inclusion in the reporting entity's financial statements (see paragraphs 37 and 40)?

Answer

We agree to the argument that if an entity's functional currency is different from its reporting entity's currency, then it is autonomous enough to be categorized as a foreign entity and therefore its financial statements should be translated using the guidelines stated in paragraph 37 and 40. The same method is also appropriate for the entities that have same functional currency as of their reporting entity, but is required to present its financial statements in any other currency to comply with the local framework.

Question 4

Do you agree that the allowed alternative to capitalize certain exchange differences in paragraph 21 of IAS 21 should be removed?

Answer

Agreed.

Question 5

Do you agree that

(a) goodwill and

(b) fair value adjustments to assets and liabilities that arise on the acquisition of a foreign operation should be treated as assets and liabilities of the foreign operation and translated at the closing rate (see paragraph 45)?

Answer

Agreed, if a foreign operation is autonomous enough to be categorized as a foreign entity, then the goodwill and fair value adjustments to its assets and liabilities should be made part of that foreign operation and being non monetary in nature translated at the closing rate.

IAS-24, *Related Party Disclosures*

Question 1

Do you agree that the Standard should not require disclosure of management compensation, expense allowances and similar items paid in the ordinary course of an entity's operations (see paragraph 2)? 'Management' and 'compensation' would need to be defined, and measurement requirements for management compensation would need to be developed, if disclosure of these items were to be required. If commentators disagree with the Board's proposal, the Board would welcome suggestions on how to define 'management' and 'compensation'.

Answer

Agreed. Management compensation and expense allowances are terms that may be differently defined in local frameworks. To develop a definition that incorporates elements of all such definitions will be a difficult and cumbersome task. Therefore, local frame works should be left to decide these disclosures requirements suitable as to their local definitions of compensation and allowances.

Question 2

Do you agree that the Standard should not require disclosure of related party transactions and outstanding balances in the separate financial statements of a parent or a wholly-owned subsidiary that are made available or published with consolidated financial statements for the group to which that entity belongs (see paragraph 3)?

(Note that this proposal is the subject of alternative views of Board members, as set out in Appendix B.)

Answer

Agreed.

IAS-27, Consolidated Financial Statements and Accounting for Investments in Subsidiaries

Question 1

Do you agree that a parent need not prepare consolidated financial statements if all the criteria in paragraph 8 are met?

Answer

Agreed.

Question 2

Do you agree that minority interests should be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity (see paragraph 26)?

Answer

Agreed.

Question 3

Do you agree that investments in subsidiaries, jointly controlled entities and associates that are consolidated, proportionately consolidated or accounted for under the equity method in the consolidated financial statements should be either carried at cost or accounted for in accordance with IAS 39, Financial Instruments: Recognition and Measurement, in the investor's separate financial statements (paragraph 29)?

Do you agree that if investments in subsidiaries, jointly controlled entities and associates are accounted for in accordance with IAS 39 in the consolidated financial statements, then such investments should be accounted for in the same way in the investor's separate financial statements (paragraph 30)?

Answer

Agreed.

<u>IAS-28, *Accounting for Investments in Associates*</u>

<u>Question 1</u>

Do you agree that IAS 28 and IAS 31, Financial Reporting of Interests in Joint Ventures, should not apply to investments that otherwise would be associates or joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities if these investments are measured at fair value in accordance with IAS 39, Financial Instruments: Recognition and Measurement, when such measurement is well-established practice in those industries (see paragraph 1)?

<u>Answer</u>

Agreed. The substance of such investments is clearly distinct from its form. Therefore, investments that are measured at fair value under IAS 39 should not be dealt under IAS 28 and 31 to avoid delusion of interpreting such investments as associates.

<u>Question 2</u>

Do you agree that the amount to be reduced to nil when an associate incurs losses should include not only investments in the equity of the associate but also other interests such as long-term receivables (paragraph 22)?

<u>Answer</u>

Considering the removal of cost method from IAS 28, the equity method will now become mandatory (except for the investments dealt under IAS 39) for the measurement of associates i.e there is no option for the entities having interests in associates to avoid the application of equity method. Keeping this in view, the practical implication of this amendment may be extensive and may have far reaching effects on the presentation of associates in the financial statements.

IAS- 33, *Earnings Per Share*

Question 1

Do you agree that contracts that may be settled either in ordinary shares or in cash, at the issuer's option, should be included as potential ordinary shares in the calculation of diluted earnings per share based on a rebuttable presumption that the contracts will be settled in shares?

Answer

Partially agreed. As the settlement of such contract is at the issuer's option, the inclusion of such potential ordinary shares in the calculation of diluted earnings per share should be marked by the intention of the issuer for settlement in ordinary shares. If an issuer intends to do so, only then such ordinary shares should be included in the calculation of diluted earning per share.

IAS 40- Investment Property

Question 1

Do you agree that the definition of investment property should be changed to permit the inclusion of a property interest held under an operating lease provided that:

(a) the rest of the definition of investment property is met; and

(b) the lessee uses the fair value model set out in IAS 40, paragraphs 27-49?

Answer

Agreed. Permitting inclusion of a property interest held under an operating lease would broaden the scope of the standard.

Question 2

Do you agree that a lessee that classifies a property interest held under an operating lease as investment property should account for the lease as if it were a finance lease?

Answer

Operating leases accounted for as finance leases may give an impression that the property is owned by the entity. It may be considered to introduce separate disclosures to present operating leases held as investment properties.

Question 3

Do you agree that the Board should not eliminate the choice between the cost model and the fair value model in the Improvements project, but should keep the matter under review with a view to reconsidering the option to use the cost model in due course?

Answer

Agreed. The choice between the cost model and the fair value model should not be eliminated at this stage. It may be considered that fair value model may be prescribed as mandatory for investments held for sale or capital appreciation while a choice between cost and fair value model is maintained for investments held to earn rentals.