To: All Members

From: Professional Standards Committee

Subject: Advisory on Application of IAS 12, IAS 10 and IAS 37 for Financial Reporting in Kenya (A 2001/3)

Members are requested to ensure the proper application of International Accounting Standards by their employers or clients. In this respect, the Committee wishes to make the following observations about specific standards:

IAS 12

The Committee has noted cases in the 2000 financial statements where companies failed to provide for deferred tax on the revaluation surpluses as required in IAS 12. The practice was defended on the basis that the tax regime in Kenya does not favour this treatment due to the Non-existence of Capital Gains Tax which means that no liability to tax or otherwise would arise in the future if the asset is sold.

The Committee wishes to clarify that this contravenes the provisions of paragraph 20 of IAS 12 which states clearly, that **"the difference between the cash amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset."** There are no exceptions provided to this rule.

Members are reminded that, in accordance with IAS 1, *Presentation of Financial Statements*,

- Financial statements should not be described as complying with IASs unless they comply with all requirements of each applicable standard and each applicable Interpretation.
- In rare circumstances where management concludes that compliance with a requirement in a standard would be misleading."… The enterprise should disclose the standard from which the enterprise has departed, the treatment that the standard would require, the nature of the departure, the reason why following the IAS would be misleading in the circumstances, and the financial impact of the departure on the enterprise's net profit/loss, assets, liabilities, equity and cash flow…"

Dealing with the Conflict between Companies Act and IAS 10 & 37

The Professional Standards Committee has noted the apparent conflict between IAS 37, *Provisions, Contingent, Liabilities and Contingent Assets*, and IAS 10, *Events After the Balance Sheet Date*, and the Companies Act in terms of the treatment of proposed dividends and is pleased to provide a solution to address the conflict.

Background to the Problem

IAS 37, which comes into force for year ends from 30 June 2000 appears to prohibit the inclusion of proposed dividends in the financial statements because such amounts do not meet the definition of a provision, being a "present obligation" of the enterprise. Proposed dividends not yet approved by shareholders do not meet this criteria. Paragraph 11 of IAS 10, on the other hand, states that dividends proposed or declared after the balance sheet date should not be recognized as a liability in the balance sheet. Conversely, the Sixth Schedule to Companies Act, Cap 486 of the Laws of Kenya, states that the aggregate amount of the dividends paid and proposed should be shown in the profit and loss account and also that the net aggregate amount which is recommended for distribution by way of dividend should be shown in the balance sheet.

Since financial reports in Kenya are currently being prepared in accordance with IASs, compliance with all applicable IASs and their Interpretations is required. To the extent therefore, that there is a difference between the requirements of the Companies Act and IAS 10 and 37 a qualified audit opinion would be necessary.

Proposed Treatment

The Professional Standards Committee suggests, the following solution in the various primary financial statements in order to meet both the requirements of IASs and Companies Act without the need for qualifications.

Profit and Loss Account

In order to comply with section 12 (1)(h) of the Sixth Schedule to Companies Act, in respect of disclosure of the aggregate amount of dividends paid and proposed, an additional line may be introduced in the profit and loss account, below the net profit and after the analysis of earnings per share, where applicable, entitled "Dividends," which should be analysed into dividends paid and dividends proposed, as shown below:

Dividends:	Notes	2000	1999
		Shs. 000	Shs. 000
Interim dividend - paid in the year	8	xx	xx
Proposed final dividend for the year	8	xx	xx
		xx	xx
		====	===

Balance Sheet

The Sixth Schedule to the Companies Act in requiring that proposed dividends be shown in the balance sheet, does not specifically state that this should be shown as a liability. Therefore the net aggregate amount (after deduction of income tax) which is recommended for distribution by way of dividend can be shown in the capital and reserves section of the balance sheet as follows:

	Notes	2000	1999
Capital and Reserves		Shs. 000	Shs. 000
Share Capital	10	xxx	xxx
Revenue Reserves	11	xxx	xxx
Proposed Dividends	12	xxx	xxx
		xxx	xxx
		===	====

Statement of Changes in Equity

The corresponding revenue reserves and proposed dividend entries would be shown on separate columns of the Statement of Changes in Equity. As long as the proposed dividend is shown in the accounts but is not included among liabilities the appropriate disclosure as required under the Companies Act will have been made without contravening the provisions of IASs.

The Statement of Changes in Equity for the year ended 30 June 2000 would appear as follows:

	Revenue Reserves	Proposed Dividends	
Year Ended 30th June 1999	Shs. 000	Shs. 000	Total
Balance at 1 July 1998	xx	xx	xx
Prior year adjustments	x	-	x

Restated balance	xx	xx	xx
Net profit for the year	xx	-	xx
Dividend for 1998 - Final	-	(xx)	(xx)
Dividend for 1999 - Interim	(xx)	-	(xx)
Proposed dividend	(xx)	xx	-
Balance at 30th June 1999	xxx	xxx	xxx
	====	=====	====
Year Ended 30th June 2000			
At 1 July 1999	xxx	xxx	xxx
Net Profit for the year	xxx	-	xxx
Dividends for 1999 - Final	-	(xx)	(xx)
Dividends for 2000 -Interim	(xx)	-	(xx)
Proposed dividend	(xx)	xx	-
Balance at 30 June 2000	xxx	xxx	xxx
	===	====	===

Note: The statement of changes in equity above has been abridged to include only the items that impact on revenue reserves and proposed dividend columns. Members should refer to IAS 1 (Revised) for the detailed Statement of changes in Equity showing the other components of the statement.

Accounting Policies

- There should also be an accounting policy statement on treatment of dividends in the accounts this could be along the following lines: **"Dividends on ordinary shares are charged to equity in the period in which they are declared. Proposed dividends are shown as a separate component of equity until declared."**

- In the above example, the prior year adjustment relating to revenue reserves would also need to be explained e.g. **"The prior year adjustment on revenue reserves relate to changes in accounting policy for investment properties as explained further in note 1 under Investment Properties".**

Disclosures

The following disclosure issues should be addressed as part of compliance with IAS 10, 37 and Companies Act.

- There should be an accounting policy on dividends e.g. that only dividends paid or declared during a financial year are deducted from retained earnings.
- There will be a change in accounting policy, in order to ensure dual compliance with statute and IAS 10 and 37 as proposed above, which will affect retained earnings both for the current and comparative years. However, this will only apply in the year in which the change is made.
- The note to dividends in the statement of changes in equity which is a new primary statement under IAS 1 (Revised), *Presentation of Financial Statements* will give details of proposed dividends.

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