SOCIETY OF ACCOUNTANTS IN MALAWI
RESPONSES TO INVITATION TO COMMENT ON EXPOSURE DRAFT OF PROPOSED IMPROVEMENTS TO INTERNATIONAL ACCOUNTING STANDARDS

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1. Introduction

1.1 The Society of Accountants in Malawi ("SOCAM") is Malawi's principal body representing the interests of accountants in practice, other qualified accountants, and accounting technicians. It has a membership of about 200 persons, being the majority of qualified accountants in Malawi, most of whom qualified initially through ACCA or ICAEW.

1.2 SOCAM is a member of ECSAFA, the Eastern, Central and Southern Africa Federation of Accountants.

1.3 SOCAM, and its Accounting and Auditing Standards Committee are required by law to promulgate standards for use in Malawi which are suitable for international acceptance and for use within Malawi.

1.4 This requirement has been met since 1 January 2001 by a general requirement to follow International Accounting Standards.

1.5 Previously, Malawi adopted International Accounting Standards on a standard-by-standard basis and issued a preface indicating where, if at all, preparers should or could deviate from the IAS, either for compliance with Company Law in Malawi, or to follow generally accepted practice in Malawi. The full introduction of IAS had more of a psychological impact than an actual change in the requirements for financial accounting (e.g. loss of jurisdiction, realisation of complexities).

1.6 SOCAM has not hitherto commented on Exposure Drafts but it has been useful to do so on this occasion, since the number of amendments are so many and cover so many standards, and because SOCAM's current requirement to accept any changes introduced also requires us to make representations where necessary.

1.7 Before commenting, on a standard-by-standard basis, we give a brief outline of the principal issues concerning preparers of financial statements in Malawi.

2. Principal issues concerning preparers of financial statements in Malawi

2.1 Malawi has a very small stock exchange with only eight companies listed. The number of companies ever registered is less than 6,000 and there are less than 30 persons registered to audit companies. All companies are required by law to have a full audit and to prepare full (un-modified) accounts, though there is no requirement to file financial statements with the Registrar of Companies.

2.2 There is significant direct investment by companies from South Africa, UK and France, sometimes in partnership with local companies.

2.3 The Malawi economy is very small and any given sector will have between one and five key players. Most companies are small private companies whose financial statements are very much for limited circulation.

2.4 Practitioners have made representations that International Accounting Standards are becoming too complex for application to most Malawi Companies. We are following developments elsewhere in the world with interest because as a small body SOCAM can hardly by itself design a robust and relevant standard for use by smaller companies whose financial statements are also used by few persons.

2.5 We have been unable to obtain a local consensus whether such a standard should allow different measurement or should be limited to reductions in disclosure. Nor could we decide whether the standard should be prescriptive or allow exercise of judgement. Finally, although it seems obvious to some, the dividing line between those companies which must comply in full, and those which could use a restricted approach, has been debated, some favouring size (by employee number, turnover asset base, net assets etc) and some favouring the nature of the users and their requirements.

2.6 Clearly, Malawi welcomes the interest being taken by the International Accounting Standards Board in developing a special standard for Small and Medium Enterprises and believes there is an urgent requirement for limited user financial statement of smaller enterprises in the developing economies such as in Malawi.

2.7 Malawi's economy is characterised by reliance for foreign exchange on commodity sales (tobacco, sugar, tea coffee) and donor support. Interest rates are high (44%) in absolute and real terms. Exchange rates can be stable for long periods but then change significantly over a short period. The economy is liberalised but there are regulatory checks on a foreign currency purchases.

2.8 Inflation is about 18% at present but has been sufficiently high enough for debate as to whether IAS 29 should be applied, since three year cumulative inflation has for many years hovered around 100%.

2.9 SOCAM has concluded that IAS 29 is not applicable, and the conclusion (when last considered in December 2001) was based on inapplicability of several of the qualitative criteria and declining inflation rates. Nonetheless, some argue that IAS 29 adjusted accounts would be incomprehensible to most users in Malawi, and that most foreign users will translate accounts in Malawi currency into a more stable currency for monitoring and consolidation purposes.

2.10 With a small auditing profession, who necessarily are best placed to advise companies on the changing requirements of IAS, some have suggested that there is an inability to handle standards such as IAS 29, and IAS 39 insofar as it applies to Malawi. Foreign currency options have only just been introduced.

3. <u>IAS 1 Presentation of Financial Statements</u>

3.1 In respect of questions 3 and 4, it may be expected (under IAS 10) that if re-financing agreements are entered into after the balance sheet date but before the date the financial statements are authorised for issue, which might lead to re-classification of loans as current or non-current, then disclosure should be made of that fact.

Perhaps this might be referred to in IAS I though we suspect it may not need to.

3.2 We agree that the disclosure of management judgements and key assumptions about the future will enhance the value of financial statements, though we see some difficulty in enforcement in Malawi for reasons which may be understood from the background notes in Section 2 above.

3.3 We presume that the requirements for staff numbers, registered office and country of incorporation are removed since they should be found elsewhere in the annual review. However, we consider that if changes in IAS 21 are introduced, it will be important to show the country of incorporation, particularly if that country's currency is not the presentation currency.

3.4 In Malawi we require disclosure (with comparatives) of relevant exchange rates and the inflation rate since in a country with exchange rate volatility and significant inflation these factors assist in understanding the financial statements.

3.5 Paragraphs 14 – 15 do not refer to conflicts arising from differences in regulatory requirements and IAS although the changes and basis for conclusions do. This is an important issue in Malawi where the Companies Act is quite old (1984) and "out of date" as regards accounting requirements.

3.6 We look forward to the completion of the review of treatment of minority interests so that their treatment is harmonised as between income statement, statement of equity, and balance sheet.

4. IAS 2, Inventories

We support the changes proposed and the retention of the requirements in respect of a reversal of a write down as in paragraphs 30 and 31.

5. IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

We agree with the proposals made. We note that the term "Estimate" or "Accounting Estimate" is not defined in paragraph 3, where we expected it to be included.

6. IAS 10, Events after the Balance Sheet Date

6.1 The changes are welcomed. Preparers in Malawi are now used to accounting for dividends when declared.

6.2 The clarification of when a non-adjusting disclosure is required (according to when non-disclosure could influence the economic decisions of users) is welcomed. It is elegantly and succinctly described.

7. IAS 15, Information Reflecting the Effects of Changing Prices

The formal withdrawal of this standard was long overdue and we support it.

8. IAS 16, Property, Plant and Equipment

8.1 We agree with the proposals set out as questions, and elsewhere.

8.2 We strongly support the retention of revaluation as an allowed alternative. In Malawi revaluation is a commonly used policy that goes some way to bringing non-current assets to fair value and in illustrating the effect of inflation on capital.

8.3 It may be appropriate to clarify the accounting for the separate cost or valuation/accumulated depreciation elements of carrying value.

- On revaluation to depreciated replacement cost, where used, should or can both cost or valuation and accumulated depreciation be re-stated, or should reversal of accumulated depreciation be required on revaluation in all cases?
- To which component of carrying value is an impairment loss credited?

8.4 Similarly, though it may come into a standard on equity or reserves, can guidance be given on whether a revaluation reserve should be written off to retained profits over the life of the related assets, or can it be left unamortised. The issue relates to the realisation of profits and is covered in company law in some countries. The determination of distributable profits is of significance in Malawi.

9. IAS 17 Leases

9.1 Because of changes in the law of land tenure, long leases will become more common, but the general view in the market place is that a long lease is as good as ownership. Acceptance by IAS of this view is welcomed as financial statements in Malawi had been drawn up on this basis.

10. IAS 21 The Effects of Changes in Foreign Exchange Rates

10.1 The standard has been thoughtfully revised and has a logical technical approach. The issue is whether it is workable.

10.2 We believe that more emphasis should be put on the rationale to be used by an entity in selecting its presentation currency. A free choice is not appropriate. It would prevent comparability in a given country. The presentation currency should be the one in which the expected users can best interpret the performance and state of affairs of the company.

10.3 We note that in Malawi it is claimed that presentation other than in Malawi Kwacha, the national currency would be illegal and/or maintaining the books of account in a different currency would not be allowed. Nonetheless, some "limited user" financial statements are presented in the functional currency and are of enhanced value to the principal users.

10.4 We are concerned about the conflict of standards and law, but note that in a country with relatively high inflation such as Malawi, and where some significant entities do in effect operate in a way where their performance is more influenced by the economics of a currency other than the Malawi Kwacha, then presentation in a relevant foreign currency will often be more informative.

11. IAS 24 Related Party Disclosures

11.1 We consider that disclosure of management compensation broadly defined should be required in line with developing corporate governance practice in Malawi and elsewhere.

11.2 In our opinion, some deference to separate legal jurisdictions is required as regards the disclosure of related party transaction and balances in a parent company. If these financial statements are next consolidated in a different legal jurisdiction or in a different presentation currency then there should be no relief from disclosure. This is because the local financial statements (e.g. of a country holding company) will have different users from the final consolidation.

12. IAS 27 CONSOLIDATION FINANCIAL STATEMENTS AND ACCOUNTING FOR INVESTMENTS IN SUBSIDIARIES

12.1 We agree with the proposed changes.

12.2 However we believe that all criteria in paragraph 8 have to be satisfied, so the word “and” has to be given after criteria (a) and (b).

13. IAS 28 Accounting for Investments in Associates

13.1 We agree with your proposals

13.2 In Malawi, because of lack of investment opportunity, it is quite common for pension funds and similar investment vehicles to hold more than 20% of equity without exhibiting significant influence. Paragraph 1 as revised is therefore welcomed.

14. IAS 33 Earnings Per Share

14.1 Because the standard is applicable only to actual or potential listed companies, (or by election), and because the companies in Malawi use little more than ordinary and preference shares and group or external loans in their capital structure, only the more straightforward computations are required here.

14.2 Accordingly we have not felt it necessary to review the standard in full.

15. IAS 40 Investment Property

15.1 Historically, revaluation of investment property was a common (but not consistent) policy. This was because of relatively high inflation such that the cost basis probably does not deliver a fair presentation.

15.2 Revaluation to income is being adopted by the major investment property holders, and although more informative, there are conflicts with the Companies Act in Malawi.

15.3 We consider that the elimination of a "cost" alternative should wait until the completion of a "small companies" standard, as the cost basis may be available for use there.

15.4 Investment property held under a long operating lease should be treated as if under a finance lease. Long leases are common in Malawi and are accepted as being as good as ownership.

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