

ACCOUNTING STANDARDS BOARD

**Accounting matters arising from the
Companies Act, 2017**

Contents

Introduction

Accounting areas

Introduction

- The Companies Act, 2017 has been enacted on May 30, 2017
- It has brought in accounting and financial reporting related changes
- Significant financial reporting related areas for ASB consideration include:
 1. IFRS compliant financial statements and disclosure requirements of the Companies Act, 2017
 2. Accounting of surplus on revaluation of fixed assets
 3. Accounting of employee option scheme
 4. Presentation of discount on issue of shares in the financial Statements
 5. Related party transactions- Arms' length basis
 6. Beneficial ownership
 7. IFRS for SMEs

Financial reporting related changes

IFRS compliant financial statements

- The companies have been allowed to prepare the statutory financial statements in accordance with the International Financial Reporting Standards (IFRS) issued by International Accounting Standards Board (IASB).
- The financial statements related disclosure requirements are contained in the Fourth and Fifth schedules of the Companies Act.
- These disclosure requirements are in addition to the disclosure requirements outlined in IFRS.

The companies preparing IFRS compliant statutory financial statements are also required to comply with disclosure requirements of the Fourth and Fifth schedules.

Financial reporting related changes

Accounting of surplus on revaluation of fixed assets

- Specific section relating to the surplus on revaluation of fixed assets (section 235 of the repealed Companies Act, 1984) has not been carried forward in the Companies Act.
- Consequently, the accounting difference between the IFRS and corporate law relating to the surplus on revaluation of fixed assets has been eliminated. The companies will now, in accordance with requirements of International Accounting Standard (IAS) 16, Property, Plant and Equipment:
 - Present surplus on revaluation of fixed assets under equity; and
 - Offset the deficit arising from revaluation of the particular category of assets.

The change in accounting of surplus on revaluation of fixed assets will result in the change in accounting policy in accordance with IAS 8, “Accounting policies, Changes in Accounting Estimates and Errors”.

Financial reporting related changes

Accounting of employee option scheme

- “Employee stock option” defined in the Companies Act.
- SECP had issued Public Companies (Employees Stock Option Scheme) Rules, 2001. The Schedule of the rules outlines the accounting of the employees stock option scheme.
- The accounting specified by SECP through above mentioned Rules is not inline with the IFRS 2 *‘Share Based Payments’*.

The accounting treatment specified shall be in accordance with the IFRS 2.

Financial reporting related changes

Determination of the Fair value of the Option

Accounting rules prescribed by SECP

- The accounting value of options shall be equal the Fair value.
- **Fair value** means
 - an option discount, or,
 - if a company so chooses, the value of an option using the Black Scholes formula or other similar valuation method; and
- Option discount means the excess of market price of the share at the date of grant of an option under a scheme over exercise price of the option. [Rule 13(1)]

IFRS 2

- Option pricing of employee share option scheme - Fair value of the equity instrument granted
- Fair value to be determined by:
 - Market prices (IFRS 2.16)
 - Valuation Techniques (IFRS 2.17)
 - Intrinsic value (FV – Exercise Price) allowed in rare cases. (IFRS 2.24)

Financial reporting related changes

Lapse after vesting date

Accounting rules prescribed by SECP

When a vested option lapses on expiry of an exercise period, after the fair value of an option has already been accounted for as employee compensation, this accounting treatment shall be reversed by a credit to employee compensation expense. [Rule 13 (4)]

IFRS 2

Once an equity-settled transaction has vested, the IFRS does not allow reversal of already charged employee compensation expense. (IFRS 2.23)

Financial reporting related changes

Presentation of discount on issuance of shares

- Every prospectus and statement of financial position to contain particulars of discount on issuance of shares.
[Section 82.(4)]
- The presentation of discount on issuance of shares is not specified in the Companies Act.
- Further, IFRS do not outline the presentation of discount on issuance of shares.

Financial reporting related changes

Discount on issuance of shares can be shown as either:

Option A

Separately as a deduction from share capital in the balance sheet and the statement of changes in equity.

Option B

Adjusted / included in the retained earnings or accumulated losses in the balance sheet and the statement of changes in equity.

In such case the discount should be disclosed by way of a note in the financial statement

Financial reporting related changes

Related party transactions - arm's length basis

- A new section on related party transactions has been incorporated, setting out framework for the related party transactions.
- It explains that the arm's length transaction means a transaction which is subject to such terms and conditions as may be specified by the SECP.

The rules / regulations specifying the basis of arm's length transaction are yet to be specified by SECP.

Financial reporting related changes

Beneficial ownership

- Disclosure of the particulars of the foreign shareholders, other than the natural person, holding more than 5% of the paid up capital required in the financial statements.
- This includes names of beneficial owners.

Financial reporting related changes

IFRS for SMEs

- The companies have been classified in various categories for the financial reporting purposes.
- IFRS for SMEs have been prescribed for certain class of companies.
- SECP had earlier allowed an exception in the IFRS for SMEs, by allowing the capitalization of borrowing costs.
- However, this exception has not been carried forward in the financial reporting framework provided in the Companies Act.

Financial reporting related changes

The impact in the first year financial statements prepared in accordance with IFRS for SMEs would be:

- An explicit and unreserved statement of compliance with IFRS for SMEs;
- Derecognition of previously capitalized borrowing cost; and
- Recognition of the related impact in retained earnings.