KPMG

Financial Reporting Matters

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AUDIT

A new financial reporting standard, FRS 107 *Financial Instruments: Disclosures,* was issued in January 2006. When fully implemented, all entities, regardless of size or industry, will have to disclose more information relating to their financial instruments.

CCDG issued FRS 107 *Financial Instruments: Disclosures* on 26 January 2006. FRS 107 supersedes the disclosure requirements in FRS 32 *Financial Instruments: Disclosure and Presentation*. The presentation requirements in FRS 32, including the requirement for split accounting, will remain unchanged.

FRS 107 is the same as IFRS 7 *Financial Instruments: Disclosures,* issued by the IASB, except for a difference in the effective date. IFRS 7 is effective for all entities applying IFRSs for annual periods beginning on or after 1 January 2007 whereas for FRS 107, this same effective date is applicable only to companies listed on the Singapore Exchange Securities Trading Limited. All other entities applying FRSs would only need to implement the standard for annual periods beginning on or after 1 January 2008.

FRS 107 is applicable to all entities, regardless of the size or industry. Early application of FRS 107 is encouraged and entities that do so are exempted from disclosing comparative information in respect of the nature and extent of risks arising from financial instruments.

For listed companies, there is approximately a one-year lead time between the issue of the standard and its mandatory application. However, we are now well into Q2 of 2006 and it is timely to start preparing now because comparative information on risk disclosures are required if the entity does not early adopt.

For private companies, which will need to apply the standard only from 2008, the preparatory work should commence now because some of the disclosures required by FRS 107, such as market risk sensitivity analysis may not be readily available outside of the financial services industry. Small and medium sized entities may have to find a way to collate the information required for disclosure. This challenge is also applicable to subsidiaries whose risks are often managed centrally by their parent entities.

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A. FRS 107 – Highlights of new disclosure requirements

Objectives of FRS 107

The objective of FRS 107 is to require entities to provide disclosures that enable users to evaluate the significance of financial instruments for the entity's financial position and performance and the nature and extent of risks arising from financial instruments to which the entity is exposed and how the entity manages them.

In general, the standard setter's aim is to simplify the disclosure requirements in the current standard in respect of concentrations of risk, credit risk, liquidity risk and market risk. However, this simplification has introduced some new disclosures – in particular, sensitivity analyses for market risk to which the entity is exposed at the balance sheet date.

Nature and extent of risk

For the purposes of meeting the objective of enabling users to evaluate the nature and extent of risks arising from financial instruments, an entity is required to disclose both qualitative and quantitative information.

Qualitative disclosures

FRS 107 expands on the qualitative disclosure requirements in FRS 32 to include the disclosure of the process that management uses to manage and measure risks exposures.

Quantitative disclosures

The level of detail of quantitative disclosures should be based on the information provided internally to key management of the entity (e.g., board of directors, CEO). At a minimum, quantitative disclosures are required with respect to credit risk, liquidity risk and market risk.

New **credit risk** disclosures include:

- the reporting entity's maximum exposure without taking into account collateral or enhancements and a description of the collateral held as security and credit enhancements;
- the credit quality of financial assets that are neither past due nor impaired; the carrying amount of financial assets with renegotiated terms that would otherwise be past due.

An important new disclosure relating to **liquidity risk** is the contractual maturity analysis for financial liabilities. The guidance in FRS 107 states that the amounts disclosed in the maturity analysis should be based on the contractual undiscounted cash flows, for example:

- gross finance lease obligations before deducting finance charges;
- prices specified in forward agreements to purchase financial assets for cash; or
- net amounts for pay-floating/receive-fixed interest rate swaps for which net cash flows are exchanged.

FRS 107 requires a sensitivity analysis for each type of **market risk** that the entity is exposed at the reporting date. The sensitivity analysis should show the effect on the profit or loss and equity of a reasonably possible changes in the relevant risk variable (e.g., prevailing market interest rates, currency rates or commodity prices). The methods and assumptions used to prepare such analysis should also be disclosed.

Significance of financial instruments

Balance sheet

New disclosures required in the balance sheet include the following:

- The carrying amount of each category of financial assets and financial liabilities, either on the face of the balance sheet or in the notes.
- With reference to loans and receivables that are designated as fair value through profit or loss:
  - the maximum exposure to credit risk at the reporting date;
  - the impact of credit derivatives on the credit exposure; and
  - the change in the fair value of the loans and receivables and any related credit derivatives due to changes in credit risk, both during the period and cumulatively since designation.
- With reference financial assets that are pledged as collateral for liabilities or contingent liabilities, the carrying amount of each asset pledged as well as the terms and conditions relating to the pledge.
- When an allowance account is used to reduce the carrying amount of financial assets impaired by credit losses, a reconciliation of the allowance for each class of financial assets.
- When a loan payable is in default at the reporting date, the carrying amount and details of the loan payable in default.

Profit and loss account

New disclosures relating to items of income, expense, gains or losses:

- Net gains or losses for each category of financial asset or financial liability;
- Impairment loss for each class of financial asset;
- Fee income and expense (other than amounts included in the determination of the effective interest rate) arising from:
  - financial assets or financial liabilities that are not at fair value through profit or loss; and
  - trust and other fiduciary activities.

Hedge accounting

FRS 107 has also expanded on the disclosure requirements relating to hedges as summarised in the following table:

Disclosure	Cash flow hedge	Fair value hedge	Net investment hedge
Description of hedged risk, hedging instrument and the related fair value	✔	✔	✔
Periods when hedged cash flows are expected to occur	✔		
Description of forecast transaction that is no longer expected to occur	✔		
Gain or loss recognised in equity and reclassified to either the profit and loss account or the carrying amount of a non-financial asset or liability	✔		
Gain or loss on hedging instrument and hedged item		✔	
Ineffectiveness recognised in the profit and loss account		✔	✔

B. Developments in international standards and interpretations

Publication of IFRIC Interpretation 9 *Reassessment of Embedded Derivatives*

Refer to IFRS Briefing Sheet 46 for details

IFRIC 9 states that the reassessment of whether an embedded derivative should be separated from the underlying host contract, should be made only when there are changes to the contract. The interpretation is effective for annual periods beginning on or after 1 June 2006 with early application encouraged.

Exposure Draft: Proposed Amendments to *IFRS 2 Share-based Payment – Vesting Conditions and Cancellations*

Refer to IFRS Briefing Sheet 47 for details

The exposure draft proposes that:

- vesting conditions be limited to service and performance conditions
- cancellations by parties other than the entity be accounted for in the same way as cancellations by the entity.

Following the publication of this exposure draft, the CCDG issued an identical exposure draft in Singapore on 7 February 2006, for comments by 2 May 2006.

IASB January 2006 Meeting

Refer to IFRS in Brief 21 for details

IASB February 2006 Meeting

Refer to IFRS in Brief 22 for details

In its January and February 2006 meetings, the IASB:

- decided that a proposed amendment to IAS 23 *Borrowing Costs* requiring the capitalisation of qualifying borrowing costs would allow prospective, retrospective or partial retrospective application for both first-time adopters and existing users of IFRS;
- decided to propose extending application of the treasury stock method of calculating diluted earnings per share to all convertible instruments; and
- decided to amend IAS 1 *Presentation of Financial Statements* to include disclosure requirements for financial instruments puttable at fair value.

The KPMG International publications covered in this issue are:

- IFRS in Brief: issues 21 & 22
- IFRS Briefing Sheet: issues 45 & 46

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

IFRS Briefing Sheet:
http://www.kpmg.com.sg/newsletters/ifrs_briefing_sht.html

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