1. Complete set of financial statements for small-sized companies

Enquiry:

Section 2 (33) of the Companies Act, 2017, include statement of other comprehensive income, statement of changes in equity and statement of cash flow in the definition of the financial statements. This section applies to all companies whether small-sized, medium-sized or large-sized.

On the other hand, section 1.2 of the 'Revised Accounting and Financial Reporting Standard for Small-Sized Entities', states that the minimum set of financial statements includes (a) Statement of Financial Position, (b) Income Statement and (c) Accounting Policies and explanatory notes. Since the law overrides the accounting standards, it transpires that the Small-Sized Companies will have to prepare the financial statements as defined in the Companies Act, 2017.

Opinion:

The Board would like to draw your attention to section 2(33) of the Companies Act, 2017 which defines financial statements as follows:

"Financial statements in relation to company, includes:

- *a) statement of financial position as at the end of the period*
- *b) a statement of profit or loss and other comprehensive income or in the case of a company carrying on any activity not for profit, an income and expenditure statement for the period;*
- *c) a statement of changes in equity for the period;*
- *d) a statement of cash flows for the period;*
- *e) notes, comprising a summary of significant accounting policies and other explanatory information;*
- *f) comparative information in respect of the preceding period; and*
- *g) any other statement as may be prescribed."*

The above definition is general and all-encompassing, whereas the third schedule of the Companies Act, 2017 specifies the framework to be followed by an entity.

Further, section 1.2 of the *'Revised Accounting and Financial Reporting Standard for Small-Sized Entities' (Revised AFRS for SSEs)*, states that the minimum set of financial statements includes:

- a) Statement of Financial Position
- b) Income Statement and
- c) Accounting policies and explanatory notes.

Based on the above definition of financial statements and requirements of section 1.2 of the Revised AFRS for SSEs, the financial statements prepared in accordance with the Revised AFRS for SSEs shall contain the statements mentioned in such standard only.

(October 02, 2017)

2. Deferred tax liability arising on revaluation of fixed assets

Enquiry:

Our client, a Small-Sized Company, had revalued its fixed assets upwards few years back. As you would be aware that the previous '*Accounting and Financial Reporting Standard for Small-Sized Entities (AFRS for SSEs)' did* not cover taxation, therefore our client took guidance from the *'Accounting and Financial Reporting Standards for Medium-Sized Entities'* issued by the ICAP as allowed under section 22 of the *AFRS for SSEs*, and provided deferred tax liability out of the revaluation surplus.

Now section 17.1 of the revised *AFRS for SSEs* does not allow recognition of deferred tax as it says that 'an entity shall apply the taxes payable method to account for its income tax', so should our client transfer the deferred tax liability to revaluation surplus now or as far as tax effects of revaluation are concerned it can carry on the deferred tax liability and make subsequent transfers upon charging of incremental depreciation and realization of revaluation surplus?

Opinion:

The companies are required to prepare financial statements in accordance with the prescribed financial reporting framework.

In accordance with the third schedule of the Companies Act, 2017, the prescribed financial reporting framework for small-sized companies is the AFRS for SSEs.

With regard to accounting and presentation of taxation, section 17 '*Taxation'* of the AFRS for SSEs allows only the taxes payable method and also mentions that the entity only reports current income tax as an expense.

Relevant section 17.1 of the AFRS for SSEs is reproduced as under:

> *"An entity shall apply the taxes payable method to account for its income taxes. The taxes payable method is a method of accounting under which an entity reports as an expense only the current income taxes for that period, determined in accordance with the Tax Law."*

With reference to the scenario explained in the enquiry, a small-sized company preparing financial statements in accordance with the AFRS for SSEs is required to comply with all the requirements of said standard, and apply the transitional provisions contained in section 22 of the AFRS for SSEs. Relevant part is reproduced hereunder:

> *22.2 "An entity shall in its opening balance sheet as of its date of transition (beginning of the earliest period presented in financial statements) to this Standard:*
>
> *a) Recognize all assets and liabilities whose recognition is required by to this Standard;*
>
> *b) Not recognize items as assets or liabilities if to this Standard do not permit such recognition;*
>
> *c) Reclassify items that it recognized under its previous financial reporting framework as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under to this Standard; and*

d) Apply to this Standard in measuring all recognized assets and liabilities.

The financial effect of above actions should be reflected in opening balance sheet by adjusting the amount of retained earnings as at the date of transition." (Underline is ours)

Accordingly in the enquired scenerio, a company preparing financial statements in accordance with the AFRS for SSEs is required to de-recognise the deferred tax liability and account for the impact in the opening balance sheet in accordance with the above paragraph of section 22.

(October 02, 2017)

3. Presentation of surplus on revaluation of fixed assets

Enquiry:

Based on our understanding, the new Companies Act, 2017 does not specify any treatment for surplus on revaluation of fixed assets. However, if we look in the applicable accounting standards, they specify different disclosure requirements for medium-sized and small-sized companies. Section 17.15C of IFRS for SMEs states that:

"the increase shall be recognized in other comprehensive income and accumulated in equity under the heading of revaluation surplus".

On the other hand, section 2.9 of the 'Revised *Accounting and Financial Reporting Standard for Small-Sized Entities (AFRS for SSEs)'* states that:

"the increase shall be credited directly to the Surplus on Revaluation of Fixed Assets and disclosed in the Statement of Financial Position after Capital and Reserves".

Please clarify, can the surplus on revaluation, in case of small-sized companies, be shown under the heading of equity after capital and reserves or it will have to be shown outside equity as was the previous legal requirement?

Opinion:

The Board would like to highlight that the specific section relating to the surplus on revaluation of fixed assets (section 235 of the repealed Companies Ordinance, 1984) has not been carried forward in the Companies Act, 2017.

Consequently, the accounting treatment and presentation of the surplus on revaluation of fixed assets shall be in accordance with the applicable accounting and reporting standards (i.e. IFRS, IFRS for SMEs, AFRS for SSEs) whereby the surplus on revaluation will be presented under equity.

It is to be noted that the fifth schedule of the Companies Act, 2017 requires the revaluation surplus on property, plant and equipment to be disclosed as a separate line item on the face of the financial statements.

(October 02, 2017)

4. Reconciliation of property, plant and equipment

Enquiry:

Section 17.31 of the IFRS for SMEs requires a reconciliation of the carrying amount at the beginning and end of the reporting period showing additions, disposals, depreciation, etc. in respect of property, plant and equipment, and specifically states that this reconciliation need not be presented for prior periods.

On the other hand the section 2.18 of the Revised *'Accounting and Financial Reporting Standard for Small-Sized Entities' (Revised AFRS for SSEs*) is silent about the presentation of the reconciliation for the prior years. So should we presume that this reconciliation need not be presented for the prior periods? We understand that small-sized entities cannot be overburdened for more disclosure in contrast to medium-sized entities.

Opinion:

Section 1.10 of the Revised AFRS for SSEs requires that the entity shall disclose comparative information in respect of the previous comparable period for all amounts presented in the current period's financial statements.

Further, section 2.18 of the Revised AFRS for SSEs outlines the requirement to present reconciliation of the property plant and equipment. A specific provision allowing the companies not to present the reconciliation for the comparative period is not contained in section 2.18. In this regard it is pertinent to mention that a specific line is included in section 3.9 relating to intangible assets, reproduced hereunder:

> *"This reconciliation need not be presented for prior periods".*

The requirements of section 1.10 and 2.18 read together require the presentation of reconciliation of the property, plant and equipment for the current and comparative period.

(October 02, 2017)

5. Transition to the Revised AFRS for SSEs and IFRS for SMEs

Enquiry:

The 'Revised Accounting and Financial Reporting Standard for Small-Sized Entities', requires retrospective adoption of the standard by amending the comparative financial statements, whereas, section 35.2 of IFRS for SMEs allows both retrospective and prospective adoption. Please clarify.

Opinion:

The Board would like to draw your attention to section 35.2 of IFRS for SMEs which states:

"35.2 <u>An entity that has applied the IFRS for SMEs in a previous reporting period, but whose most recent previous annual financial statements did not contain an explicit and unreserved statement of compliance with the IFRS for SMEs, must either apply this section or apply the IFRS for SMEs retrospectively</u> in accordance with Section 10 Accounting Policies, Estimates and Errors as if the entity had never stopped applying

the IFRS for SMEs. When such an entity does not elect to apply this section, it is still required to apply the disclosure requirements in paragraph 35.12A in addition to the disclosure requirements in Section 10." (underlining is ours)

Section 35 of the IFRS for SMEs outlines the procedures for preparing financial statements at the date of transition. The treatment for most items is retrospective and only for certain items is prospective such as specified below:

"35.9 On first-time adoption of this Standard, an entity shall not retrospectively change the accounting that it followed under its previous financial reporting framework for any of the following transactions:

(a) derecognition of financial assets and financial liabilities. ----------
(b) hedge accounting ----------
(c) accounting estimates.
(d) discontinued operations"

Section 22 *'Transition to the Accounting Standard SSEs'* of the *'Revised Accounting and Financial Reporting Standard for Small-Sized Entities' (Revised AFRS for SSEs*) states that:

"22.2 An entity shall in its opening balance sheet as of its date of transition (beginning of the earliest period presented in financial statements) to this Standard:

a) Recognize all assets and liabilities whose recognition is required by to this Standard;
b) Not recognize items as assets or liabilities if to this Standard do not permit such recognition;
c) Reclassify items that it recognized under its previous financial reporting framework as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under to this Standard; and
d) Apply to this Standard in measuring all recognized assets and liabilities.

The financial effect of above actions should be reflected in opening balance sheet by adjusting the amount of retained earnings as at the date of transition."

From the above it is clear that for transition to the Revised AFRS for SSEs the retrospective approach will be followed.

(October 02, 2017)