KPMG

Financial Reporting Matters

March 2009 **Issue 26**

AUDIT

In this issue, we discuss some of the accounting issues to consider as entities prepare for their 31 March 2009 quarterly or year-end financial reporting. We also discuss the accounting for the reduction in corporate income tax rate and the Jobs Credit Scheme introduced in the recent Budget, INT FRS 117 on distributions of non-cash assets to owners, IFRIC 18 on transfers of assets from customers and ED 10 on consolidated financial statements.

Contents

The extraordinary measures introduced in the recent Budget announced on 22 January 2009 will go a long way in helping Singapore entities weather the current difficult economic conditions. The key measures include a reduction in the corporate income tax rate from 18% to 17% from the year of assessment 2010 and a cash grant in the form of a Jobs Credit Scheme to provide immediate support to employers.

In this issue, we take the opportunity to discuss the accounting for the reduction in the corporate income tax rate and the Jobs Credit Scheme.

The adoption of FRS 1 (revised 2008) *Presentation of Financial Statements* and FRS 108 *Operating Segments* could also have an impact on Q1 2009 reporting. For many entities, the reporting of "operating segments" would not cause many difficulties. For others, it could signify a need to re-allocate goodwill and re-perform impairment testing.

In January 2009, the ASC issued INT FRS 117 *Distributions of Non-Cash Assets to Owners* which provides accounting guidance on what is commonly termed as distributions in the form of "dividends in specie".

We also highlight some of the requirements under IFRIC 18 *Transfers of Assets from Customers* which was recently issued by the IASB. IFRIC 18 has not been issued in Singapore.

ED 10 *Consolidated Financial Statements* was issued for comments by the IASB in December 2008. As part of its response to the current credit crisis and the recommendations of the Financial Stability Forum, the IASB has proceeded directly to the publication of this ED. As the proposed changes to the definition of "control" could have a significant impact on Singapore entities, we address some of the implications in this issue. ED 10 is expected to be issued as a final standard in the second half of 2009.

You can access KPMG's past issues of Financial Reporting Matters at:
http://www.kpmg.com.sg/newsletters/fr_matters.html

A. Key financial reporting issues for 31 March 2009

i. Reduction in corporate income tax rate

What is the reduction in income tax rate and when will it be effective?

In the Budget for financial year 2009 announced on 22 January 2009, the corporate income tax rate was reduced from 18% to 17%. This will be effective from the Year of Assessment (YA) 2010.

Can unutilised trade losses and capital allowances be carried back?

Any unutilised trade losses and capital allowances for YA 2009 and YA 2010 can also be carried back to set off against assessable income of the three immediately preceding YAs up to a limit of $200,000.

Should a tax rate of 18% or 17% be used?

Impact on financial statements for annual periods ended 31 December 2008 and for annual periods ended prior to 22 January 2009

Financial statements relating to financial periods that ended on 31 December 2008 and prior to 22 January 2009 should use 18% for the purposes of computation of current and deferred taxes, as the reduction in corporate tax rates was enacted after the balance sheet date.

Where the effect of the reduction in tax rate is significant, an entity should disclose the nature and an estimate of the financial effect on current and/or deferred tax had 17% been used (paragraph 21 of FRS 10 *Events After Balance Sheet Date*) as a "subsequent event" note.

Impact on financial statements for annual periods ending on or after 22 January 2009

Financial statements relating to financial periods that end subsequent to 22 January 2009 should use the tax rate of 17% in computing the amount of provision for current and deferred taxes.

Is there an impact on dividend payments?

As the one-tier taxation system is now fully in effect, the reduction in corporate income tax will have no impact on Singapore dividends.

ii. Adoption of FRS 1 (revised 2008) and FRS 108

How does FRS 1 (revised 2008) affect the presentation of the primary statements for Q1 2009 reporting?

FRS 1 *Presentation of Financial Statements* (revised 2008), which is effective for financial statements with annual periods beginning on or after 1 January 2009, has led to consequential changes in FRS 34 *Interim Financial Reporting*.

An entity that adopts FRS 34 for its financial statements for the quarter ending 31 March 2009 (Q1 2009) will be required to present its interim financial statements based on FRS 1 (revised 2008). This will include a statement of financial position (balance sheet), a statement of comprehensive income (income statement and other comprehensive income), a statement of changes in equity and a statement of cash flows. There are a few variations in the name and format of the statements that could be used.

An entity that does not adopt FRS 34 for its Q1 2009 financial statements will likely be reporting its Q1 2009 results in accordance with the format of its 31 December 2008 annual financial statements. It can however opt to present its interim financial statements based on FRS 1 (revised 2008).

ii. Adoption of FRS 1 (revised 2008) and FRS 108 (continued)

When is FRS 108 effective and are all entities required to apply it?

FRS 108 *Operating Segments* is effective for annual periods beginning on or after 1 January 2009. It is applicable to entities which are in the process of issuing equity or debt securities in a public securities market or whose equity or debt securities are publicly traded.

How does FRS 108 affect Q1 2009 reporting?

An entity that adopts FRS 34 for its Q1 2009 financial statements will be required to comply with FRS 108 when presenting its interim financial statements. This essentially means that an entity reporting for Q1 2009 will be applying FRS 108 for the first time.

iii. Impact of FRS 108 on impairment of goodwill

What is the concept of "operating segment" under FRS 108?

FRS 108 introduced the concept of "operating segment", which is different from the primary or secondary segment format prescribed in the superseded FRS 14 *Segment Reporting*. FRS 108 defines an operating segment as a component of an entity:

- Which engages in business activities from which it may earn revenues and incur expenses
- Whose operating results are regularly reviewed by the entity's Chief Operating Decision Maker (CODM)
- For which discrete financial information is available

Is there an impact of FRS 108 on impairment of goodwill?

If an entity finds that an operating segment under the new requirements of FRS 108 is smaller than a Cash Generating Unit (CGU) it had previously allocated goodwill to, then the entity may need to carry out a goodwill impairment test based on the operating segment.

Prospective or retrospective approach?

FRS 108 requires the comparative segment information to be re-presented. However, if the entity is required to re-perform the impairment test on the goodwill based on the new operating segment structure, this new approach to impairment testing may be adopted prospectively for practical reasons.

How does this issue affect Q1 2009 reporting?

Goodwill impairment testing should be carried out by an entity for its Q1 2009 financial reporting based on the new FRS 108 operating segments if there is any indication of impairment of any operating segment after it has re-allocated its goodwill (or if the entity's annual impairment testing is historically performed in Q1). Any impairment identified should be recorded as an expense in earnings of the current period.

iv. Provision for bonus: Should they be reversed?

What are the criteria for recognising a provision for bonus under FRS 19?

FRS 19 *Employee Benefits* requires an entity to recognise the expected cost of bonus payments only when:

- The entity has a present legal or constructive obligation to make such payments as a result of past events and
- A reliable estimate of the obligation can be made

A present obligation exists only when there is no realistic alternative but to make the payments. FRS 19 also states that an entity can make a reliable estimate of its legal or constructive obligation for bonus only when:

- Its formal plans has a formula to determine the amount of the benefit
- It determines the amounts to be paid before the financial statements are authorised for issue or
- Past practice gives clear evidence of the amount of the entity's constructive obligation

Does the provision for bonus still meet the criteria under FRS 19?

With the current economic turmoil, many entities are facing challenges in meeting their revenue or profit projections/budgets. Many have implemented or are planning to make drastic cost-cutting measures, including reductions in labour costs.

Hence, even if an entity used to pay annual bonuses, a constructive obligation may no longer exist under current economic conditions since it may no longer be probable that bonuses will still be paid. Therefore, a reversal of the provision may be necessary.

Do the provisions for other costs still meet the criteria under FRS 37?

All entities should reassess their provisions for other costs that are currently held in their balance sheets to ensure that the amounts held still meet the criteria for provisioning under FRS 37 *Provisions, Contingent Liabilities and Contingent Provisions*. If it is no longer probable that there will be an outflow of resources embodying economic benefits to settle such obligations, these provisions should be reversed.

v. Other issues

What are the other issues for consideration?

Entities should also consider how the current credit crisis would affect their Q1 2009 or year-end financial reporting. The following are some of the other areas for consideration:

- Going concern assumption
- Significant judgements, estimates and assumptions
- Fair valuation
- Impairment loss on non-financial assets
- Investments in quoted equity securities classified as available-for-sale
- Deferred tax assets
- Purchase commitments and onerous contracts
- Provision for restructuring costs
- Sensitivity analysis on financial instruments
- Fraud

Information regarding the above areas can be found in *Financial Reporting Matters January 2009 – Credit Crisis Special Report II*.

B. Accounting for Jobs Credit Scheme

What is the Jobs Credit Scheme?

On 22 January 2009, the Minister for Finance announced the Jobs Credit Scheme in his Budget Speech. Under this scheme, a cash grant will be automatically given to eligible employers to help them with their labour costs and cash flow.

Details of the Jobs Credit Scheme, including the criteria for eligibility, the method of computation, illustrative examples of various scenarios and frequently asked questions are available on the IRAS website.

Key features of the Scheme

A cash grant of 12% of the first $2,500 of each employee's monthly wages (for the preceding calendar quarter) will be given to the employer at the end of the current calendar quarter (if the employer has made CPF contributions for its employees for January, April, July and October 2009 by 14 of February, May, August and November 2009 respectively).

The qualifying period, CPF contribution dates and Jobs Credit payment dates are given in the table below.

Qualifying period of wages to compute Jobs Credit	Deadline for employers to make CPF contributions	Jobs Credit payment date
Oct to Dec 2008	14 Feb 2009 – CPF based on Jan 2009 wages	31 Mar 2009
Jan to Mar 2009	14 May 2009 – CPF based on Apr 2009 wages	30 Jun 2009
Apr to Jun 2009	14 Aug 2009 – CPF based on Jul 2009 wages	30 Sep 2009
Jul to Sep 2009	14 Nov 2009 – CPF based on Oct 2009 wages	31 Dec 2009

Financial reporting implications – When should the benefits be recognised?

The Jobs Credit Scheme was announced on 22 January 2009. The Scheme meets the definition of government grants and should be accounted for in accordance with FRS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

FRS 20.7 states that government grants, including non-monetary grants at fair value, shall not be recognised until there is reasonable assurance that:
(a) The entity will comply with the conditions attaching to them
(b) The grants will be received.

FRS 20.12 states that government grants shall be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate.

Financial reporting implications - When should the benefits be recognised?

ICPAS is presently deliberating on the appropriate accounting treatment for the Jobs Credit Scheme. It is likely to make a decision in April 2009.

The two possible methods that ICPAS is currently considering for the recognition of the Jobs Credit cash grant are as follows:

Method 1

This method takes the view that FRS 20 requirements are clear and can be applied to the circumstances.

- As an asset:
  The cash grant is recognised as an asset in accordance with FRS 20.7. As the first Jobs Credit amount payable on 31 March 2009 is computed based on the payroll for October to December 2008, the amount is known by 22 January 2009 and can be recognised as an asset in the 31 January 2009 financial statements. The second, third and fourth payments can be recognised on 31 March, 30 June and 30 September 2009 respectively.

- As income:
  The cash grant payments are computed based on the past calendar quarter's payroll costs. At the time of payment, there are no conditions attached or any current or future performance obligations. As such, the grant is not regarded as intended to compensate any current or future expenses or related costs. The full amount recognised under FRS 20.7 can be immediately recognised as income in the current period.

Accounting entries:

Following this view, the entire amount of cash grant payable on 31 March 2009 will be recognised in the month ended 31 January 2009 (as an asset or as income) as follows:

Dr Grant receivable
  Cr Other income or staff costs

In addition, the entire amount of cash grant payable on 30 June 2009 will be recognised on 31 March 2009 (as an asset or as income) since an entity will have reasonable assurance of whether the employee will continue to be in its employment in April 2009. Under the Scheme, the employer is still eligible for the credit as long as the employee is on the April 2009 payroll (even if it is for part of the month) and CPF is contributed by the employer by 14 May 2009. In addition, the amount that it will receive will be based on the staff costs incurred from January to March 2009, which will be known by 31 March 2009.

Financial reporting implications - When should the benefits be recognised? (continued)

Method 2

This method takes the view that the Jobs Credit Scheme is intended to compensate employers for staff costs incurred from January to December 2009. The purpose is to help employers preserve jobs. The use of the staff costs incurred in the preceding calendar quarter to compute the amount of the cash grant is intended to allow the government to distribute the grant to employers on a timely basis and fulfil the objective of saving jobs. It is not intended to compensate costs incurred in the preceding period nor is it intended to compensate for future costs or expenses.

For example, if an employee left on 31 December 2008, no cash grant will be paid to the employer on 31 March 2009. Conversely, the entity would be entitled to the cash grant if the employee continued to be in its employment in January 2009, which is a condition that has to be met in 2009.

- As an asset:
  Same as **Method 1.**

- As income:
  Companies should recognise the cash grant from the Jobs Credit Scheme on a monthly accrual basis from January to December 2009.

Accounting entries:
On a monthly basis from January to December 2009, the amount computed will be recognised as follows:

Dr Grant receivable
  Cr Other income or staff costs/ Deferred income

How should the cash grant be presented and disclosed in the financial statements?

The cash grant should be presented in the income statement either as:

(a) Part of "other income"
(b) Deducted in reporting the related expense "staff costs"

Where material, the effect of the grants on "other income" or "staff costs" should be disclosed.

Tax exemption on the Jobs Credit Scheme

Tax implications

According to the IRAS website, the cash grant from the Jobs Credit Scheme will be exempted from corporate tax. This is intended to maximise the impact of the fiscal stimulus of Budget 2009.

C. INT FRS 117 *Distributions of non-cash assets to owners*

Background

INT FRS 117 *Distributions of non-cash assets to owners* was issued in Singapore on 20 January 2009. It provides guidance on how distributions of non-cash assets to owners (commonly termed as "dividends in specie") should be accounted for.

INT FRS 117 is the same as IFRIC 17 issued by the IASB in November 2008.

What is in the scope of INT FRS 117?

It applies to non-reciprocal distributions of non-cash assets to owners acting in their capacity as owners, in which all owners of the same class of equity instruments are treated equally.

This interpretation also applies to distributions that *gives* owners a choice of receiving either the non-cash assets or a cash alternative.

For example, an entity could distribute its investments in equity shares of another entity and give its shareholders a cash alternative.

INT FRS 117 addresses the accounting by the entity making the distribution. The accounting treatment by recipients of dividends will be determined by the relevant financial reporting standard, such as FRS 18 *Revenue* and FRS 27 (revised 2008) *Consolidated and Separate Financial Statements*. For further details on the accounting for dividends received under FRS 27, you may refer to the *December 2008 issue of Financial Reporting Matters.*

What is outside the scope of INT FRS 117?

The following transactions are not in the scope of INT FRS 117:

(a) **Common control transactions** (i.e. the non-cash asset being distributed is ultimately controlled by the same parties before and after the distribution)

(b) **Shares in a subsidiary is distributed**, but the entity continues to retain control of the subsidiary after the distribution. For example, the parent of a 100% owned subsidiary distributes 20% of the subsidiary's shares to its own shareholders, and continues to retain a controlling interest in the subsidiary.

Also, this interpretation would not apply to bonus dividends distributed to shareholders, since an entity's own shares are not assets of the entity.

What are the key accounting issues for non-cash dividends?

When an entity distributes dividend in the form of non-cash assets, the key question that arises is whether the dividend should be measured at the carrying amount (usually book value) of the non-cash assets, or at its fair value.

If the dividend is measured at fair value, then the next question is where to recognise the gain/loss between book value and fair value, i.e. should the difference be recognised in the profit or loss or directly in equity.

Before INT FRS 117

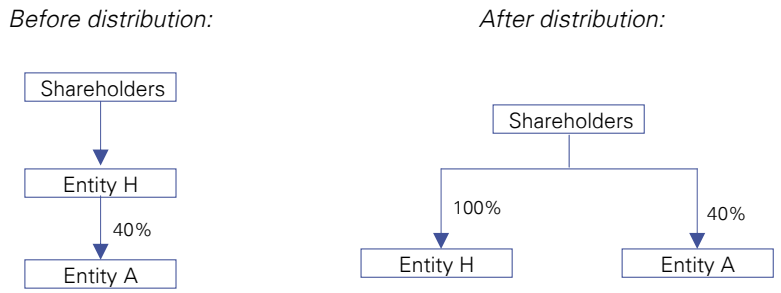
Before INT FRS 117 was issued, there was no specific guidance in this area. In practice, entities have an accounting policy choice of accounting for the non-cash dividends either at book value or fair value, with book value being more commonly adopted. Accordingly, no difference arises that needs to be accounted for.

INT FRS 117 requires non-cash dividends to be accounted for at fair value

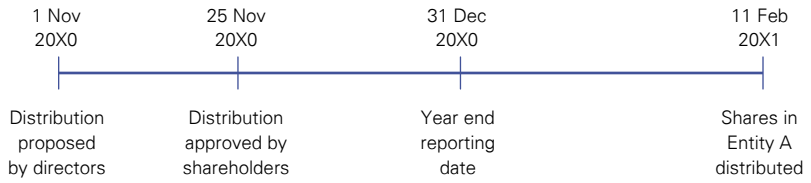
When an entity adopts INT FRS 117, it will be required to account for all non-cash dividends (within the scope of INT FRS 117) at fair value. We illustrate the key requirements of INT FRS 117 using a worked example:

Worked example – 1

Singapore Entity H owns 40% of the equity of its associated entity, Entity A. On 1 November 20X0, H's directors approved the distribution of all of its shares in A to its shareholders as a final dividend, to be settled on 11 February 20X1. In Singapore, final dividends proposed by the directors require shareholders' approval and this was obtained on 25 November 20X0.



The following dates are relevant in this example:



The following values of the net assets of Entity A are relevant in this example:

Date	Carrying amount in H's financial statements	Fair value of Entity A
25 Nov 20X0	$20,000	$30,000
31 Dec 20X0	$21,000	$32,000
11 Feb 20X1	$21,500	$35,000

When should a liability for the non-cash distribution be recognised and at what amount?

INT FRS 117 requires the liability for the non-cash dividend to be recognised when the dividend has been authorised and is no longer at the discretion of the entity. This date varies depending on the legal requirements of a particular jurisdiction.

In Singapore, an entity needs to obtain shareholders' approval to pay a final dividend. Therefore, the liability for the non-cash dividend is recognised when shareholders' approval is obtained.

When should a liability for the distribution be recognised and at what amount? (continued)

Worked example – 2

The liability is recognised on 25 November 20X0, when shareholders have approved the distribution. Entity H records the following entry:

Dr Equity – Accumulated profit	$ 30,000	
Cr Dividend payable		$30,000

To record liability for dividend payable at the fair value of Entity A.

When should the non-cash assets held for distribution be recognised and at what amount?

INT FRS 117 only deals with the measurement of the liability. With regard to the measurement of the assets to be distributed, an entity should follow the requirements of FRS 105 *Non-current assets held for sale and discontinued operations*.

For non-cash assets that are already carried at fair value (for example, investment property), the entity will continue carrying the asset at fair value. However, for most other non-current assets, FRS 105 requires the asset to be measured at the "*lower of its carrying amount and fair value less costs to distribute*" while it is being held for distribution, with impairment losses taken to profit or loss.

The assets should be reclassified as "*held for distribution to owners*" when:

(a) **The assets are available for immediate distribution** in their present condition

(b) **The distribution is highly probable** (actions to complete the distribution should be initiated and expected to be completed within one year from the date of classification)

The asset could be reclassified as being "held for distribution" earlier or later than the date the liability is recognised.

Is there any adjustment required to be made on the assets that is to be distributed?

Worked example – 3

If on 1 November 20X0, shareholder's approval is outstanding but it is highly probable that it will be obtained, then the investment in shares in Entity A would be classified as a current asset "held for distribution" on 1 November 20X0. This would be earlier than the date the liability for the distribution is recognised.

In this case, since the carrying amount of the investment is lower than the fair value, no adjustment is necessary.

How should changes in fair value of the dividend payable be recognised?

At the end of each reporting period and up to the settlement of the liability, any changes in the fair value of the liability should be recognised directly in equity.

Worked example – 4

Since the fair value of the liability increased from $30,000 on 25 November 20X0 to $32,000 on 31 December 20X0, the following entry is passed:

Dr Equity – Accumulated profit	$2,000	
Cr Dividend payable		$2,000

What is the accounting required on actual distribution of the asset?

On the date which the assets are distributed to settle the dividend liability, any gains would be recognised. This difference between the carrying amount (book value) of the assets and fair value of the asset is recognised in the profit or loss, in the same way that an entity would account for a disposal of the asset.

It is unlikely that an entity would recognise a loss on distribution since it would have recognised an impairment loss earlier, if the carrying amount is below fair value.

Worked example – 5

On 11 February 20X1:
(a) Re-measure dividend payable liability to latest fair value of non-cash assets:

Dr Equity – Accumulated profit	$ 3,000	
Cr Dividend payable		$3,000

(b) Recognise distribution of non-cash assets at fair value:

Dr Liability for dividend payable	$35,000	
Cr Investment in Entity Y		$21,500
Cr Gain on distribution (profit or loss)		$13,500

INT FRS 117 introduces additional disclosure requirements

INT FRS 117 requires specific disclosures for distributions relating to the amount of the dividend payable, and any changes in fair value of the assets to be distributed.

It also specifies the disclosures required where a distribution of non-cash assets is declared after the end of the reporting period but before the financial statements are authorised for issue.

Effective date and first-time adoption rules

INT FRS 117 and the consequential amendments to FRS 105 are effective for annual periods beginning on or after 1 July 2009.

The requirements of INT FRS 117 should be adopted prospectively. Accordingly, an entity is not allowed to restate comparative amounts for distributions made in previous periods.

An entity may choose to early adopt the requirements of INT FRS 117, provided it also adopts the revised IFRS 3 *Business Combinations* and IAS 27 *Consolidated and Separate Financial Statements* that were issued by the IASB on January 2008. It should be noted that Singapore has not yet adopted the revised IFRS 3 and IAS 27.

D. IFRIC 18 *Transfers of Assets from Customers*

Why was IFRIC 18 issued?

In some industries, suppliers of goods or services require their customers to contribute an item of property, plant and equipment (PPE), or cash to acquire or construct the PPE in order to connect customers to a network in order to provide them with access to a supply of goods or services. In addition to the contribution of PPE or cash, customers are usually required to pay for the goods or services based on their usage.

Prior to IFRIC 18, accounting practices by the receiving entity in respect of contributed assets had not been uniform. Some recognised the contributed assets at fair value and others recognised it at zero cost or a carry over amount. For those that recorded the asset at fair value, the resulting credit could be recognised in revenue immediately or over the period of the related service or over the life of the contributed asset. IFRIC 18 will eliminate such diversity in accounting practices.

What issues do IFRIC 18 address?

IFRIC 18 was issued by the IASB to provide guidance to entities who receive an item of PPE or cash from customers. It addresses the following issues:

1. Should the asset be recognised by the entity receiving it?
2. If yes, at what amount should the asset be recognised initially?
3. If the asset is initially recorded at fair value, how should the resulting credit be accounted for?
4. How should a cash contribution be accounted for?

Who are affected by IFRIC 18?

Although this interpretation is particularly relevant for entities in the utility sector, IFRIC 18 might also affect other industries and arrangements such as telecommunications entities and outsourcing arrangements.

The interpretation does not apply to government grants defined by IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, and infrastructure used in service concession arrangements that are within the scope of IFRIC 12 *Service Concession Arrangements*.

What is the effective date?

IFRIC 18 is to be applied prospectively to *transfers of assets from customers received* on or after 1 July 2009. Earlier application is permitted provided that the necessary valuations and other information were obtained at the time that those transfers occurred.

Singapore is likely to issue the interpretation with the same effective date.

Issues addressed by IFRIC 18

1. Should the asset be recognised by the entity receiving the transfer?

The asset should be recognised by the entity receiving the transfer if it meets the definition of an "asset" and the entity can exercise "control" over the transferred asset.

To determine if the entity controls the transferred asset, management should make the assessment based on the relevant facts and circumstances surrounding the arrangement, such as whether the entity:

- Obtains the right of ownership of the transferred asset
- Can exchange that asset for other assets, employ it to produce goods or services, charge a price for others to use it, use it to settle liabilities, hold it or distribute it to owners
- Is able to decide how the asset is operated and maintained, and when it should be replaced.

2. If yes, at what amount should the asset be recognised initially?

According to IFRIC 18, if the transferred asset meets the definition of an asset of the receiving entity, then it is recognised as an item of PPE in accordance with paragraph 7 of IAS 16 *Property, plant and equipment*. In addition, the entity should record the transferred asset at its fair value on initial recognition in accordance with paragraph 24 of IAS 16.

If the entity does *not control* the transferred asset, then it should *not* be recognised in the receiving entity's books.

3. If the asset is initially recorded at fair value, how should the resulting credit be accounted for?

In most cases, an entity may agree to deliver one or more services using the transferred asset. These services usually include providing:

- A connection to a network supplying goods and services
- An ongoing access to a supply of goods or services.

An entity is required to identify and separately account for the different services to be delivered in accordance with paragraph 13 of IAS 18 *Revenue*. This means that the resulting credit should be allocated to each of the "separately identifiable services" that the entity is obliged to provide within the arrangement based on the fair value of each service.

IFRIC 18 lists features indicating when connecting to a network and providing ongoing access to a supply of goods or services are "separately identifiable service". These features are summarised below:

3. If the asset is initially recorded at fair value, how should the resulting credit be accounted for? (continued)

IFRIC 18 lists features indicating when connecting to a network and providing ongoing access to a supply of goods or services are "separately identifiable service". These features are summarised below:

Connection to a network	Ongoing access to a supply of goods or services in the future
Connection service is delivered to the customer and represents stand-alone value for that customer.	Customer making the transfer receives the ongoing access, the goods or services, or both at a price lower than would be charged without the transfer of the asset.
The fair value of the service connection can be measured reliably.	
Customers that make a transfer pay the same price as those that have not contributed an asset.	

The entity will recognise revenue allocated for each identifiable service as and when it performs the different services. Where the identifiable service is to provide ongoing access to a supply of goods or services in the future, the period over which revenue shall be recognised is generally determined by the terms of the agreement with the customer. However, this period shall not be longer than the useful life of the transferred asset used to provide the ongoing service.

Illustrative example

A manufacturing company is building a large plant in a remote area where there is no existing connection to the electricity network. It is therefore required to construct an electricity substation and transfer the substation to the network company owning the electricity infrastructure. The network company will use the substation to connect the plant to its electricity network. Although the manufacturing company can purchase electricity from other suppliers, it can also purchase electricity directly from the network company. Under this arrangement, the network company will provide network access and supply electricity to the manufacturing company for a period of five years.

In this example, IFRIC 18 applies to the network company that receives the electricity substation from the manufacturing company. Assuming that the electricity substation meets the definition of an asset for the network company, the network company recognises the substation from the manufacturing company as an item of property, plant and equipment and measures its cost on initial recognition at its fair value in accordance with IAS 16 *Property, plant and equipment*.

In this arrangement, the network company is providing the following services to the manufacturing company:

- A connection to a network supplying electricity
- An ongoing access to the network and supply of electricity.

What services are provided by the network company *in exchange for the substation* (i.e. what are the separately identifiable services provided in exchange for the substation)?

Illustrative example (continued)

Ongoing access to the network and supply of electricity is not a separately identifiable service provided in exchange for the substation

If the network company is legally obliged *under the terms of the company's operating license or other regulation* to charge the manufacturing company the same price for the ongoing network access and electricity supply as others who did not contribute an asset, then this indicates that the ongoing access to the network and supply of electricity is *not* a separately identifiable service in this arrangement.

The only service provided by the network company to the manufacturing company in exchange for the substation is to connect the plant to the network. Therefore, revenue is recognised when the connection to the network is completed.

Ongoing access to the network and supply of electricity is a separately identifiable service provided in exchange for the substation

Conversely, if the network company will charge the manufacturing company a *lower price* for the ongoing network access and electricity supply compared to the other customers who did not contribute any assets, this indicates that the ongoing access to the network and supply of electricity is a separately identifiable service.

Assuming that the initial connection is also a separately identifiable service because it adds value, on a standalone basis, to the manufacturing company and the fair value of the connection service can be measured reliably, in such a fact pattern, the fair value of the substation received will be allocated to each service based on their fair values.

IFRIC 13 (INT FRS 113) *Customer Loyalty Programmes* provides guidance on how to allocate fair value of the total consideration received (fair value of the transferred asset) for the agreement to each separately identifiable service. Please refer to *Financial Reporting Matters June 2008* for a discussion on INT FRS 113.

Revenue allocated for each service is then recognised as follows:

- **Connection to network:** revenue is recognised when the connection to the network is completed.
- **Ongoing access to the network and supply of electricity:** revenue is recognised on a basis that reflects the timing, nature and value of the benefits provided over the shorter of the useful life of the substation or five years.

4. How should a cash contribution be accounted for?

Cash contributions will be accounted for under IFRIC 18 only if:

- The cash contribution is used to construct or acquire an asset to connect the customer to the network or to provide them with access to a supply of goods or services
- It meets the definition of an asset of the entity

E. ED 10 *Consolidated Financial Statements*

Deadline for public comment: 6 February 2009

Refer to IFRS Briefing Sheet – Issue 119 for details

In December 2008, the ASC issued an exposure draft of a new accounting standard, ED 10 *Consolidated Financial Statements*. ED 10 will replace the consolidation requirements in FRS 27 *Consolidation and Separate Financial Statements* and INT FRS 12 *Consolidation - Special Purpose Entities*. ED/FRS 10 is the Singapore-equivalent of ED 10 *Consolidated Financial Statements* published by the IASB on 18 December 2008.

Why is there a need to revamp the consolidation requirements under FRS 27?

This ED proposes a single control model for all entities - including Special Purpose Entities (SPEs). SPEs are referred to as structured entities in ED 10. The rationale for the proposed change is that there is a perceived difference between the identification of control for consolidation purposes in FRS 27 and INT FRS 12.

FRS 27 requires the consolidation of entities that are controlled by the reporting entity. Control is defined as having the power to govern the financing and operating policies of that entity so as to obtain benefits from its activities. This is known as "control model". However, it is usually difficult to apply the FRS 27 control model to determine the need to consolidate SPEs.

The reason is that an SPE (an entity in which receivables are securitised) is often created with legal arrangements that impose strict and at times, permanent limits on the decision-making powers of its governing board, trustee or management over the operations of the SPE. Frequently, these provisions specify that the policy guiding the on-going activities of the SPE cannot be modified. Therefore, it would appear that an SPE is structured as a 'brain dead' entity with no further ability to change its financing and operating policies. In such circumstances, identifying the entity with the power to govern the financing and operating policies of the SPE is either no longer relevant or very difficult.

INT FRS 12 is intended to provide guidance on whether a reporting entity should consolidate an SPE. In practice, applying INT FRS 12 usually means that the party which absorbs the majority of the risks and rewards of an SPE is deemed to be the controlling entity. This approach is frequently known as the "risks and rewards" model.

Many accountants currently find that it is not clear which entities are within the scope of FRS 27 and which are within the scope of INT FRS 12, resulting in diversity in accounting practices.

What is the objective of ED 10?

The proposed single control model is based on a new principle of control. ED 10 also proposed to eliminate the risks and rewards model. The aim of this ED is obviously to ensure consistency in accounting practices and to reduce structuring opportunities.

Extensive disclosures focusing on off-balance sheet activities, in particular, relating to unconsolidated structured entities, are also proposed in ED 10 to enhance the quality of information for financial statements users.

Changes proposed under ED 10

What is the concept of "single control model" under ED 10?

Single control model - Underlying principle

ED 10 proposed a new definition of control as "the power of a reporting entity to direct the activities of another entity to generate returns for the reporting entity". This underlying principle is intended to apply to all entities, including structured entities.

Power

ED 10 refers to a reporting entity as having power to direct the activities if it can "determine the other entity's *strategic* operating and financing policies", and notes that power can be achieved by virtue of the reporting entity holding the majority of the voting rights, and in a number of other ways such as:

- Holding options and convertible instruments to acquire shares
- Contractual arrangements
- Being the dominant shareholder, if other voting interests are widely dispersed (or "de facto" control)

What is the concept of "de facto control" under ED 10?

The concept of power is therefore broader in ED 10 than in the current FRS 27.

Returns

The concept of returns is also very broad in the ED. It is explicitly stated that the returns can be positive or negative. Moreover, returns may vary with the activities of the controlled entity and cover not only the traditional ownership benefits such as dividends, but also returns such as fees, tax benefits, access to liquidity facilities and achieving economies of scale.

Is the concept of "potential voting rights" still relevant under ED 10?

Options and Convertible instruments (or Potential Voting Rights)

The consideration of options and convertible instruments in determining control is not new. FRS 27 refers to these instruments as giving potential voting rights to the investor and requires only currently exercisable potential voting rights to be taken into consideration when determining control. For example, the potential voting rights arising from an option to acquire shares in another entity, which the investor can currently exercise is taken into consideration when determining control.

ED 10 proposed that potential voting rights whether currently exercisable or not should be assessed, together with all facts and circumstances when determining control.

Interests Held via an Agent

ED 10 provides explicit guidance, currently lacking in FRS 27 and INT FRS 12, on interests held in another entity via an agent, and how to assess a reporting entity's dual role as both principal and agent.

It appears that one of the aims of this guidance is to assist in determining whether a fund manager should consolidate the funds that it manages.

Is the concept of "structured entity" described under ED 10 similar to the concept of "SPE" under INT FRS 112?

Structured Entities

ED 10 introduces the term "structured entity" as an entity whose activities are restricted because they are not directed through the exercise of voting rights or other arrangements. The IASB notes that a structured entity is unlikely to differ from what is referred to as an SPE.

Whereas for non-structured entity, ED 10 retains the presumption in FRS 27 that control exists if a reporting entity holds more than half the voting power of the entity, in the absence of arrangements or activities that indicate otherwise, ED 10 included specific factors for assessing control for structured entities. The factors include:

- The activities of the structured entity and the extent to which the strategic operating and financing polices are pre-determined
- The reporting entity's ability to change any restrictions or pre-determined strategic operating and financing policies
- The extent of the exposure to the variability of returns derived from the structured entity and the quantum of the exposure compared to any other parties

What are the new disclosure requirements proposed in ED 10?

Increased Disclosures

ED 10 also proposed the following additional disclosure requirements:

- Information about the basis of control, including any significant assumptions or judgements made by management in applying the definition of control and the accounting consequences of those judgements
- Information about the interest that non-controlling interests have in the group's activities
- Information about restrictions on consolidated assets and liabilities, including the claims of non-controlling interests
- Information about unconsolidated structured entities with which the entity is involved, such as the nature of and risks associated with the involvement

What is the effective date and transitional requirements proposed in ED10?

Effective Date

ED 10 did not have an effective date but proposed a prospective application and permitted early adoption. The IASB expects to issue this as a final standard in the second half of 2009.

General comments and potential impact

What are the potential implications of the proposals under ED 10 on Singapore entities?

Overall, the assessment of control will become more difficult and requires application of significant judgement by management.

The proposal of "de facto" control as the basis for consolidation may result in consolidation and deconsolidation in different years, depending on whether the ability to control an entity exists at each reporting date. This does not appear to be the intended purpose of ED 10. If ED 10 is adopted in its current form, many entities will need to put in place additional procedures to respond to changes in circumstances. This may include the need to measure the underlying assets at fair value when gaining control and also measure the investment at fair value when losing control as required under IFRS 3 *Business Combination (revised).*

One of the issues raised by many accountants is that they find it unclear which entities are within the scope of FRS 27 and which are within the scope of INT FRS 12. The definition of a structured entity in ED 10 reduces a structured entity to a residual category. This definition does not appear to be of much help in reducing the current difficulty in practice.

The additional disclosures proposed in ED 10 will require additional procedures and efforts to track, obtain and verify the information. In particular, information required for the extensive disclosures of the nature of and risks associated with the reporting entity's involvement with structured entities, which the reporting entity does not control, may be extremely difficult to obtain.

Preparers of financial statements should consider the impact of this standard earlier, rather than later, so that systems and procedural changes can be made in advance to comply with the new requirements.

F. International Developments

Improving Disclosures about Financial Instruments – Amendments to IFRS 7 Financial Instruments: Disclosures

Refer to IFRS Briefing Sheet – Issue 126 for details.

On 5 March 2009, the IASB issued *Improving Disclosures about Financial Instruments – Amendments to IFRS 7* in response to the current financial crisis. These proposed amendments aim to enhance disclosures about fair value and liquidity risks of financial instruments.

Entities are required to disclose how the fair value of their financial instruments are measured using a 'three-level' fair value hierarchy. This is to inform users of the relative accuracy of each valuation.

Level 1 is the highest level - fair value are measured based on quoted prices (unadjusted) from active markets for an identical assets or liabilities.

Level 2 is the next level - fair values are measured using inputs, other than those used for Level 1 that are observable for the asset or liability either directly (prices) or indirectly (derived from prices).

Level 3 is the lowest level – fair values are measured using inputs which are not based on observable market data (unobservable inputs). Additional disclosures are required for Level 3 fair value measurements.

In addition, the amendments improve disclosures about liquidity risk to address diversity in practice, including proposing quantitative disclosures for derivative financial liabilities based on how liquidity risk is actually managed.

The amendments are applicable for annual periods beginning on or after 1 January 2009. In the first year of application, an entity need not provide comparative information for the disclosures required by the amendments. Earlier application is permitted.

Singapore is expected to issue the amendments with the same effective dates.

In the next issue of this publication (June 2009), we will discuss this amendment in more detail, focussing on illustrative examples and practical implementation issues.

ED *Embedded Derivatives – Proposed amendments to IFRIC 9 and IAS 39*

Refer to IFRS Briefing Sheet – Issue 121 for details.

The IASB has issued ED *Embedded Derivatives – Proposed amendments to IFRIC 9 Reassessment of Embedded Derivatives* and IAS 39 *Financial Instruments: Recognition and Measurement* to clarify the accounting treatment for embedded derivatives in relations to the amendments made to IAS 39 in October 2008 to permit the reclassification of financial assets.

The proposals would require an entity to assess whether an embedded derivative is required to be separated from a host contract when the entity reclassifies a hybrid financial asset out of the fair value through profit or loss category.

In its February 2009 meeting, the IASB decided that the proposed amendments would be effective for annual periods ending on or after 30 June 2009, instead of annual periods ending on or after 15 December 2008 as originally planned.

The IASB invited comments on this ED by 21 January 2009. In Singapore, the ASC issued the same ED, and the deadline for comments was 9 January 2009.

ED Relationship with the State – Proposed amendments to IAS 24

Refer to IFRS Briefing Sheet – Issue 117 for details.

The IASB published the ED with revised proposals for related party disclosure exemptions for state-controlled entities.

The revised ED proposes to provide an exemption to *all* state-controlled entities from disclosing related party transactions with the state or other state-controlled entities, regardless of whether any of those transactions were influenced by the related party relationship.

Instead, state-controlled entities would disclose:

- The name of the state
- The nature of the entity's relationship with the state (control, joint control or significant influence)
- The types of transactions
- The extent of such transactions (qualitative or quantitative)

The ED also proposes to amend the definition of a related party to define two entities as related parties whenever a person or a third entity has joint control over one entity and that person (or a close member of that person's family) or the third entity has joint control or significant influence over the other entity or has significant voting power in it.

The IASB invited comments on the ED by 13 March 2009. In Singapore, the ASC issued the same ED, and the deadline for comments was 6 February 2009.

DP Preliminary Views on *Revenue Recognition in Contracts with Customers*

Refer to IFRS Briefing Sheets – Issue 120 for details.

The IASB and FASB (the Boards) published their joint DP Preliminary Views on *Revenue Recognition in Contracts with Customers*.

The DP proposes a single revenue recognition model to be applied to all contracts with customers. Under the proposed model, the contract with a customer would be broken down into separate performance obligations to the extent that they are performed at different times. Revenue would be recognised as and when the entity satisfies performance obligations in the contracts.

The proposed model may have significant effects on current practice, including:

- **Identification of performance:** For example, warranties would be accounted for as separate performance obligations in a contract, rather than as cost accruals.
- **Construction contacts:** Contracts previously accounted for on a percentage-of-completion basis would be accounted for on the basis of the timing of discharge of the underlying performance obligations. This may mean that revenue is recognised later than under current practice.

The IASB has invited comments on the ED by 19 June 2009. In Singapore, the ASC has issued the same ED, and the deadline for comments is 3 April 2009.

IASC Foundation's Constitution - Conclusion to Part 1 of IASC Foundation Constitution Review

Refer to IFRS Briefing Sheets – Issue 123 for details.

On 29 January 2009, the IASC Foundation published amendments to its Constitution as a conclusion to phase I of its second Constitution Review.

These amendments include:

- Creating a Monitoring Board to establish a direct link of public accountability between the IASC Foundation and capital market authorities effective on 1 February 2009
- Increasing the size of the IASB from 14 to 16 members by mid-2012
- Introducing geographical distribution guidelines for Board members of the IASB

IASC Foundation's Discussion Document Review of the Constitution

Refer to IFRS Briefing Sheets – Issue 118 for details.

This discussion document represents phase II of the International Accounting Standards Committee (IASC)'s Foundation's Constitution Review.

Part II invites comments on a number of specific issues such as:

- Objectives and governance of the IASC Foundation
- Trustees structure of the IASC Foundation
- IASB's agenda-setting process, due process and the option of having a "fast track" procedure for IFRSs changes
- Structure of the Standard Advisory Council

The IASC Foundation has invited comments on the discussion document by 31 March 2009. In Singapore, the ASC issued the same discussion document, and the deadline for comments was 22 February 2009.

Meetings of the International Accounting Standards Board – December 2008, January and February 2009

Refer to IFRS in Brief – Issue 53, 54 and 55

Issues discussed during the IASB's meetings in the last three months from December 2008 to February 2009 include:

(a) Derecognition of financial instruments

In response to the global financial crisis, the IASB has accelerated the project to improve the existing derecognition requirements under IAS 39, which have been perceived to be difficult to understand and apply in practice.

Currently, two approaches are being developed to make the derecognition principle operational:

- **Approach one** focuses solely on the transferor's present access, for its own benefit, to the cash flows from the financial asset.
- **Approach two** starts with determining whether the derecognition principle will be applied to an asset in its entirety or a component thereof (IASB's preferred approach).

An ED is expected to be issued in March or April 2009.

(b) Fair value measurement

The IASB is finalising various matters relating to fair value measurement for the upcoming ED. An ED is expected to be issued in the early second quarter of 2009.

The objectives of this ED are:

- To establish a single standard for all fair value measurements required or permitted by existing IFRSs to reduce complexity and improve consistency in their application
- To clarify the definition of fair value
- To enhance disclosures about fair value

(b) *IFRS for Non-Publicly Accountable Entities* (previously "IFRS for Private Entities" and "*IFRS for SMEs*")

The Board has now made tentative decisions on all substantive issues, and plans to assess in March 2009 whether there is a need to re-expose the ED.

For a summary of the status of the IASB's current projects, you may refer to *IFRS Briefing Sheet* Issue 125. The KPMG International publications covered in this issue are:

- IFRS in Brief: Issues 53 to 55
- IFRS Briefing Sheet: Issues 117 to 126

This section provides highlights of international developments, of relevance to the local context, reported in our international publications – *IFRS in Brief* and *IFRS Briefing Sheet*. You can access the electronic versions at:

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

kpmg.com.sg

Common abbreviations defined

ASC - Accounting Standards Council

ACRA – Accounting & Corporate Regulatory Authority

DP – Discussion paper

ED – Exposure Draft

FASB – US Financial Accounting Standards Board

FRS – Singapore Financial Reporting Standard

GAAP – Generally Accepted Accounting Principles

IAS – International Accounting Standard

IASB – International Accounting Standards Board

IASC – International Accounting Standards Committee

ICPAS – Institute of Certified Public Accountants of Singapore

IRAS – Inland Revenue Authority of Singapore

IFRIC - International Financial Reporting Interpretations Committee

IFRS – International Financial Reporting Standard

INT FRS – Interpretation Financial Reporting Standard

SGX – Singapore Exchange

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

Jeremy Hoon
Partner, Professional Practice Department
Tel: +65 6213 2608
jeremyhoon@kpmg.com.sg

KPMG LLP
16 Raffles Quay , #22-00 Hong Leong Building, Singapore 048581
Tel: +65 6213 3388 Fax: +65 6225 0984