

This issue of *Financial Reporting Matters* discusses the recently issued Amendment to FRS 21 – *Net Investment in a Foreign Operation* and provides guidance on several practical issues on implementing FRS 102 *Share-based Payment*.

The Council on Corporate Disclosure and Governance (CCDG) issued the long-awaited Amendment to FRS 21– *Net Investment in a Foreign Operation* on 25 January 2006 following the international issue on 15 December 2005. It is effective from 1 January 2006, consistent with the international amendment and early application is encouraged. The implications of the Amendment and considerations relating to the early adoption for the 31 December 2005 financial statements are highlighted.

As listed companies apply FRS 102 *Share-based Payment* for the first time, several practical issues have surfaced. For example, where a parent grants employee share options over its shares to the employees of its subsidiary, the subsidiary is required to recognise the expense from the employee services that it receives. The accounting issues relating to these and other intra-group share-based payment transactions are analysed.

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## Disclosure of impending changes in standards

With effect from 1 January 2005, when an entity has not applied a standard or interpretation that has been issued but is not yet effective, the entity is required to disclose this fact in its financial statements, together with an assessment of the known or reasonably estimable impact arising on application of the impending change. In addition, the standard suggests that the reporting entity consider disclosing the title of the new standard and the nature of the impending change.

Where these standards have been announced during the financial year, there would normally be sufficient time to identify the impending changes and consider their likely impact. However, where such changes happen after the financial year-end, there might not be sufficient time to identify such changes and their impact by the time that the financial statements are finalised. Where such changes have not been identified up to the date of issue of the financial statements, care should be taken to ensure that this fact is suitably disclosed.

For the purpose of the disclosure, we have provided a list of standards or interpretations that have been issued but not yet effective as at 1 February 2006 at the back page.

## A. Amendment to FRS 21 – *Net Investment in a Foreign Operation*

### Background

Refer to *IFRS Briefing Sheet* Issue 41 for details

FRS 21 generally requires foreign exchange gains and losses to be recognised in the profit and loss account. One exception to this rule relates to monetary items that in substance form part of the net investment in a foreign operation – long term receivables or loans that are quasi-equity in nature. In the consolidated financial statements that include the reporting entity and its foreign operation, foreign exchange gains and losses arising from such items are recognised directly in equity as a foreign currency translation reserve.

However, in the separate financial statements of the reporting entity, any foreign exchange gains and losses arising from its investment in the foreign operation are recognised in the profit and loss account.

### Concerns

Concerns with respect to two issues were raised:

- Is the exception on monetary items that form part of the net investment in a foreign operation limited only to those loans directly between the investor and investee?
- If a loan is in substance part of the investment in a foreign operation, then does FRS 21 require such a loan to be in the functional currency of either the investor or the investee?

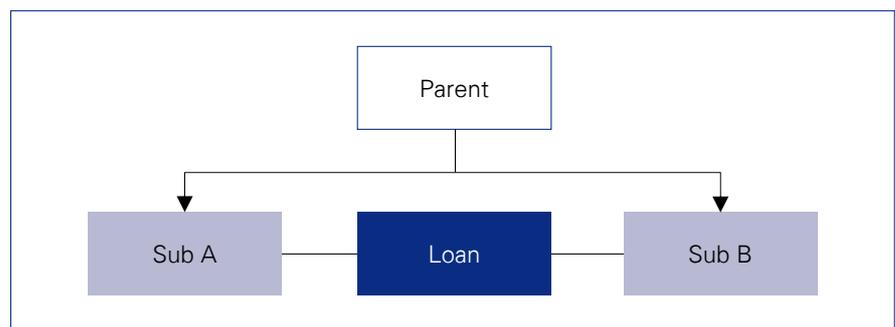
### The two consensus under the Amendment to FRS 21

The following consensus was reached in the Amendment to FRS 21:

- Loans from other entities within the group may form part of the net investment, so long as settlement is not planned and not likely to occur within the foreseeable future.
- Exchange differences arising from the translation of a monetary item that is denominated in any currency is recognised in equity in the consolidated financial statements, when the criteria for qualifying net investments are met.

### Consensus (1)

Our view is that consensus (1) simply confirms current practice under FRS 21 explicitly. Assume the following structure, a loan from subsidiary A to subsidiary B is considered to be part of its net investment in subsidiary B in the consolidated financial statements of the parent.



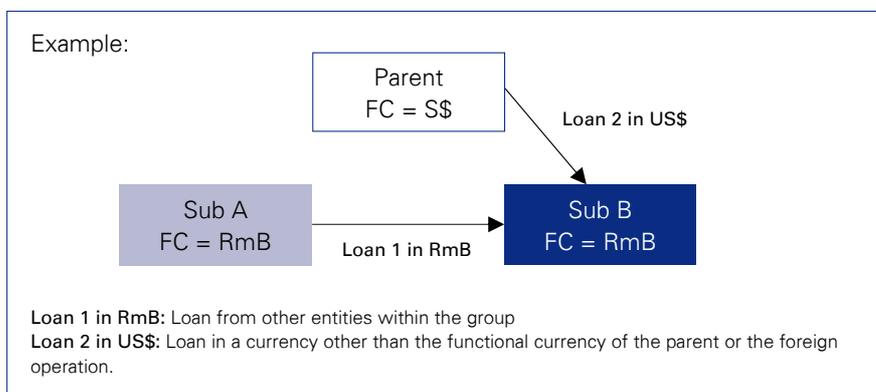
### Consensus (2)

In our view, consensus (2) clearly changes the existing FRS 21 and therefore it could only be applied to the 31 December 2005 financial statements of entities that early adopt the Amendment to FRS 21.

**Consider early adoption of the Amendment**

The effective date of the Amendment is for all annual periods beginning on or after 1 January 2006 and earlier application is encouraged. Companies are encouraged to early adopt the Amendment to FRS 21 because the current version of the standard which restricts the currency of the loan to that of the functional currency of either the parent or the foreign operation only came into operation from 1 January 2005. Prior to that, the practice was similar to consensus (2) where companies were able to take to equity exchange differences arising from the translation of a monetary item that is denominated in any currency, when the criteria for qualifying net investments were met.

Therefore, if an entity has quasi-equity inter-company loans that are denominated in a currency other than its own functional currency or those of the respective foreign operations, it would have to restate its comparative numbers in both its 2005 as well as 2006 financial statements, if it does not early adopt the Amendment. An example might illustrate this point more succinctly.



The tables below summarise the accounting treatment of the foreign exchange difference arising from Loan 1 and Loan 2 in the Parent’s consolidated financial statements:

Where the Parent entity applies the Amendment only from 1 January 2006:

	Loan 1	Loan 2
31 December 2004	Equity	Equity
31 December 2005	Equity	Profit and loss account, comparatives to be reclassified from currency translation reserve to retained earnings
31 December 2005	Equity	Equity, comparatives to be reclassified from retained earnings to currency translation reserves

Where the Parent entity early adopts the Amendment from 1 January 2005:

	Loan 1	Loan 2
31 December 2004	Equity	Equity
31 December 2005	Equity	Equity
31 December 2005	Equity	Equity

## B. Practical Issues in the Implementation of FRS 102 *Share-based Payment*

### Main requirements of FRS 102

FRS 102 *Share-based Payment*, effective for listed companies from 1 January 2005, requires entities to recognise, as expense, employee services received in exchange for the grant of employee share options or other equity instruments.

The debit is charged as an expense to the profit and loss account unless the goods/services qualify for recognition as assets.

The credit is:

- recorded as a liability if the employee is to receive cash (cash-settled share-based payment transactions); or
- recorded directly in equity if the employee is to receive the entity's equity instruments (equity-settled share-based payment transactions).

For equity-settled share-based payment transactions, the fair value of each instrument is measured at the date of grant and is not subsequently re-estimated.

For cash-settled share-based payment transactions, the transaction is measured at the fair value of the liability on initial recognition. After initial recognition, the fair value of the liability is re-measured at each balance sheet date until settlement. Changes as a result of the re-measurement of the fair value are recognised in the profit and loss account.

Several practical issues have arisen as a result of listed companies implementing FRS 102 for the first time.

### Issue 1 – Intra-group share-based payment transactions

**How should a transaction where a subsidiary grants share options over its parent's shares to its employees be accounted for?**

FRS 102 applies even though the entity grants share options over shares that are not part of its own share capital so long as they are equity instruments of the another entity in the same group. However, it does not give guidance on how such a transaction should be classified.

### *Consolidated financial statements*

From the perspective of the consolidated financial statements of the parent, the arrangement would be accounted for as an equity-settled share-based payment transaction.

### *Subsidiary's financial statements*

From the perspective of the financial statements of the subsidiary, D17 *FRS 102 – Group and Treasury Shares Transactions* proposes that such a transaction should be accounted for as a cash-settled share-based payment transaction because the instruments granted is a financial instrument (option over another entity's shares) and is not part of its equity.

Arguably, the transaction could also be considered an equity-settled share-based payment transaction because of the classification in the consolidated financial statements of the group.

Our view is that before D17 is issued as a final interpretation, the subsidiary could account for the transaction as a cash-settled or as an equity-settled transaction and it should make an accounting policy election with regard to such transactions.

## Issue 2 – Intra-group share-based payment transaction

**How should a transaction where a parent grants share options over its shares to the employees of a subsidiary be accounted for?**

### *Consolidated financial statements*

If a parent grants share options over its shares to the employees of a subsidiary, such an arrangement would be accounted for as an equity-settled share-based payment transaction in the parent's consolidated financial statements.

### *Subsidiary's financial statements*

As the subsidiary is the entity that receives the employee services, the subsidiary should recognise an expense relating to the employee services received in exchange for its parent's equity instrument. The question is where should the credit be? Under D17, such an arrangement should be accounted for as an equity-settled share-based payment transaction and hence the corresponding credit should be recognised in equity as a capital contribution from the parent. We support the treatment proposed in D17.

### *Parent's separate financial statements*

D17 proposes that the parent should, in its separate financial statements, account for the grant as an issue of an equity instrument and a capital contribution to the subsidiary. The effect is to increase its investment in the subsidiary.

An alternative view is that a capital contribution need not be imputed, and thus the parent would not recognise an increase in equity until such time as the shares are issued to the employees. The rationale for this alternative treatment is that the granting of a share-based payment transaction is a related party transaction, which, like other related party transactions can be undertaken at book value, fair value or the contract amount.

Prior to the issue of D17 as a final interpretation, a parent that has granted share options over its shares to the employees of its subsidiary should make an accounting policy election and apply it consistently.

## Issue 3 – Where entity plans to buyback its own shares rather than to issue new shares to meet its obligation relating to the share-based payment transaction

**Would it make a difference to the classification of the transaction if the company plans to buyback its own shares to meet the share-based payment obligation?**

No, the granting of share options to employees under such an arrangement should be classified as an *equity-settled share-based payment transaction* even though the entity plans to buyback its own shares rather than to issue new shares to meet its obligation to deliver shares. There is general consensus that such an arrangement should be accounted for as an equity-settled share-based payment transaction.

The main reason is because the entity is delivering shares, which are equity instruments, in exchange for services from its employees.

The above rationale applies whether the equity instruments are the entity's own shares or are shares of other entities within the group.

## C. Developments in international standards and interpretations

### **Publication of IFRIC Interpretation 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies**

Refer to *IFRS Briefing Sheet* Issue 40 for details

IFRIC 7 requires that in the year in which an entity identifies the existence of hyperinflation in the economy of its functional currency, the entity should restate for the effects of inflation as if it always had done this restatement. The interpretation applies for annual periods beginning on or after 1 March 2006.

In Singapore, following the publication of IFRIC 7, the CCDG issued INT FRS 107, the equivalent of IFRIC 7 on 25 January 2006. This interpretation is expected to have limited application in Singapore.

### **Publication of IFRIC Interpretation 8 Scope of IFRS 2**

Refer to *IFRS Briefing Sheet* Issue 42 for details

IFRIC 8 provides guidance on accounting for share-based payment transactions when the fair value of identifiable goods/services received by an entity is *less than* the fair value of the share-based payment.

For example, a company may issue shares to a charity as a contribution. Although no identifiable tangible goods and services may have been received, the company would probably have enhanced its corporate image in the process. The company may then expand its customer base or receive other future economic benefits as a result of its enhanced corporate image. The interpretation requires the company to recognise the unidentifiable consideration received on the grant date at the fair value of the shares issued.

### **Exposure Draft 8 *Operating Segments***

Refer to *IFRS Briefing Sheet* Issue 44 for details

ED 8 proposes segment disclosure based on the components of the entity that management monitors in making decisions about operating matters. Such components would be identified on the basis of internal reports that the entity's chief operating decision maker reviews regularly in allocating resources to segments and in assessing their performance.

This "management approach" differs from IAS 14 *Segment Reporting*, which requires the disclosure of two sets of segments, business and geographical segments, based on a disaggregation of information contained in the financial statements.

Following the publication of ED 8, the CCDG issued an identical exposure draft in Singapore on 25 January 2006, for comments by 19 April 2006.

### **IFRIC Draft Interpretation D18 *Interim Financial Reporting and Impairment***

Refer to *IFRS Briefing Sheet* Issue 43 for details

This draft interpretation proposes that an impairment loss recognised in an interim period with respect to goodwill, an investment in an equity instrument or a financial asset carried at cost *should not be reversed* subsequently.

Following the publication of D18, the CCDG issued an identical exposure draft in Singapore on 25 January 2006, for comments by 28 February 2006.

### IASB publishes discussion paper on *Management Commentary*

Refer to *IFRS Briefing Sheet* Issue 38 for details

The paper proposes that the IASB develop a principle-based standard on the presentation of a Management Commentary. In the short-term, the paper proposes that the local regulator decides whether such a standard should be voluntary or mandatory, but ultimately, compliance with the standard should be a prerequisite for compliance with IFRSs.

In Singapore, the CCDG issued an identical discussion paper in November 2005, for comments by 28 March 2006.

### IASB issues Canadian Discussion Paper on *Measurement Bases for Financial Accounting*

Refer to *IFRS Briefing Sheet* Issue 39 for details

The paper analyses a number of possible bases of measurement for assets and liabilities on initial recognition. The IASB expects the analysis of the discussion paper and reader's reactions to it to be valuable to the Board in its project on the conceptual framework, as well as in future projects that address the measurement requirements of financial reporting.

In Singapore, the CCDG issued an identical discussion paper in December 2005, for comments by 19 April 2006.

### IASB November 2005 meeting

Refer to *IFRS in Brief* Issue 19 for details

### IASB November 2005 meeting

Refer to *IFRS in Brief* Issue 20 for details

In its November and December 2005 meetings, the IASB:

- discussed the possible simplification of recognition and measurement principles contained in IFRSs as they relate to small-and medium-sized entities (SMEs);
- decided to propose changes to the treasury share method of computing earnings per share; and
- had an initial discussion of comments received on its exposure draft of proposed changes to IFRS 3 Business Combinations.

The KPMG International publications covered in this issue of Financial Reporting Matters are:

- IFRS in Brief: Issues 19 & 20
- IFRS Briefing Sheet: Issues 38 to 44

This section provides a highlight, particularly the relevance of international developments in the local context, of our International publication – IFRS in Brief and IFRS Briefing Sheet. You can access the electronic version as follows:

IFRS in Brief:

[http://www.kpmg.com.sg/newsletters/ifrs\\_in\\_brief.html](http://www.kpmg.com.sg/newsletters/ifrs_in_brief.html)

IFRS Briefing Sheet:

[http://www.kpmg.com.sg/newsletters/ifrs\\_briefing\\_sht.html](http://www.kpmg.com.sg/newsletters/ifrs_briefing_sht.html)

## List of Financial Reporting Standards and Interpretations issued but not yet effective (Updated up to 1 February 2006)

No.	Title	Date of issue	Effective for annual periods beginning on or after
FRS 102	<i>Share-based Payment</i>	6 September 2004	1 January 2006 (non-listed companies)
FRS 40	<i>Investment Property</i>	4 February 2005	1 January 2007
Amendments to FRS 19	Amendments to FRS 19 Employee Benefits – <i>Actuarial gains and losses, Group plans and Disclosures</i>	1 June 2005	1 January 2006
INT FRS 104	<i>Determining whether an Arrangement contains a Lease</i>	1 June 2005	1 January 2006
INT FRS 105	<i>Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds</i>	1 June 2005	1 January 2006
Amendments to FRS 39	Amendments to FRS 39 <i>Financial Instruments: Recognition and Measurement – Cash Flow Hedge Accounting of Forecast Group Transactions</i>	18 August 2005	1 January 2006
INT FRS 106	<i>Exploration and Evaluation of Mineral Resources</i>	18 August 2005	1 January 2006
INT FRS 106	<i>Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment</i>	6 January 2006	1 December 2005
Amendments to FRS 39	Amendments to FRS 39 <i>Financial Instruments: Recognition and Measurement – The Fair Value Option</i>	6 January 2006	1 January 2006
Amendments to FRS 39	Amendments to FRS 39 <i>Financial Instruments: Recognition and Measurement – Financial Guarantee Contracts and Credit Insurance</i>	6 January 2006	1 January 2006
FRS 107	<i>Financial Instruments: Disclosures</i>	6 January 2006	1 January 2007 (listed companies)
	Amendments to FRS 1 <i>Presentation of Financial Statements – Capital disclosures</i>		1 January 2008 (non-listed companies)
Amendments to FRS 21	Amendments to FRS 21 <i>The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation</i>	25 January 2006	1 January 2006
INT FRS 107	<i>Applying the Restatement Approach under FRS 29 Financial Reporting in Hyperinflationary Economies</i>	25 January 2006	1 March 2006

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