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Financial Reporting Matters

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AUDIT

In this issue, we discuss the revisions made to FRS 103 *Business Combinations* and FRS 27 *Consolidated and Separate Financial Statements* (2009) and the second annual *Improvements to FRSs* 2009. We also provide an update on IASB's activities, and summarise its progress to address the accounting issues that surfaced as a result of the global financial crisis.

About one and a half years after the IASB issued the revised financial reporting standards on business combination and consolidation, the ASC decided in June 2009 to adopt these revised standards in Singapore. The significant time lapse in issuing the revised standards in Singapore provides a glimpse to the significance of the changes and the impact on mergers and acquisitions. We discuss the significant changes in these revised standards.

Also in June 2009, the ASC issued its second omnibus standard "*Improvements to FRSs 2009*", which is equivalent to "*Improvements to IFRSs* 2009" issued by the IASB in April 2009. The *Improvements to IFRSs 2009* is the result of the IASB's second annual improvements project. This project involves the IASB accumulating throughout the year what it believes are non-urgent but necessary improvements to IFRSs and then processing these amendments collectively. We summarise these 15 improvements to 12 standards and interpretations. While most are relatively minor and many entities will be unaffected, it is worth double-checking this list against your own circumstances to see if any of them introduce any changes in policy or presentation or are relevant to this year's transactions.

The IASB has also acted swiftly to address the concerns raised by various stakeholders about accounting standards as the financial crisis unfolds across the globe. Since our last update, the IASB has accelerated a number of projects to address calls for greater comparability and reduced complexity in accounting for financial instruments. At the same time, new projects were added to address new accounting issues that surfaced as the financial crisis continues. We summarise the IASB's progress on the accelerated and new projects.

Contents

Announcement:

Singapore Illustrative Financial Statements (IFS) 2009

The Singapore IFS illustrates some of the best practice disclosures and the requirements of the Singapore Companies Act, Singapore FRS, and the SGX Listing Manual. For the year ending 31 December 2009, the key changes in financial reporting requirements from 2008 include the adoption of the revised FRS 1 *Presentation of Financial Statements* (2008), FRS 108 *Operating* Segments, the revised FRS 23 *Borrowing Costs* and amendments to FRS 107 *Financial Instruments: Disclosures.*

The IFS 2009, incorporating the above changes, will be available for download from our website at kpmg.com.sg and in printed copies in October 2009.

A. Revised FRS 103 *Business Combinations* and FRS 27 *Consolidated and Separate Financial Statements* (2009)

In June 2009, the ASC issued a revised standard, FRS 103 *Business Combinations*, and related amendments to FRS 27 *Consolidated and Separate Financial Statements*. These standards become almost immediately effective as it is mandatory for business combinations in annual financial statements beginning on or after 1 July 2009.

These revised standards came almost one and a half years after the IASB issued them. The long time lapse in issuing these revised standards in Singapore provides a hint of the magnitude of changes and the potential impact on the business community.

In this issue, we take a closer look at the revised scope of FRS 103 (2009) and some of the key changes in accounting introduced by this standard and the revisions to FRS 27. We have also added a few illustrative examples to help you in understanding and applying these changes.

Key changes to accounting for business combinations

Many of the basic principles concerning the purchase price allocation exercise remain the same

However, there are key changes to the detailed application requirements which may impact the consolidated financial statements both in the year of obtaining control and subsequently

Many of the basic principles of the "purchase method" used to account for business combinations remain the same in the revised FRS 103. That is, the "cost" of the combination is calculated based on the fair value of the consideration as at the date of acquisition and this amount is compared with the fair value of the identifiable assets, liabilities and contingent liabilities acquired, in order to compute goodwill or "excess" (now renamed "gain from a bargain purchase").

In addition, acquirers are still given a period of up to 12 months after the date of the acquisition in which to finalise the identification of the net assets and contingent liabilities acquired, and to estimate their fair values, as well as the fair value of the consideration given. This period is now referred to as the "measurement period" and, while the guidance has been made explicit that adjustments are only made to arrive at the acquisition date fair values (i.e. that post acquisition factors should not be taken into account), the basic concept remains the same.

However, there are a number of key changes in the application of the purchase method, which may have a significant impact on the consolidated financial statements of the acquirer both in the year of obtaining control and subsequently. This is often the case when contingent amounts are involved or the acquisition is a step-up of a previous holding.

The key changes are a reflection of a guiding principle which has predominated the standard setters' approach, being that obtaining or losing control over an entity is a significant economic event, which involves crossing a threshold at a single particular point in time.

Specifically, the key changes to accounting for the cost of the combination and recognising the net assets acquired which reflect this new mindset are as follows:

All transaction costs are to be expensed as incurred

Transaction costs

Currently, the "cost" of the combination includes any transaction costs attributable to that transaction (e.g. fees for services provided by lawyers, financial advisers, valuers and other professionals). Consequently, these costs are effectively capitalised into goodwill.

Under FRS 103R, all transaction costs relating to the acquisition must be expensed as incurred. The logic for this treatment is that these costs are not part of the fair value exchange between the buyer and seller of the business and instead relate generally to separate services received.

It should be noted that this requirement cannot be circumvented by asking the seller to cover the acquirer's transaction costs (and presumably agreeing to pay an appropriately higher price for the business), since FRS 103R includes specific requirements concerning separating out from the business combination any components which do not relate to obtaining control over the business.

Contingent consideration must be fair valued as of the date of acquisition

Any post acquisition adjustments to contingent consideration will impact the income statement

Contingent consideration

Currently, any consideration which is contingent on future events (e.g. additional amounts that will be payable by the acquirer to the seller if the acquired company performs well post acquisition) is only recognised as part of the cost of the combination when the settlement is probable and the amount can be measured reliably. Once recognised, the consideration will be re-measured until settlement, with a corresponding re-measurement impact on goodwill.

Under FRS 103R, contingent consideration is required to be fair valued as at the date of obtaining control, irrespective of whether settlement is probable. That is, "probability of settlement" would simply be one of the factors to consider when arriving at the fair value at acquisition date, rather than being a recognition threshold as is currently the case. Furthermore, the only subsequent adjustments permitted to the amount to be included as part of the "consideration transferred" (i.e. as part of the goodwill calculation) are those arising during the measurement period from obtaining additional information concerning circumstances that existed at the acquisition date.

Any other subsequent differences between the amount accrued as part of the consideration transferred and the amount expected to be settled, or actually settled will have to be reflected directly in the income statement.

For example, if the acquired entity performs better than expected post acquisition, and an additional amount is consequently payable to the seller, then this additional amount will need to be recorded as an expense in the post acquisition income statement, and there would be no adjustment to goodwill.

Previous holdings in the acquiree are to be fair valued at the date of acquiring a controlling interest, with gains or losses on re-measurement recognised in the income statement

Step up acquisitions

Currently, if a business combination is achieved in stages (e.g. an entity buys a further 30 percent of an associate and thereby gains control over that entity), then the "cost" of the combination (i.e. the consideration given), and consequently goodwill, is calculated on a step up basis. That is, currently the cost and goodwill are in effect an amalgamation of the cost and goodwill which related to each step along the path towards gaining control. In addition, any fair value uplifts to assets and liabilities acquired are made through equity, to the extent they relate to the existing ownership interest.

FRS 103R takes a fundamentally different approach to this type of transaction by viewing the crossing of the control threshold as a single step. Any previously held interest in the same entity are effectively treated as if sold and re-purchased at fair value at that time. Therefore, a gain or loss on disposal of the previous interest will be recorded in the income statement, and the fair value of the previous interest will form part of the fair value of the consideration given for obtaining the controlling interest.

Illustrative example – Step acquisition

Facts

1 January 20X0	Entity A acquired 30% of Entity B for $80,000 (accounted for as an associate)
31 December 20X0	Entity A recognised its share of profit of $7,000 (in profit and loss) and its share of the fair value gain from available-for-sale (AFS) gain recognised by Entity B of $1,000 (in other comprehensive income). Thus, the carrying amount of the investment in the associate = $88,000 ($80,000+$7,000+$1,000)
1 January 20X1	Entity A acquires remaining 70% of Entity B for $230,000. The fair value of the 30% interest already owned is $90,000.

Application of FRS 103R

(a) Gain in profit or loss:	
– Fair value gain of AFS deferred in equity	$1,000
– Re-measurement of existing 30% to fair value (Fair value of 90,000 less carrying amount of $88,000)	$2,000
Total	$3,000
(b) Consideration paid for 100% in Entity B:	
– Fair value of 30% interest	$90,000
– Consideration paid for remaining 70%	$230,000
Total	$320,000

This treatment effectively considers that the 30% interest held prior to obtaining control is sold (and thus a gain for the difference between fair value and carrying amount is recognised in profit or loss), and subsequently repurchased at the acquisition date (and thus the 100% interest is recognised at fair value). Goodwill from previous purchases is ignored and remeasured once control is obtained.

Note: The per share fair value of the 30% interest is expected to be a different amount from the per share fair value of the 70% interest, most likely due to the control premium that would be included in the per share valuation of the 70% interest.

Post acquisition recognition of acquiree's deferred tax assets will generally impact the income statement, rather than goodwill

Post acquisition recognition of acquired deferred tax assets

Currently, an acquirer would make an adjustment to goodwill, if, at some point after obtaining control, the acquirer is able to realise the benefit from deferred tax assets of the acquiree that had previously failed to satisfy the recognition criteria. This would be the case, for example, if at some point after acquisition, the group became able to utilise tax losses accumulated by the acquiree prior to acquisition.

Under FRS 103R and the consequential amendments to paragraph 68 of FRS 12 *Income Taxes*, adjustments are only made to goodwill when the acquired deferred tax assets are recognised within the measurement period (i.e. during the 12 month period for finalising fair values of the assets and liabilities acquired, as introduced above) as a result of new information which arose during that period about facts and circumstances that existed at the acquisition date. All other post acquisition changes will generally be dealt with in profit or loss. As discussed below, as an exception to the general transitional provisions, this new requirement is applicable prospectively to business combinations entered into before the effective date of FRS 103R, as well as to those entered into after.

Fair values of contingent liabilities acquired are only recognised if they arise from a present obligation which exists at the date of acquisition

Contingent liabilities

Currently, all contingent liabilities of the acquiree are included in the fair value of the identifiable net assets acquired, provided that their fair values can be reliably measured.

Under FRS 103R, the same limitation on recognition of contingent liabilities applies. That is, contingent liabilities are only recognised if their fair values can be reliably measured. However, FRS 103R further limits the recognition of contingent liabilities by distinguishing between those contingent liabilities that arise from "possible obligations" and those that arise from "present obligations".

Only those contingent liabilities which are "present obligation" at the date of acquisition are included in the fair value of the identifiable net assets acquired. Any contingent liabilities which are only "possible obligations" at the date of acquisition should not be included in the valuation of the net assets acquired.

Acquirers are permitted, but not required, to recognise goodwill attributable to the non-controlling interest

Measurement of minority interests (non-controlling interests)

Currently, when a parent acquires less than 100 percent of the acquiree, the minority interest (MI) in the acquiree is measured at the MI's share of the fair value of the acquiree's identifiable net assets. Consequently, the goodwill included in the group's balance sheet includes only the acquirer's share of the goodwill inherent in the acquiree and no amount of the goodwill is attributable to the MI.

Under FRS 103R, an acquirer can continue to use the method required by the current FRS 103. That is, the acquirer can measure the MI (now referred to as the non-controlling interest or NCI) based on the NCI's share of the fair value of the acquiree's identifiable net assets.

However, acquirers can also choose to measure the NCI at fair value at the acquisition date, i.e. at the fair value of the NCI's interest in the acquiree as a whole, rather than simply the NCI's interest in the fair value of the acquiree's net assets. Under this alternative method, the goodwill reflected in the consolidated balance sheet of the acquirer would be attributable to both the parent and the NCI, in the same way as any other of the acquiree's net assets that are reflected in the consolidated balance sheet. It would therefore represent more closely 100 percent of the goodwill inherent in the acquiree's business.

Surprisingly, this choice of measurement approach is not required to be a policy choice, i.e. the acquirer's approach to this issue can vary from one acquisition to the next.

Illustrative example – Measuring non-controlling interest

Facts

On 31 December 20X0, Entity A acquires 60% of Entity B for cash of $1,000. On this date:

– Fair value of identifiable net assets of Entity B	$1,500
– Carrying amount of identifiable net assets of Entity B	$1,200
– Fair value of NCI (40%), based on market price of the shares that the acquirer does not obtain	$ 650

Alternative 1: NCI at fair value

Entity A will record the following consolidation entry related to its investment in Entity B in preparing its 31 December 20X0 consolidated financial statements:

Dr Identifiable net assets of Entity B	$1,500*	
Dr Goodwill	$ 150	
Cr Equity (NCI)		$ 650 (fair value)
Cr Investment in Entity B (controlling interest)		$1,000 (cash paid)

Alternative 2: NCI at proportionate interest in the fair value of identifiable assets and liabilities

Entity A will record the following consolidation entry related to its investment in Entity B in preparing its 31 December 20X0 consolidated financial statements:

Dr Identifiable net assets of Entity B	$1,500*	
Dr Goodwill	$ 100	
Cr Equity (NCI)		$ 600**
Cr Investment in Entity B (controlling interest)		$1,000 (cash paid)

The implication of recognising the NCI at its proportionate interest in the fair value of the identifiable assets and liabilities of the acquiree is that both the NCI and goodwill are lower because no goodwill is ascribed to the NCI.

* Full fair value of net assets acquired.
** 40% of $1,500

FRS 103R contains new requirements and guidance on a range of areas where the current standards is silent

Additional guidance on the purchase price allocation exercise

FRS 103R contains new requirements and guidance on a range of areas where the current standard is silent and so may help to reduce diversity and uncertainty in practice. This material should be taken note of if considering the potential accounting implications of a proposed business combination, or when carrying out the post-acquisition purchase price allocation exercise to identify and value the acquiree's net assets. Specifically, FRS 103R has requirements covering the following:

- **Settlement of pre-existing relationships** (e.g. where a supply contract already existed between the acquirer and acquiree before the acquirer obtained control)
- **Classifying or designating the acquiree's identifiable assets and liabilities at the date of obtaining control** (e.g. classifying financial assets as held to maturity or designating a derivative as a hedging instrument)
- **Replacement of the acquiree's share-based payment awards** with share-based payment awards of the acquirer
- **Indemnification assets** (e.g. where the seller indemnifies the acquirer in respect of losses arising from an unsettled law suit)
- **Reacquired rights recognised as intangible assets** (e.g. where the acquirer had previously granted the acquiree an exclusive license to sell the acquirer's brand)
- **Continuing recognition of assets given to the acquiree** (rather than the seller of the acquiree) as part of the consideration, i.e. assets which effectively remain under the acquirer's control post acquisition

- **Recognition of the fair value of favourable and unfavourable operating leases** (i.e. leases where remaining lease payments are below or above the amounts that would be expected if the leases were entered into at the acquisition date, based on current market conditions) where the acquiree is the lessee or the lessor
- **Determining whether arrangements for contingent payments to employees or the former owners of the acquiree** are part of the business combination or separate transactions.

Key changes to accounting requirements applicable after control is obtained

Amendments to FRS 27 include the following:

- **Profit or loss and each component of comprehensive income should be attributed to the owners of the parent and the NCI**, according to their respective interests, even if this results in the NCI having an overall deficit balance. There is no longer a requirement for the NCI to be under a binding obligation to make good the losses before allocating the losses to such an extent.
- **Changes in a parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions** (i.e. as transactions with owners in their capacity as owners). As a result, no gain or loss would be recognised in the group's profit or loss, for example, if a parent decreased its shareholding from 100 percent to 80 percent (or vice versa), provided that it retained control. Instead, all differences between the consideration transferred or received, and the change in the NCI's share of the consolidated net assets would be recognised in equity.

Illustrative example – Changes in ownership interests while retaining control

Facts

Entity A owns 60% of the shares in Entity B.
On 1 January 20X0, Entity A acquires an additional 20% of Entity B, paying $400.

The carrying amount of NCI in the consolidated financial statements of Entity A on 1 January 20X0 is $500.

Application of FRS 27R

The acquisition of the 20% interest of the NCI is recorded as follows:

Dr Equity (NCI)	$ 250 ($500 * 20/40)	
Dr Other equity	$ 150	
Cr Cash		$400

Entity A recognises the "loss" of acquisition of the additional 20% as a direct decrease in equity, as a transaction with owners. No adjustments are made to the recognised amounts of assets and liabilities or to goodwill.

- **Changes that result in a parent losing control over a subsidiary are accounted for as a disposal of the entire interest** in that subsidiary, with a resulting gain or loss being recognised in profit or loss. Any interest that has in fact been retained would be recognised at fair value as if reacquired. This treatment is therefore the mirror image of the treatment required in step up acquisitions when control is obtained, as discussed above.

Illustrative example – Loss of control

Facts

Entity A owns 60% of the shares in Entity B.
On 1 January 20X0, Entity A disposes 20% interest in Entity B, and loses control over Entity B.

On 1 January 20X0:

– Consideration received for sale of shares in Entity B	$ 400
– Carrying amount of net assets of Entity B	$1,750
– Carrying amount of NCI	$ 700
– Fair value of remaining 40%	$ 800

Application of FRS 27R

The disposal of the 20% interest in Entity B is recorded as follows:

Dr Cash	$ 400		
Dr Equity (NCI)	$ 700		
Dr Investment in Entity B	$ 800		
Cr Net assets of Entity B		$ 1,750	
Cr Gain on disposal		$ 150	

The gain on disposal consists the following:

(a) Increase in fair value of retained 40%	$800 less 40%*$1,750 =	$100
(b) Gain on sale of 20%	$400 less 20%*$1,750 =	$50
Total gain		$150

The remaining 40% investment in Entity B will be recorded at its fair value of $800.

Consequential changes have been made to apply this approach consistently as follows:

- FRS 105 *Non-current Assets Held for Sale and Discontinued Operations*, has been amended through the IASB's first Annual Improvements Project, such that if there is an intention to dispose of a controlling interest in a subsidiary which meets the definition of "held for sale" at the balance sheet date, then 100 percent of the subsidiary's net assets, as are included in the consolidated financial statements, would be classified as "held for sale", irrespective of whether the parent was expected to retain an interest in that entity after the disposal
- FRS 28 *Investment in Associates*, and FRS 31 *Interests in Joint Ventures*, are amended at the same time as FRS 27R such that if an entity loses significant influence or joint control over the investee, this is also treated as a full disposal, with any remaining interest being recognised initially at fair value.

Extended disclosure requirements

FRS 103R contains extended disclosure requirements. For example, an entity is required to disclose the following:

- Primary reasons for the business combination
- Amounts recognised in respect of contingent consideration arrangements and indemnification assets, a description of the arrangements, the basis for determining the amount of the payments and an estimate of the range of outcomes (or the reason why such a range cannot be estimated)
- Contractual amounts receivable in respect of acquired receivables and a best estimate at the acquisition date of the amount of contractual cash flows not expected to be collected, in addition to disclosing the receivables' fair value
- Transaction costs, including details of the income statement line items in which they were included and details of any other separately recognised transactions

Effective date and transition

The amendments are first effective for annual periods beginning on or after 1 July 2009

FRS 103R and FRS 27R are effective for annual periods beginning on or after 1 July 2009.

Generally the amendments are required to be applied prospectively as from the first transaction that occurs after the effective date

FRS 103R prohibits adoption of its requirements to previously recognised business combinations. In addition, FRS 27R prohibits retrospective adjustments arising from the changes outlined above concerning changes in the parent's interest (whether retaining or losing control as a result) and allocation of losses to the NCI. Instead, the new requirements should be applied as and when the first relevant transaction occurs after the effective date (or date of early adoption).

The requirements concerning post acquisition changes in deferred taxes are an exception to this principle: these are to be applied prospectively to all such deferred tax assets, even if they were acquired in business combinations before the effective date

There is one exception to the above principle. FRS 103R states that the new requirements concerning the post acquisition treatment of deferred tax assets should also apply prospectively to business combinations which occurred before the effective date of FRS 103R. That is, as from the effective date of FRS 103R, it will no longer be acceptable to make adjustments to goodwill as a result of initially recognising the acquiree's deferred tax assets (i.e. recognising for the first time a deferred tax asset of the acquiree which previously had failed to meet the recognition criteria in FRS 12), irrespective of whether that asset was acquired in a business combination which occurred before or after the effective date of FRS 103R. Instead, the credit should be recognised in accordance with FRS 12, i.e. generally in profit or loss.

B. *Improvements to FRSs* 2009

The ASC has on 22 June 2009 issued its second omnibus standard "*Improvements to FRSs 2009*". The improvements follows very closely to those issued by the IASB in April 2009.

The *Improvements to IFRSs 2009* is the result of the IASB's second annual improvements project. This project involves the IASB accumulating throughout the year what it believes are non-urgent but necessary improvements to IFRSs and then processing these amendments collectively.

The *Improvements to IFRSs 2009* contains 15 amendments to 12 standards and interpretations. Effective dates, early application and transitional requirements are dealt with on a standard-by-standard basis.

We set out below a brief summary of each of these amendments. While most are relatively minor and many entities will be unaffected, it is worth double-checking this list against your own circumstances to see if any of them introduce any changes in policy or presentation or are relevant to this year's transactions.

In particular, we highlight below four amendments that may be worth noting earlier:

1. **Amendments relevant to first year of adopting FRS 108 *Operating Segments***

   Two of the amendments relate to FRS 108 *Operating Segments*. Since entities are adopting FRS 108 for the first time for annual periods beginning on or after 1 January 2009, entities may wish to adopt these amendments in 2009 rather than waiting until 2010. Specifically, these amendments are as follows:

   (i) FRS 108 is amended to clarify that segment assets should only be disclosed if such amounts are regularly provided to the chief operating decision maker.

   (ii) FRS 36 *Impairment of Assets* is amended to state explicitly that the unit, or group of units, to which goodwill is allocated should not be larger than an operating segment as defined in FRS 108 *before* aggregation. The question of how goodwill has been allocated for impairment testing purposes should therefore be considered at the same time as identifying operating segments for the purposes of adopting FRS 108.

For entities early adopting these amendments, appropriate disclosures should be made in the financial statements.

2. **Amendment relevant to first year of adopting INT FRS 116 *Hedges of a Net Investment in a Foreign Operation***

   The amendment relate to INT FRS 116 which is effective for the first time for annual periods beginning on or after 1 October 2008. The restriction that prevented the hedging instrument from being held by the foreign operation that itself is being hedged is removed from INT FRS 116. In applying INT FRS 116, entities may also wish to early adopt this amendment rather than the effective date of annual periods beginning on or after 1 July 2009.

   For entities adopting this amendment earlier, appropriate disclosures should be made in the financial statements.

3. **New guidance on determining whether an entity is acting as a principal or an agent**
   Guidance has been added to FRS 18 *Revenue* and is effective immediately. Entities are advised to double check their policies against this guidance if they have business relationships which either have been classified as agency arrangements or the decision between agent and principal was a borderline one.

4. **Classification of leasehold land and buildings**
   The amendment to IAS 17 *Leases* will remove one of the fundamental differences between IFRS and FRS. The amendment is consistent with our current FRS 17 and should therefore have no impact on entities preparing financial statements based on FRS.

Summary of Improvements to FRSs 2009

Subject of Amendment	Amendment	Effective Date
FRS 102 *Share-based Payment – Scope of FRS 102 and revised FRS 103 Business Combinations*	FRS 102 is amended to state that common control transactions and the contribution of a business on the formation of a joint venture are both outside the scope of FRS 102, notwithstanding that such transactions are outside the scope of FRS 103.	Effective for annual periods beginning on or after 1 July 2009. Early application is permitted; it is required if FRS 103 (2009) is adopted early.
FRS 105 *Non-current Assets Held for Sale and Discontinued Operations – Disclosures of non-current assets (or disposal groups) classified as held for sale or discontinued operations*	FRS 105 is amended to state that the required disclosures for non-current assets (or disposal groups) classified as held for sale or discontinued operations are specified in that standard. The disclosure requirements of other FRSs are applicable to those assets (or disposal groups) only if they specifically require disclosures in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations, or they relate to items not within the measurement scope of FRS 105.	The amendments are to be applied prospectively for annual periods beginning on or after 1 January 2010. Earlier application is permitted.
FRS 108 *Operating Segments – Disclosure of information about segment assets*	FRS 108 is amended to state that segment information with respect to total assets is required only if such information is regularly reported to the chief operating decision maker. A related Basis for Conclusion paragraph also has been deleted with new guidance added.	Effective for annual periods beginning on or after 1 January 2010. Earlier application is permitted.
FRS 1 *Presentation of Financial Statements – Current / non-current classification of convertible instruments*	FRS 1 is amended to state that the classification of the liability component of a convertible instrument as current or non-current is not affected by terms that could, at the option of the holder of the instrument, result in settlement of the liability by the issue of equity instruments.	Effective for annual periods beginning on or after 1 January 2010. Earlier application is permitted.
FRS 7 *Statement of Cash Flows – Classification of expenditures on unrecognised assets*	FRS 7 is amended to state explicitly that only expenditures that result in the recognition of an asset can be classified as a cash flow from investing activities.	Effective for annual periods beginning on or after 1 January 2010. Earlier application is permitted.
FRS 17 *Leases – Classification of leases of land and buildings*	Under the amendments, a land lease with a lease term of several decades or longer may be classified as a finance lease, even if at the end of the lease term title will not pass to the lessee, because in such arrangements substantially all risks and rewards are transferred to the lessee and the present value of the residual value of the leased asset is considered negligible.	Effective for annual periods beginning on or after 1 January 2010. Earlier application is permitted.
FRS 18 *Revenue – Determining whether an entity is acting as a principal or as an agent*	The appendix accompanying FRS 18 is amended to include additional guidance on determining whether an entity is acting as a principal or as an agent in a transaction. The guidance is provided in the form of indicators.	No effective date is given since the appendix is not an integral part of the standard.

Summary of Improvements to FRSs 2009 (continued)

Subject of Amendment	Amendment	Effective Date
FRS 36 *Impairments of Assets – Unit of accounting for goodwill impairment test*	FRS 36 is amended to state that the largest unit to which goodwill should be allocated is the operating segment level as defined in FRS 108 before applying the aggregation criteria of FRS 108.	The amendments are to be applied prospectively for annual periods beginning on or after 1 January 2010. Earlier application is permitted.
FRS 38 *Intangible Assets – Additional consequential amendments arising from revised FRS 103*	Guidance in FRS 38 on accounting for intangible assets acquired in a business combination is amended as a consequence of guidance contained in FRS 103 (2009). The amendments indicate that an intangible asset that is separable only together with a related contract, identifiable asset or liability is recognised separately from goodwill together with the related item. In addition, the amendments state that complementary intangible assets with similar useful lives may be recognised as a single asset.	The amendments are to be applied prospectively for annual periods beginning on or after 1 July 2009. Early application is required to conform to the adoption date of FRS 103 (2009) if that standard is adopted early.
FRS 38 – *Measuring the fair value of an intangible asset acquired in a business combination*	The amendments clarify the description of valuation techniques commonly used by entities when measuring the fair value of intangible assets acquired in a business combination for which no active market exists.	The amendments are to be applied prospectively for annual periods beginning on or after 1 July 2009. Earlier application is permitted.
FRS 39 *Financial Instruments: Recognition and Measurement – Treating loan prepayment penalties as closely related embedded derivatives*	The amendments provide additional guidance on determining whether loan prepayment penalties result in an embedded derivative that needs to be separated. If an exercise price of an embedded prepayment option reimburses the lender for an amount not exceeding the approximate present value of the lost interest for the remaining term of the host contract, then the economic characteristics and risks of the prepayment option embedded in a host debt or host insurance contract are closely related to the host contract and the embedded derivative is not separated from the host contract.	The amendments are to be applied prospectively to all unexpired contracts for annual periods beginning on or after 1 January 2010. Earlier application is permitted.
FRS 39 – *Scope exemption for business combination contracts*	The amendments state that the scope exemption in FRS 39 paragraph 2(g) is restricted to forward contracts, i.e., not options, between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a business combination at a future acquisition date. In addition, the term of the forward should not be longer than a period normally necessary to finalise the transaction.	The amendments are to be applied prospectively to all unexpired contracts for annual periods beginning on or after 1 January 2010. Earlier application is permitted.
FRS 39 – *Cash flow hedge accounting*	The amendments state that the gains or losses on a hedged instrument should be reclassified from equity to profit or loss during the period that the hedged forecast cash flows impact profit or loss.	The amendments are to be applied prospectively to all unexpired contracts for annual periods beginning on or after 1 January 2010. Earlier application is permitted.
INT FRS 109 *Reassessment of Embedded Derivatives – Scope of INT FRS 109 and revised FRS 103*	The scope of INT FRS 109 is amended so that embedded derivatives in contracts acquired in business combinations as defined in FRS 103 (2009), joint venture formations and common control transactions remain outside the scope of INT FRS 109.	The amendments are to be applied prospectively for annual periods beginning on or after 1 July 2009. Early application is required to conform to the adoption date of FRS 103 (2009) if that standard is adopted early.
INT FRS 116 *Hedges of a Net Investment in a Foreign Operation – Amendment to the restriction on the entity that can hold hedging instruments*	The restriction that prevented the hedging instrument from being held by the foreign operation that itself is being hedged is removed from INT FRS 106. Hence, as long as the criteria for hedge accounting in FRS 39 are met, a group would be able to designate in its consolidated financial statements a hedge of the net investment in a foreign operation using a hedging instrument held by that foreign operation itself.	Effective for annual periods beginning on or after 1 July 2009. Earlier application is permitted.

C. IASB's response to the global financial crisis – an update

Leaders from the G20 countries, the European Commission and other International bodies such as the Financial Stability Forum (FSF) have raised various concerns about the accounting standards as the financial crisis unfolds across the globe.

The initial concerns were targeted at the application of fair value accounting in illiquid markets and the need for increased transparency regarding off-balance sheet activities and fair value measurements. Those concerns were subsequently followed by calls for greater comparability between financial statements prepared under IFRS and U.S. GAAP and reduced complexity in accounting for financial instruments.

The IASB has acted swiftly to address the concerns raised by various stakeholders. Since our last update in June 2009, the IASB has accelerated a number of projects to address calls for greater comparability and reduced complexity in accounting for financial instruments. At the same time, new projects were added to address new accounting issues that surfaced as the financial crisis continues. These projects include:

- Replacing IAS 39 by 2nd quarter of 2010
- Reconsidering the appropriateness of including credit risk in liability measurement
- Addressing issues surrounding rights issues in foreign currency and accounting treatment for debt for equity swap

We summarise the progress of the accelerated and new projects below.

i. Update on IASB's activities in response to the financial crisis

Report issued by the FCAG

Brief summary

The IASB and the FASB (the boards) jointly set up the Financial Crisis Advisory Group (FCAG) to consider financial reporting issues arising from the global financial crisis. The FCAG will advise the boards about the standard-setting implications and potential changes to the global regulatory environment.

Progress to-date

The FCAG held six meetings from January to July 2009 and also solicited inputs from the public. In July 2009, the FCAG issued its report, setting out recommendations to the boards relating to accounting standard-setting activities, and other changes to the international regulatory environment following the global financial crisis.

The report focuses on recommendations to:

- Improve financial reporting especially for financial instruments, derecognition and consolidation
- Converge accounting standards
- Strengthen standard setters' independence and accountability
- Respond to the limitations in financial reporting

The FCAG believes the financial crisis exposed weaknesses in accounting standards and their application, but accounting standards were not a root cause of the financial crisis and did not lead to understatement of the value of assets.

Report issued by the FCAG (continued)

In its report, the FCAG cites four weaknesses in financial reporting standards and their application, revealed by the financial crisis:

- Difficulty in applying fair value accounting in illiquid markets
- Delayed recognition of losses on a variety of instruments measured at amortised cost due to the use of an incurred loss impairment approach
- Accounting standards currently permit off-balance sheet financing structures
- The complexity of accounting standards for financial instruments, including multiple approaches to measurement and impairment of financial instruments

To address these weaknesses, the FCAG recommends that the boards make simplifying, improving and converging their standards on financial instruments their highest priority. The FCAG also recommends the boards to:

- Reconsider the appropriateness of an entity's recognition of gains and losses as a result of fair value changes in the entity's own debt because of changes in its creditworthiness
- Explore alternative to incurred loss model for impairment of financial asset that use more forward-looking information

The FCAG also recommends that the boards set as their next level of priority, converged and improved standards on consolidation and derecognition to address off-balance sheet issues and converged solutions to the other agenda items specified in the Boards' Memorandum of Understanding.

The FCAG will reconvene in December 2009 to review the progress made on its recommendations.

Reducing the complexity of accounting standards for financial instruments

Brief summary

The IASB has received repeated messages from various stakeholders to simplify the accounting standards for financial instruments as preparers and users find the accounting standards complex and the results lack comparability and are difficult to understand.

A complete replacement of IAS 39 is expected by 2nd Quarter 2010

The need to review IAS 39 on a comprehensive basis is also driven by calls to have comparable accounting with entities preparing financial statements under U.S. GAAP especially in areas such as fair value accounting, classification and impairment of financial assets.

Further, many expressed concerns about the impairment loss model under IAS 39. The current impairment loss model under IAS 39 prohibits provision of impairment loss unless a triggering event has occurred after the initial recognition of a financial asset that has a negative effect on its future cash flows, and that effect can be reliably estimated. This is known as the incurred loss model. Under the incurred loss model, losses, including credit losses, expected as a result of future events, no matter how likely, are not recognised. Many believe that this results in a provision that is too late in the life of the financial assets to provide adequate "early" warning on the credit quality of that asset.

Progress to-date

The IASB adopted an aggressive timetable to complete a comprehensive review of IAS 39 before end of 2009 and at the May 2009 meeting, the IASB decided to replace IAS 39 in three phases:

- **Phase 1**- to replace the classification and measurement requirements by 4th quarter 2009
- **Phase 2** - to replace the impairment requirements by 2nd quarter 2010
- **Phase 3** - to simplify the hedge accounting requirements by 2nd quarter 2010

Phase 1 - Classification and measurement

The IASB published an ED on *Financial Instruments: Classification and Measurement* in July 2009 for public comment by 14 September 2009. The IASB is committed to make the final amendments on classification and measurement available for voluntary early adoption for 2009 financial statements. In Singapore, the ASC issued the same proposal for comment and the comment period closed on 19 August 2009.

The following are the key proposals in the ED:

i. Reduction in the number of measurement categories to two primary measurement categories for financial assets and financial liabilities: amortised cost and fair value. Financial instruments with basic loan features and are managed on a contractual yield basis would be measured at amortised cost. All other financial instruments would be measured at fair value.
ii. Embedded derivatives with financial host contracts would not be bifurcated; instead the hybrid financial instrument would be assessed as a whole to determine whether it would be measured at amortised cost of fair value.
iii. Allows an option to classify financial instruments that meet the amortised cost criteria as at fair value through profit or loss if doing so reduces accounting mismatches.
iv. If a financial instrument is measured at fair value, all changes in fair value would be recognised in profit or loss, with one exception:
    - For equity investments which are not held for trading, an entity can choose to recognise gains and losses in other comprehensive income with no recycling of gains and losses into profit or loss. If an equity instrument is so designated, then dividend income also would be recognised in other comprehensive income.
v. The classification of an instrument would be determined on initial recognition. No subsequent reclassifications will be permitted or required.
vi. The existing tainting provisions for disposals before maturity of a financial asset would be eliminated.
vii. The exemption allowing some unquoted equity instruments and related derivatives to be measured at cost would be eliminated.
viii. No change is proposed to accounting for embedded derivatives with non-financial host contracts.

Phase 2 - Impairment of financial assets

The IASB may be inclined to replace the current incurred loss model with an expected loss model.

The expected loss model considered by the IASB does not require impairment 'trigger' for recording impairment loss. Instead, credit losses that are expected at initial recognition are included in the estimated future cash flows used to compute the initial effective interest rate. Credit loss expectations would need to be re-estimated continuously and a subsequent or additional impairment loss might need to be recognised depending on such estimates. An adverse change in credit loss expectations, i.e. when credit losses are expected to be higher than previously expected, would result in an impairment loss that is recognised in profit or loss. A favourable change in credit loss expectations, i.e. when credit losses are expected to be less than previously expected, would result in a reversal of an impairment loss recognised in profit or loss.

To ascertain the feasibility of the expected loss model, the IASB published a Request for Information *('Expected Loss Model') Impairment of Financial Assets: Expected Cash Flow Approach* in June 2009 seeking inputs from respondents on the practical issues that would arise if an expected loss model is required for recording impairment of financial assets. The comment period closed on 1 September 2009. In Singapore, the ASC issued the same request for comment and the comment period closed on 7 August 2009.

Phase 3 - Hedge accounting

The IASB will deal with simplifying hedge accounting and increasing transparency in hedging activities after they have completed phase 1 and phase 2 above.

ii. New projects added to the IASB's activities

Examining the area of credit risk in liability measurement

Brief summary

The inclusion of an organistion's own credit risk in the measurement of its liabilities carried at fair value has always been a controversial issue. However, the effect on the income statement was not apparent when the economy was stable. During the financial crisis, an increasing number of entities' were recognising gains in the income statement on the reduction in the fair value of own debt from credit deterioration. This raise concerns about the decision-usefulness of reflecting gains when an entity's financial health is deteriorating and losses when the entity's financial health improves.

Progress to-date

The IASB published a Discussion Paper on *Credit Risk in Liability Measurement* in June 2009, seeking views on whether current measurements of liabilities (including fair value), at initial recognition and subsequent measurement, should incorporate the chance that an entity will fail to perform as required. If not, whether there should be an alternative measurement basis for liability. The comment period closed on 1 September 2009. In Singapore, the ASC issued the same request for comment and the comment period closed on 5 August 2009.

Addressing issues surrounding rights issues in foreign currency and accounting for debt for equity swap

Brief summary

As a result of the financial crisis, an increasing number of entities have undertaken rights issues or have renegotiated with their creditors to accept the entities' equity instrument, such as ordinary shares, as payment for all or a part of their existing debt obligations. Questions arise as to:

(i) Whether a call option, such as a rights issue, that would entitle the holder to receive a fixed number of the entity's own equity instruments when the price is fixed in a currency other than the entity's functional currency should be accounted for as a derivative liability

(ii) How an entity would recognise own equity instruments issued when those instruments are issued in connection with the extinguishment of a financial liability, i.e., as a result of a debt for equity swap

Two exposure drafts ED on *Classification of Rights Issues - Proposed Amendment to IAS 32 Financial Instruments: Presentation* and IFRIC Draft Interpretation on *Extinguishing Financial Liabilities with Equity Instruments* were issued in August 2009 for public comment by 7 September 2009 and 5 October 2009 respectively. The final standards are expected to be in place by fourth quarter 2009. In Singapore, the ASC issued the same exposure drafts for public comment and the comment periods closed on 23 August 2009 and 1 September 2009 respectively.

In the ED on *Classification of Rights Issues*, the IASB proposes that if the rights are issued *pro rata* to *all* of an entity's existing shareholders and are exercisable for a fixed amount of any currency, then the acquisition rights should be considered equity instruments.

In the draft IFRIC on *Extinguishing Financial Liabilities with Equity Instruments*, the IFRIC proposes that:

- Equity instruments issued in a debt for equity swap would be measured initially at the fair value of those equity instruments or at the fair value of the financial liability extinguished, depending on which is more reliably determinable
- Any gain or loss arising from the entire or partial extinguishment of a financial liability would be disclosed as a separate line item in the statement of comprehensive income and the separate income statement (if presented), or in the notes

D. XBRL filing – an update

Filing of financial statements with ACRA

The following three filing options are available for Singapore incorporated companies when they file their financial statements with ACRA:

1. **Option A** – Filing the full set of financial statements in XBRL format (full XBRL)
2. **Option B** – Filing certain financial statements in XBRL format together with a PDF copy of the full set of financial statements (partial XBRL)
3. **Option C** – Filing the full set of financial statements in PDF copy.

Option C is only available for companies excluded from XBRL filing requirements and companies filing financial statements relating to financial periods ended before 30 April 2007.

For companies that are required to file their financial statements in XBRL format, they may elect either Option A or B.

Three versions of the ACRA taxonomy

Companies only dealt with one version of the ACRA taxonomy in the past. Following the revisions to FRSs applicable for financial periods beginning on or after 1 January 2009, two additional versions are available from 31 August 2009.

A comparison of these versions is detailed below:

<table>
<tr><th>Version</th><th>1.22 (2007)</th><th>2.00 (2009)</th><th>2.01 (2009)</th></tr>
<tr><td>Applicable for financial statements with periods</td><td>Beginning on or before 31 December 2008</td><td>Beginning on or after 1 January 2009 or earlier if the company elects to adopt FRS 1 (2008) early</td><td>Beginning on or after 1 July 2009 or earlier if the company elects to adopt FRS 103 and FRS 27 (2009) early</td></tr>
<tr><td>Changes in titles used for primary financial statements</td><td>• Balance sheet
• Income statement
• Cash flow statement</td><td colspan="2">• Statement of financial position
• Statement of comprehensive income and/or Income statement
• Statement of cash flows</td></tr>
<tr><td rowspan="2">Differences between versions</td><td colspan="2">Presentation of components of other comprehensive income and “Total Comprehensive Income” in the Statement of Comprehensive Income</td><td></td></tr>
<tr><td></td><td colspan="2">Use of the term ‘Minority Interest’ vs. ‘Non-controlling Interests’</td></tr>
</table>

E. International developments

IFRS for Small and Medium-sized Entities (SMEs)

On 9 July 2009, the IASB published *IFRS for SMEs* and is intended to facilitate financial reporting for small and medium-sized (SMEs) entities by:

- Providing significantly less guidance than full IFRSs
- Simplifying in certain areas the recognition and measurement requirements compared to full IFRSs
- Removing the more complex option in certain areas in which full IFRSs allow for more than one accounting option

A summary of the key requirements in the *IFRS for SMEs,* and the significant differences between the *IFRS for SMEs* and existing IFRS requirements (full IFRS) is available in *IFRS Briefing Sheet* – Issue 144.

The *IFRS for SMEs* does not contain an effective date; instead, it will take effect from a date determined by the national regulator in each jurisdiction.

Singapore has yet to issue this new standard.

Amendments to IFRS 2 *Share-based Payment – Group Cash-settled Share-based Payment Transactions*

On 18 June 2009, the IASB issued amendments to IFRS 2 *Share-based Payment – Group Cash-settled Share-based Payment Transactions*. The amendments review the accounting for group cash-settled share-based payment transactions.

Currently effective IFRSs requires attribution of group share-based payment transactions only if they are equity-settled. The amendments resolve diversity in practice regarding attribution of cash-settled share-based payment transactions and require an entity receiving good or services in either an equity-settled or cash-settled payment transaction to account for the transaction in its separate or individual financial statements.

The amendments provide guidance on accounting for group cash-settled share-based payment transactions from the perspective of the receiving entity as well as the settling entity.

As a result of the amendments, IFRIC 8 *Scope of IFRS 2* and IFRIC 11 *IFRIC 2 – Group and Treasury Share Transactions* are incorporated into IFRIC 2 and withdrawn.

Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards – Additional Exemptions for First-time Adopters*

On 23 July 2009, the IASB issued amendments to IFRS 1 *First-time Adoption of IFRSs – Additional Exemptions for First-time Adopters*.

The amendments permit entities in the oil and gas industry to use their previous GAAP carrying amounts as deemed cost at the date of transition for oil and gas assets, in certain circumstances.

The amendments permit entities to not reassess the determination of whether an arrangement contains a lease in accordance with IFRIC 4 *Determining whether an Arrangement contains a Lease* if the same assessment was made under previous GAAP.

The amendments are effective for annual periods beginning on or after 1 January 2010. This means that first-time adopters of IFRSs who present two years of information in their first IFRS financial statements will apply the amendment to dates of transition on or after 1 January 2009. Early application is permitted.

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

ED 2009/8 *Rate-regulated Activities*

On 23 July 2009, the IASB issued ED 2009/8 *Rate-regulated Activities*. The objective of the proposals is to establish how assets and liabilities resulting from rate-regulated activities should be recognised and measured under IFRSs.

An entity would apply the proposals in the ED to its operating activities when:

(i) An authorised body establishes the price that the entity must charge its customers, and that price is binding

(ii) The price is designed to recover specific costs that the entity incurs in providing the regulated goods or services and to earn a specified return (cost-of-service regulation)

The IASB has invited comments on this ED by 20 November 2009.

ED 2009/4 *Prepayments of a Minimum Funding Requirement – Proposed amendments to IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

On 28 May 2009, the IASB issued ED *Prepayments of a Minimum Funding Requirement – Proposed amendments to IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*.

The proposed amendment is intended to address the accounting treatment for prepayments made when there also is a minimum funding requirement. The ED proposes to amend paragraph 30 of IFRIC 14 to specify that there is an asset to be recognised when there is a prepayment of the minimum funding requirement contributions.

The IASB and the ASC have invited comments on the ED. The comment period has closed.

ED *Management Commentary*

On 23 June 2009, the IASB issued an ED *Management Commentary*, which proposes a framework to assist in the preparation of management commentary that accompanies financial statements prepared in accordance with IFRSs. The proposals in the ED will not result in an IFRS; accordingly, once finalised, an entity will not be required to comply with the framework for the preparation and presentation of management commentary in order to assert compliance with IFRSs.

The IASB has invited comments on the ED by 1 March 2010.

Draft DP *Extractive Activities*

On 10 August 2009, the IASB released a working draft of a forthcoming DP *Extractive Activities* for informational purposes only. The draft DP proposes a new IFRS to replace IFRS 6 *Exploration for and Evaluation of Mineral Resources*. It proposes a single accounting approach for both minerals, and oil and gas extractive activities. Downstream activities, such as refining, sales and marketing, are excluded from its scope.

The IASB has not invited comments on this draft DP. It plans to request comments in the first quarter of 2010.

For a more detailed update on these, you can access our website 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 in Singapore
ACRA	– Accounting & Corporate Regulatory Authority
DP	– Discussion Paper
ED	– Exposure Draft
FASB	– U.S. Financial Accounting Standards Board
FSP	– FASB Staff Position
FRS	– Singapore Financial Reporting Standard
GAAP	– Generally Accepted Accounting Principles
IAS	– International Accounting Standard
IAASB	– International Auditing and Assurance Standards Board
IASB	– International Accounting Standards Board
IASC	– International Accounting Standards Committee
ICPAS	– Institute of Certified Public Accountants of Singapore
IFRIC	– International Financial Reporting Interpretations Committee
IFRS	– International Financial Reporting Standard
INT FRS	– Interpretation of Financial Reporting Standard
IRAS	– Inland Revenue Authority of Singapore
SGX	– Singapore Exchange
XBRL	– eXtensible Business Reporting Language

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