

Reminders for the 2006 annual financial statements and quarterly financial reporting for the first quarter 2007

Many companies are now in the midst of finalising their 2006 annual report and preparing for the announcement of their financial results for the first quarter of 2007. It is thus timely to discuss the findings from two recent financial statements reviews conducted internationally and in the UK. Also considered are changes in financial reporting matters that may have an impact on the financial results for the first quarter of 2007.

Financial statements prepared under IFRS are often said to be too long and too complicated. Furthermore, some companies tend to use “boiler plate” descriptions. This is regardless of whether the matters described actually apply to them. This, is one of the findings in two separate reviews of financial statements prepared under the International Financial Reporting Standards (IFRS).

In this issue, let us discuss a few findings from these reviews that are more relevant to our local context. These include suggested recommendations from these reviews for purposes of financial statements disclosure and presentation.

We also discuss the accounting implication of changes in financial reporting matters that might be relevant as companies start preparing for their 2007 financial statements. These include:

- a reduction in the Singapore corporate income tax rate from 20 to 18 %;
- implementation of the revised Code of Corporate Governance 2005;
- revision to the criteria for quarterly reporting of financial results; and
- the changes in financial reporting standards, such as FRS 40 *Investment Property* and FRS 107 *Financial Statements: Disclosures*.

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Exposure Draft of an IFRS for Small and Medium-sized Entities (SMEs IFRS)

On 15 February 2007, the International Accounting Standards Board (IASB) published an exposure draft (ED) of an IFRS for SMEs. The IASB has invited comments on the ED by 1 October 2007.

The Council on Corporate Disclosure and Governance (CCDG) has also issued an equivalent ED in Singapore on 7 March 2007. A brief summary of the exposure draft is provided in this publication. We will discuss more details of the ED in our next issue of this publication.

A. Financial statements disclosures and presentation

KPMG International undertook a cross-border review of the application of the IFRS by first-time adopters in late 2005, covering companies in various countries.

The UK Financial Reporting Review Panel also published a preliminary report in December 2006 on the results of its first review of annual reports by UK listed companies prepared in accordance with the IFRS.

Attached below, are some of the findings and key messages from the surveys. These would be relevant to companies in Singapore preparing their financial statements under Singapore Financial Reporting Standards (SFRS), which is similar to the IFRS.

	Observation	Recommendation
General	The IFRS accounts are often said to be too long and complicated. Companies have a tendency to use "boiler plate" descriptions for accounting policies, whether or not the matters described actually apply to the company concerned.	Companies should adopt a more thoughtful and focused approach relevant to the circumstances of the company. This would reduce the length and complexity of the accounts.
Income statement	When the analysis of expenses in the income statement is presented based on their function, companies included additional line items such as impairment charges and the amortisation of intangibles acquired as a result of a business combination.	An analysis of expenses should be presented using a classification based on either the nature of expenses, or their function. It should not be a hybrid containing analysis of expenses by nature and by function.
	Income and expenses are inappropriately presented on a net basis in the income statement. Examples include: other income/expense (net) and interest income/expense (net)	Income and expense should only be presented net when the criteria for offset within the relevant IFRS are met. Companies should take note that gross finance costs is a mandatory disclosure item on the face of the income statement.
Statement of changes in equity	Sub-totals for items of income and expense recognised directly in equity or for total income and expense for the period were not disclosed.	Companies are reminded to provide the sub-total for items of income and expense recognised directly in equity, and for total income and expense recognised in equity. This is to distinguish clearly the income and expense recognised directly in equity and amounts of transactions with equity holders.

	Observation	Recommendation
Cash flow statements	Cash flows from investing and financing activities are sometimes presented on a net basis. Examples include: acquisitions and disposals of equity and debt instruments.	Cash flows from investing and financing activities should be presented on a gross basis. Reporting cash flows on a net basis is acceptable only in limited circumstances, such as when turnover is quick, the amounts are large and the maturity periods are short.
Accounting policies and estimates	<p>Terminology used in the financial statements are not consistent with IFRSs. Imprecise descriptions leave it unclear whether the standards have been correctly applied.</p> <p>Examples:</p> <ul style="list-style-type: none"> • Initial measurement of financial instruments at cost • Description of measurement of impairment of receivables as “when it is determined that they are not collectible” or “allowance for irrecoverable amount”. • Impairment loss reversed if there is an indication that an impairment loss may have decreased. 	<p>Terminology used in the financial statements should be consistent with IFRSs.</p> <ul style="list-style-type: none"> • FRS requires initial measurement financial instruments to be measured at fair value plus directly attributable transaction costs. • FRS 39 sets out detailed rules on assessing impairment of financial assets • Impairment loss reversed if there has been a change in the estimates used to determine the recoverable amount.
	<p>In several cases, accounting policies that are not consistent with the IFRSs are disclosed, on the grounds that the impact of non-compliance is immaterial.</p> <p>Examples:</p> <ul style="list-style-type: none"> • Incomplete consolidation of subsidiaries, ie. only “<i>significant subsidiaries</i>” are consolidated) • Items of property, plant and equipment below a certain amount are expensed 	<p>If the impact of divergence from the IFRSs is not material, then it is preferable to omit such disclosure or revise the policy description to be consistent with the IFRSs.</p> <ul style="list-style-type: none"> • Where insignificant subsidiaries are excluded from consolidation, accounting policy should state that subsidiaries are consolidated, without qualifying the statement to include only significant subsidiaries • Where the effect of expensing such items is immaterial, this need not be included.

	Observation	Recommendation
Accounting policies and estimates	The IFRS requires disclosure of key sources of estimation uncertainty. The survey noted that in some cases, companies only made superficial comments which were bland and uninformative. They also had little or no information relevant to the particular circumstances.	Companies are encouraged to provide more specific and informative disclosure regarding the key sources of estimation uncertainty.
	The IFRS requires disclosure of the likely impact of new standards and interpretations that have been issued but which are not yet effective. Not all companies complied with this requirement.	Companies should consider the possible impact on their financial statements of published standards and Interpretations not yet effective at their reporting date and give appropriate disclosure.
Goodwill and impairment testing	The IFRS requires the disclosure and explanation of factors giving rise to goodwill arising from business acquisitions. In various cases, it was observed that disclosure is in the form of bland statements giving little specific information.	Companies are reminded to give an explanation of factors giving rise to goodwill arising from business acquisitions.
	In some cases, disclosures relating to estimates used for measuring recoverable amounts of cash-generating units containing goodwill or intangible assets with indefinite useful lives were omitted.	Companies are advised to review the sufficiency of their disclosure to support their impairment testing of goodwill and intangible assets with indefinite useful life.
Related party disclosures	There were questions raised as to the completeness of related party disclosures in respect of key management personnel who are not directors. This is particularly where these individuals are named elsewhere in the annual report.	Where narrative reports refer to key management personnel by name, companies should consider whether their remuneration and other details should be included within the disclosure of related party transactions.

B. Financial reporting matters to take note for first quarter of 2007

Many companies are in the process of finalising their annual report of 2006 and starting the preparation for announcement of financial results for the first quarter of 2007. We set out below several significant changes in financial reporting matters to take note of.

Reduction in Singapore corporate income tax rate from 20% to 18%

Effective: Year of Assessment 2008

The Singapore Budget Speech for financial year 2007 delivered on 15 February 2007 included a cut to corporate tax of two percentage points.

For purposes of computing current and deferred taxes, financial statements relating to financial periods that ended prior to 15 February 2007 should not be adjusted to reflect the reduction in corporate tax rates. This is because the reduction in tax rate was enacted after the balance sheet date and is a non adjusting subsequent event.

Where the effect of the reduction in tax rate is significant, an entity should disclose the nature of, and an estimate of its financial effect as a "subsequent event".

Companies that continue to remain on the imputation system should frank dividends paid during the period from 1 January 2007 to 31 December 2007 at 18%. Note that for financial statements which have not been authorised for issue by 15 February 2007 and:

- where proposed dividends are only disclosed in the financial statements, the reduced tax rate of 18% should be used.
- where dividends are declared and recognised as a liability by the balance sheet date, the tax rate applicable to dividends payable to be used should still be 20%.

For purposes of interim financial statements, the effect of the reduction in tax rate from 20% to 18% on the opening balances of deferred tax should be accounted for in the first quarter or half year ended on 31 March 2007.

Code of Corporate Governance 2005

Effective: Annual General Meetings held on or after 1 January 2007

For Corporate Governance Statements to be included in annual reports for annual general meetings held on or after 1 January 2007, companies should use the revised Code of Corporate Governance (2005).

The main changes are:

- the role of the audit committee has been expanded to include arrangements for staff of the company to raise concerns, in confidence, about possible improprieties in financial reporting or other matters; and
- the Remuneration Committee (RC) should comprise entirely non-executive directors. The majority of whom, including the chairman of the RC, should be independent.

Quarterly reporting requirements

Listed companies with market capitalisation of less than \$75 million are exempted from quarterly reporting. Previously, the exemption was based on listed companies' market capitalisation calculated on 31 March 2003 (or based on their IPO price if they were listed after that date).

Companies that were previously exempted from quarterly reporting will need to review their market capitalisation at the end of each calendar year, starting from 31 December 2006. If their market capitalisation at 31 December 2006 exceeds \$75 million, companies that were previously exempted will have a one year grace period to prepare for quarterly reporting. They will have to commence quarterly reporting from 1 January 2008 onwards.

Although there is a one year grace period, companies will need to start their preparation in the first quarter of 2007. This is to collate the relevant comparative information required when they commence quarterly reporting in 2008.

FRS 40 Investment Property

Effective: Annual periods beginning from 1 January 2007

Companies have to adopt the new accounting standard for investment property in 2007. Appropriate adjustments, if any, would have to be made in the first quarter's reporting of financial results. When a company first adopts FRS 40, the company has a choice between using the cost model or the fair value model. This is irrespective of whether the current accounting policy is at cost or at valuation.

The following table summarises the transition rules and the adjustments on transition:

Current policy	Policy under FRS 40	Adjustments on first adoption of FRS 40
At valuation	Fair value model	Transfer any revaluation reserve existing at the date of first adoption to the opening retained earnings. It is not mandatory, but comparatives may be restated if the company has previously disclosed publicly the fair value information.
At valuation	Cost model	Account for the change in accounting policy retrospectively in accordance with FRS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> . Any revaluation reserve existing at the date of first adoption is reversed to restate the property at historical cost. The accumulated depreciation is recorded retrospectively by adjusting the opening retained earnings.
At cost	Fair value model	Ascertain the fair value of the property at the date of transition, eg. 1 January 2007, and adjust the carrying amount of the property at that date to its fair value. The difference between the fair value and the carrying amount under the cost model is adjusted against the opening retained earnings. Comparatives are not allowed to be restated if the fair value of the investment properties had not been previously disclosed.
At cost	Cost model	No adjustment required.

FRS 107 *Financial Instruments: Disclosures and Amendments to FRS 1 Presentation of Financial Statements – Capital Disclosures*

Effective: Annual periods beginning from 1 January 2007 (listed companies) and 1 January 2008 (all other companies)

FRS 107 supersedes the disclosure requirements in FRS 32 *Financial Instruments: Disclosure and Presentation*. FRS 107 is applicable to all entities, regardless of the size or industry.

It is timely to start preparing for the implementation of FRS 107 now because comparative information on risk disclosure is required if the entity is not an early adopter of FRS 107. FRS 107 has introduced some new disclosures – in particular, sensitivity analysis for market risk to which an entity is exposed at the balance sheet date.

KPMG International has published a supplement to the *Illustrative Financial Statements* to assist companies in assessing the impact of IFRS 7 (which is similar to FRS 107). We will also be publishing an updated set of *Illustrative Financial Statements* to provide more detailed guidance on the disclosures required by FRS 107, as well as other changes for financial year 2007.

INT FRS 108 *Scope of FRS 102*

Effective: Annual periods beginning from 1 May 2006

INT FRS 108 provides guidance on accounting for share-based payment transactions when the fair value of identifiable goods or services by an entity is less than the fair value of the share-based payment.

It is common for a parent entity to grant options over its equity instruments to the employees of its subsidiaries. Under INT FRS 108, as the identifiable consideration received by the parent entity for the option in this situation (nil), would be less than the fair value of the equity instruments granted, the parent entity would then have to account for this transaction by recognising an increase in equity and a corresponding increase to the parent entity's investment in the subsidiary.

INT FRS 110 *Interim Financial Reporting and Impairment*

Effective: Annual periods beginning from 1 November 2006

INT FRS 110 states that an entity should not reverse an impairment loss recognised in a previous interim period. These include goodwill, an investment in an equity instrument, or a financial asset carried at cost.

With the adoption of INT FRS 110, companies are not allowed to subsequently reverse impairment losses recognised in a previous interim period. This is even if the subsequent interim period is within the same financial year as the interim period in which the impairment loss is first recognised. Companies that are required to announce interim results should support their impairment review carefully. Once the impairment loss is recognised, it cannot be reversed even if estimates change in subsequent interim period within the same financial year.

C. KPMG publications

Amidst the backdrop of numerous changes in financial report standards and their increasing complexity, many requests were received asking about the publications that KPMG has to assist you in implementing the changes. We take this opportunity to set out a list of the more recent and relevant publications available.

Publications by KPMG in Singapore

Singapore Illustrative Financial Statements 2006



This publication illustrates best-practice financial statements disclosures, updated to comply with the latest requirements of the Singapore Companies Act, SFRS, and the Singapore Exchange Limited Listing Manual. This is applicable to companies with a financial year ending on 31 December 2006.

The more significant accounting changes and developments that become effective for the first time in 2006 include INT FRS 104 *Determining Whether an Arrangement Contains a Lease* and various amendments to FRS 39 on accounting for financial instruments. The Companies (Amendment) Act 2005 also introduces changes to rules relating to share capital and share transactions.

Singapore Accounting Disclosure Trends



This publication is based on the financial statements of companies listed on the Singapore Exchange Securities Trading Limited for the financial periods between 31 March 2005 and 30 June 2006. This publication illustrates disclosures made by Singapore companies in their financial statements. These disclosures are useful in assessing the type of information being disclosed in practice, and the format and methods of disclosure.

Publications by KPMG International

Insights into IFRS 3rd Edition 2006/7

Insights into IFRS focuses on the application of standards in practice and explains the conclusions we have reached on many interpretative issues. It is based on actual questions that have arisen in practice around the world and includes illustrative examples to elaborate or clarify the application of the standards.

The 3rd edition 2006/7 of *Insights into IFRS* is based on the IFRSs that are applicable for an annual period beginning on or after 1 January 2006.

The Application of IFRS: Disclosures in Practice

This publication is based on a review of the consolidated financial statements of 199 companies from 16 countries for an annual period ending on or after 30 June 2005; most companies had a balance sheet date of 31 December 2005. The publication illustrates disclosures made by these companies in their consolidated financial statements that we believe may be useful in assessing the type of information being disclosed in practice, as well as the formats and methods of disclosure. Each section is accompanied by an overview of the disclosures that relate to that topic.

**The Application of IFRS:
Choices in Practice**

This survey considers how almost 200 companies dealt with 26 explicit options offered by the IFRSs. It is a companion to our publication *The Application of IFRS: Disclosures in Practice*.

**Illustrative Financial Statements
(August 2006)**

The purpose of this publication is to assist you in preparing financial statements in accordance with the IFRS. It illustrates one possible format for financial statements, based on a fictitious multinational corporation involved in general business. This publication reflects the IFRS in issue at 1 August 2006 that are required to be applied by an entity with an annual period beginning on 1 January 2006.

**IFRS 7 for corporates
(December 2006)**

This publication is intended as a supplement to the August 2006 edition of our publication *Illustrative Financial Statements*. Those illustrative financial statements are based on an annual reporting date of 31 December 2006 and do not illustrate the requirements of IFRS 7 *Financial Instruments: Disclosures*.

The purpose of this publication is to assist you in assessing the impact of IFRS 7 on financial statements for annual periods beginning on or after 1 January 2007, the effective date of the standard.

This publication is aimed at entities other than banks, insurance companies and financial institutions. In addition, it illustrates the amendments to IAS 1 *Presentation of Financial Statements* in respect of capital disclosures that were introduced at the same time as IFRS 7 with the same effective date.

**IFRS Disclosure Checklist
(August 2006)**

The purpose of this Disclosure Checklist is to assist you in preparing financial statements in accordance with IFRS by identifying the disclosures required. The Disclosure Checklist reflects the IFRS in issue at 1 August 2006 that are required to be applied by an entity with an annual period beginning on, or after 1 January 2006.

**First Impressions: IFRIC 12 *Service
Concession Arrangements*
(January 2007)**

This publication considers the requirements of IFRIC 12 *Service Concession Arrangements*, which was published by the IASB on 30 November 2006.

It includes a discussion of the key elements of the new requirements and highlights areas that may result in a change of practice. Examples are provided to assist an assessment of the impact of implementation.

IFRS: An overview (August 2006)

IFRS: An overview is an executive summary of the key requirements of the IFRSs. This edition is based on the IFRSs in issue at 1 August 2006 that are applicable for financial periods beginning on or after 1 January 2006.

For ease of reference, the overview is organised by topic, following the typical presentation of items in financial statements.

Financial Instruments Accounting (February 2006)

This publication provides a comprehensive overview of the existing IAS 32 and IAS 39. It addresses accounting for financial instruments with an emphasis on practical application issues. It takes into account examples based on practical experience from working with KPMG member firms' clients.

Commentary is also provided on new requirements that apply only to periods beginning on or after 1 January 2007, but which may be adopted earlier; in particular, the IFRS 7 *Financial Instruments: Disclosures* is discussed as a forthcoming requirement.

We have a range of publications that can assist you further. To find out more about our publications or to purchase copies of the above publications, please contact Ms Wong Woon Ling at 6213-2669 or email woonlingwong@kpmg.com.sg.

D. Developments in international standards and interpretations

IFRS 8 *Operating Segments*

Refer to *IFRS Briefing Sheet – Issue 58* for details.

The Council on Corporate Disclosure and Governance (CCDG) adopted this international standard as FRS 108 in Singapore on 22 February 2007. FRS 108 will replace FRS 14 *Segment Reporting*, when FRS 108 becomes effective for annual periods beginning on or after 1 January 2009. FRS 108 would require the restatement of comparatives.

FRS 108 requires 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 regularly reviews when allocating resources to segments and in assessing their performance. This "management approach" differs from IAS 14, which currently requires the disclosure of two sets of segments, based on a disaggregation of information contained in the financial statements.

IFRIC 12 *Service Concession Arrangements*

Refer to *IFRS Briefing Sheet – Issue 59* for details.

The CCDG adopted this international interpretation as INT FRS 112 on 22 February 2007. INT FRS 112 becomes effective for annual periods beginning on or after 1 January 2008.

The scope of INT FRS 112 is public-to-private service concession arrangements in which the public sector controls or regulates the services provided with the infrastructure and their prices. The public sector also controls any significant residual interest in the infrastructure.

Exposure Draft of an *IFRS for Small and Medium-sized Entities*

Refer to *IFRS Briefing Sheet – Issue 62* for details.

The CCDG published the equivalent exposure draft (ED) in Singapore on 7 March 2007, for comments by 1 September 2007.

The SMEs IFRS is intended to facilitate financial reporting and provide accounting standards suitable for SMEs that want to use international standards.

The IASB planned to provide a simplified and slimmed-down version of the full IFRS for SMEs. This has resulted in the following approach in the proposals:

- Transactions that the IASB considers less relevant to SMEs are omitted from the ED or are cross-referenced to full IFRS in the event that such transactions occur (eg. equity-settled share-based payments).
- Simplifications have been made to the recognition and measurement requirements of full IFRS in some areas (eg. there are only two categories of financial assets).
- In some areas where the full IFRS include more than one accounting option, the proposals include the simpler option and cross-reference to full IFRS for details on applying the more complex option (eg. SMEs accounting for investment property using the fair value model would refer to IAS 40 *Investment Property*).

There would be no quantitative thresholds in order to qualify as a SME. It is envisaged that national regulators would decide which entities would be permitted/required to comply with the SMEs IFRSs in their jurisdictions.

Exposure Draft of Proposed Amendments to IAS 24 Related Party Disclosures – State-controlled Entities and the Definition of a Related Party

Refer to *IFRS Briefing Sheet – Issue 64* for details.

The CCDG published the equivalent ED in Singapore on 7 March 2007, for comments by 25 April 2007.

One significant proposed amendment is to include an exemption from disclosures on related party transactions for entities that are state-controlled or under significant influence by a state.

In order to qualify for the exemption, there must be no indicators that the reporting entity influenced, or was influenced by the other entity (who was also state-controlled or under significant influence by a state). The reporting entity is also required to confirm that there were no transactions with other state-owned entities that were impacted by their related party relationship. This is disclosed as a statement to that effect in the financial statements.

The proposed amendment does not set out guidance on how to determine when state control is pervasive in an economy, or how to determine whether entities are controlled by the same state. The proposed amendment is likely to have significant impact for Singapore, as Singapore was specified as a country that has large state-controlled entities in one of the IASB's agenda papers.

Meetings of the International Accounting Standards Board – November and December 2006, and January and February 2007

Refer to *IFRS in Brief – Issues 30 to 33* for details.

The topics that were discussed in recent IASB meetings include:

- proposed amendments to IFRS 3 *Business Combinations*
- financial statement presentation project
- conceptual Framework project, including distinction between liabilities and equity as well as the parent/group entity views and its implication on the preparation of consolidated financial statements
- comment letters in response to the ED *Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation*
- proposed amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- treatment under IAS 12 *Income Taxes* of an investment allowance in excess of the purchase price of an asset
- proposed amendment to IAS 39 *Financial Instruments: Recognition and Measurement*, to specify the risks that qualify for designation as a hedged risk.

The KPMG International publications covered in this issue are:

- IFRS in Brief: Issues 30 to 33
- IFRS Briefing Sheet: Issues 58 to 64

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*. Electronic versions are available at kpmg.com.sg

Should you wish to discuss any matter highlighted in this publication, please contact:



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