KPMG

Financial Reporting Matters

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In this issue, we discuss the recently issued FRSs on related party disclosures and the accounting for rights issues and debt for equity swaps. We also summarise other key developments that have an impact on financial reporting and provide an update on the IASB's activities arising from the global financial crisis.

AUDIT ▪ TAX ▪ ADVISORY



KPMG Seminar Series

Financial Reporting Standards | 2010 Update

Date
Wednesday, 21 April 2010

Time
9.00am to 5.30pm

Venue
Shangri-La Hotel, Singapore

Seminar Fees

Client: S$480.00 per participant
KPMG Alumni: S$480.00 per participant
Non-client: S$550.00 per participant

The fee is inclusive of GST at the prevailing rate, seminar materials, lunch and refreshments.

Registration
kpmg.com.sg/seminar

Closing Date
Thursday, 15 April 2010

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Please make cheque payable to KPMG LLP, 16 Raffles Quay, #22-00 Hong Leong Building, Singapore 048581. KPMG LLP will provide a tax invoice upon clearance of your cheque. Please inform KPMG LLP of substitution(s) prior to the event date to avoid inconvenience. In circumstances beyond our control, we reserve the right to cancel the event, or make changes to the schedules, venue and speakers.

Financial professionals need to keep abreast of changes in accounting and financial reporting requirements to effectively protect their organisation's marketplace credibility.

KPMG will be holding a seminar to help financial professionals keep up-to-date with the changes in reporting requirements. The seminar will provide a comprehensive update on the changes in accounting standards and interpretations that are effective for financial year beginning on or after 1 January 2010. The changes are illustrated with discussions on practical implementation issues.

Why Attend

The seminar will provide a comprehensive update on changes and current trends encompassing the following content areas:

- Revised FRS 103 *Business Combinations* and FRS 27 *Consolidated and Separate Financial Statements* (2009)
- *Improvements to FRSs* 2009
- Amendments to FRS 39 *Financial Instruments: Recognition and Measurement – Eligible Hedged Items*
- INT FRS 117 *Distributions of Non-cash Assets to Owners*
- Amendments to FRS 102 *Share-based Payment – Group cash-settled share-based payment transactions*

In addition, this seminar will discuss recently issued standards. An early understanding of the following standards would be useful in assessing the impact on business systems and processes:

- Amendments to FRS 32 *Financial Instruments: Presentation – Classification of Rights Issues*
- INT FRS 119 *Extinguishing Liabilities with Equity Instruments*
- Revised FRS 24 *Related Party Disclosures (2010)*

Who Should Attend

Chief Financial Officers, Financial Controllers, Accountants and those involved in the preparation and interpretation of financial statements. Other users of financial information will also find the seminar beneficial.

Presenters

Tan Yee Peng, Head of the Department of Professional Practice at KPMG in Singapore, and audit partners and senior managers will lead the seminar.

Revised standard on related party disclosures

On 22 January 2010, the ASC published the revised FRS 24 *Related Party Disclosures* (2010). FRS 24 (2010) simplifies the disclosure requirements for government related entities and clarifies the definition of a related party. FRS 24 (2010) supersedes FRS 24 (2004) with the same title and is the equivalent of the IASB's IAS 24 (2009) issued in November 2009.

What are the main changes of FRS 24 (2010)?

There are two main changes to FRS 24 (2010):
Firstly, entities that are controlled, jointly controlled or significantly influenced by the government are considered to be "government related" and can therefore benefit from the more "relaxed" modified related party disclosure requirements.

Secondly, the definition of a related party has been replaced. The new definition under FRS 24 (2010) will require companies to re-assess which new relationships to include as related party and which ones to remove from the related party disclosures.

In this issue, we discuss the reasons for the changes and highlight areas that may impact or change practice.

A. Related party disclosure requirements for government related entities

What are the reasons for the change?

In countries where government ownership, direct or indirect, extend to many commercial areas of the economy, complying with related party disclosures under the current FRS 24 (2004) can be difficult. It also can result in a significant amount of information needing to be disclosed for transactions which were not impacted by the related party relationship.

Under the revised FRS 24 (2010), government related entities can now opt to follow the "modified" disclosure requirements under paragraph 26 of FRS 24 (2010) and be relieved from the full disclosure requirements under paragraph 18 of FRS 24 (2010) in respect of certain related party transactions. The changes should result in government related entities focusing their disclosures on those transactions in which the relationship with the government may have played a role in either the occurrence of the transaction or its terms and conditions.

Who can benefit from the more relaxed disclosure requirements?

A reporting entity that is a 'government related' entity will benefit from the more relaxed disclosure requirements. A government related entity is an entity that is controlled, jointly controlled or significantly influenced by a government.

Full versus modified disclosure requirements

Below is a comparison of the related party disclosure requirements for government related entities under the "full" and "modified" disclosure requirements.

Full disclosure requirements	Modified disclosure requirements
1. Nature of relationship 2. Amount of transaction, for example: – Sales and purchases of goods or services – Sales and purchases of assets – Leases – Transfers of research and development – Transfer under license arrangements or finance arrangements – Guarantee or collateral 3. Outstanding balances, including their terms and conditions and details of guarantees given or received 4. Provision for doubtful debts and related expense, including bad debts, for the period	1. Name of government and nature of relationship 2. Nature and amount of each *individually significant* transaction 3. A qualitative or quantitative indication of the extent of other transactions that are *collectively, but not individually*, significant

What is the meaning of "significant"?

Under the modified disclosure requirements, an entity is required to make disclosure of individually or collectively significant transactions.

FRS 24 (2010) does not include any quantitative indications or "bright lines" concerning the meaning of "significant". However, the standard indicates that in determining the information to be disclosed, the reporting entity should consider the closeness of the related party relationship and other factors relevant in establishing the level of significance of the transaction, such as whether it is:

- significant in terms of size
- carried out on "non-market" terms
- outside normal day-to-day business operations, such as the purchase and sale of businesses
- disclosed to regulatory or supervisory authorities
- reported to senior management
- subject to shareholder approval.

How do we determine whether a transaction is collectively, but not individually significant?

Judgement will be required to determine whether a transaction is individually or collectively significant or whether it is insignificant.

This will include assessment of both quantitative and qualitative factors such as whether the transaction is on non-market terms or otherwise outside the normal day-to-day operations.

In this regard, it might be useful for entities to establish criteria that can be applied consistently in order to determine whether transactions are individually or collectively significant.

Consequential amendment to FRS 108 *Operating Segments*

As a result of the revised FRS 24 (2010), a consequential amendment was made to paragraph 34 of FRS 108 *Operating Segments*.

FRS 108 requires disclosure of reliance on major customers. Prior to the amendment, a group of entities known to a reporting entity to be under the control of the same government shall be treated as a single customer. The amended paragraph now requires entities to exercise judgement in assessing whether a government and entities known to the reporting entity to be under the control of that government are considered as a single customer. In doing so, it requires the reporting entity to consider the extent of economic integration between those entities.

Below are some factors that may be considered when determining the extent of economic integration:

- **Proximity of the relationship** between customers which are known to be government-controlled entities. For example, entities in the same closely-held group.
- **Centrally-controlled operations**. For example, if tenders or supply contracts for sales to these government controlled entities are required to be submitted via a central department responsible for budget allocation or other procurement policies, then this could indicate a level of economic integration of the entities.
- **Past events or circumstances** may provide an indication that common government control has resulted in economic integration of these customers.

B. New definition of a related party

Why was the definition of a related party changed and what are the major changes?

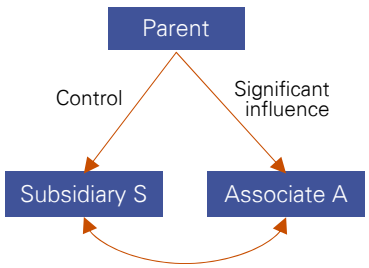
The current definition of a related party was criticised for being too complex, lacking symmetry and included some inconsistencies.

In summary, the major changes to the new definition of a related party under the revised FRS 24 (2010) are:

- Related party relationships are symmetrical in all cases (if A is related to B for the purpose of B's financial statements, then B also is related to A in A's books as well).
- All direct relationships involving control, joint control or significant influence are related party relationships.
- Significant influence and KMP relationships are treated as the same level of "closeness". These relationships are not as close as a relationship of control or joint control.
- Reference to associates and joint ventures specifically includes subsidiaries of those associates and joint ventures.

Which new relationships are now included in the revised definition?

1. An associate and a subsidiary of an investor



✓ **FRS 24 (2004):**
S is related to A in A's financial statements; but

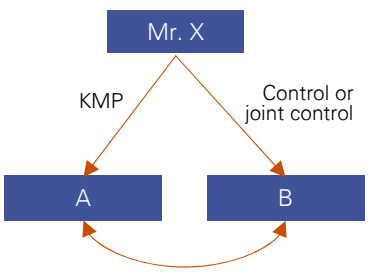
✗ A is not related to S in S's financial statements

✓ **FRS 24 (2010):**
S and A are related to each other in both A's and S's financial statements

Who is affected by this change?

The change will affect subsidiaries since management of subsidiaries is unlikely to possess full information on investments of its parent and may need to obtain it from its parent.

2. Investments of key management personnel (KMP)



✓ **FRS 24 (2004):**
B is related to A in A's financial statements

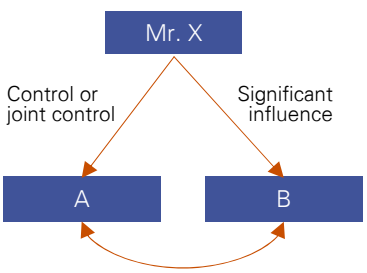
✗ A is not related to B in B's financial statements

✓ **FRS 24 (2010):**
A and B are related to each other in both A's and B's financial statements

Who is affected by this change?

The change will affect Entity B since it would require certain additional personal information about roles and / or investments held by individual investors (Mr. X) in other entities.

3. Other investments of an individual investor in a reporting entity



✗ **FRS 24 (2004):**
B is not related to A in A's financial statements

✗ A is not related to B in B's financial statements

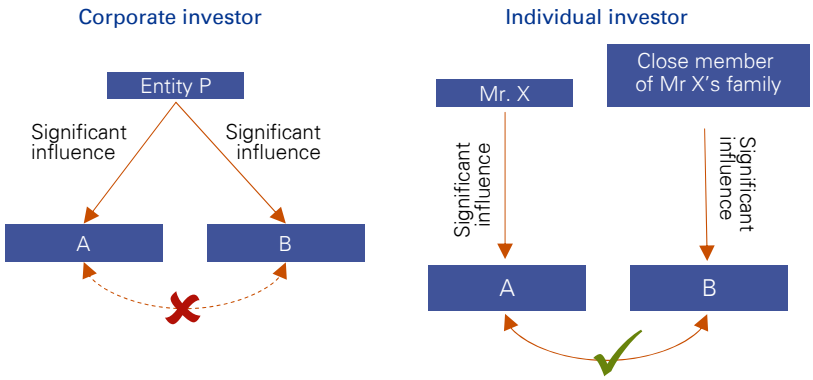
✓ **FRS 24 (2010):**
A and B are related to each other in both A's and B's financial statements

Under FRS 24 (2004), if a person has joint control over a reporting entity and a close member of that person's family has joint control or significant influence over another entity, then the second entity is treated as a related party of the reporting entity. However, the definition does not include relationships between two investees of the same individual, unless control exists over both.

Which old relationship is now excluded from the revised definition?

4. Eliminating inconsistencies with relationships between two associates

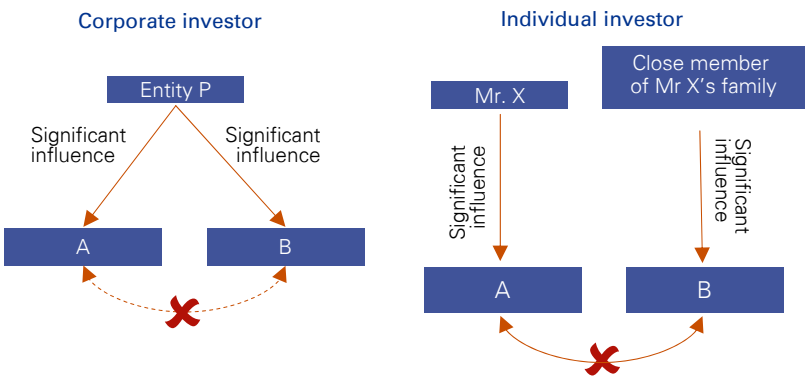
FRS 24 (2004)



FRS 24 (2004) does not treat two associates of a corporate investor as related parties to each other. However, if an individual investor's family has significant influence over one entity and a close member of that individual investor's family has significant influence over another entity, then these two entities would be treated as related parties.

FRS 24 (2010)

The revised standard removes these consistencies and the definition of a related party has been amended to exclude these relationships. The basis is that common significant influence is not sufficiently strong to create a related party relationship.



What are some of the practical issues arising from the new definition?

While removing the asymmetry and inconsistencies from the definition of a related party makes the standard more straightforward, all entities will need to re-assess their related party relationships.

Collection and disclosure of additional information may be required, especially in respect of other investments and roles of individual investors and their close family members.

Effective date and transitional provisions

FRS 24 (2010) specifies retrospective application for annual periods beginning on or after 1 January 2011.

Earlier application is permitted. Entities may early adopt either:

- all amendments (i.e. the modified disclosure for government related entities and the new definition of a related party)
- only the modified disclosure for government related entities (includes consequential amendment to FRS 108).

Entities cannot early-adopt the new definition of a related party on its own without adopting all other changes.

Find out more

First Impressions: Amendments to IAS 24 Related Party Disclosures
is a publication produced by KPMG International Standards Group.

This publication addresses the issues discussed above and other issues in greater detail. It also provides illustrative related party disclosures for government related entities.

This publication is available for download at:
http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/first-impressions/Pages/First-Impressions-Revised-IAS24.aspx.

Accounting for rights issues and debt for equity swaps

During the global financial crisis, many entities were raising funds from their existing shareholders through rights issues to meet their funding needs. Many others re-negotiated with their creditors to accept their own equity instruments, such as ordinary shares, as payment to extinguish or modify all or part of their existing debt obligations (i.e. debt for equity swap).

In October and November 2009, the IASB issued a limited scope amendment to IAS 32 *Classification of Rights Issues (Amendment to IAS 32 Financial Instruments: Presentation),* and an interpretation, IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*, to address weaknesses in the application of accounting standards on rights issues and debt for equity swaps.

Following the IASB lead, the ASC issued *Classification of Rights Issues (Amendment to FRS 32 Financial Instruments: Presentation*) and INT FRS 119 *Extinguishing Financial Liabilities with Equity Instruments* in November 2009 and January 2010 respectively.

The details of the new requirements are discussed below.

A. Classification of Rights (Amendment to *FRS 32 Financial Instruments: Presentation)*

What is a rights issue?

A rights issue entitles the holder the right but not the obligation to acquire a fixed number of new shares at a fixed exercise price within a specified period. The rights are generally offered *pro rata* to all existing holders of a class of equity shares for no consideration.

The exercise price is normally below the current market price of the shares so as to encourage subscription of the new shares. A rights issue is therefore similar to derivative instruments such as warrants and equity call options except that a rights issue usually expires within a short period of time (typically less than two months).

Why amend FRS 32?

FRS 32 *Financial Instruments: Presentation* allows a derivative instrument relating to an entity's own equity instruments (such as rights issue, warrant and equity call option) to be classified as equity if it results in the exchange of a fixed number of equity instruments for a fixed amount of cash or another financial asset (the "fixed for fixed" criterion).

If the exercise price of a rights issue is denominated in a foreign currency, the cash to be received on exercise of the rights would be variable when measured in the issuer's functional currency. Such rights would fail the "fixed for fixed" criterion for classification as an equity instrument and the issuer would have to account for the rights as a derivative liability with changes in fair value recognised in profit or loss.

Many view rights issue as transaction with owners. Often, the exercise price of the rights issued is fixed in a foreign currency because the entity is listed in one or more jurisdictions where the local currency is not the entity's functional currency. Classifying such an instrument as a derivative liability and recognising gains and losses in profit or loss fails to reflect the substance of the transaction.

Amended FRS 32 relaxes the "fixed for fixed" criterion

The amendment relaxes the "fixed for fixed" criterion. It allows the rights, options and warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency to be classified as equity instruments so long as the entity offers the rights, options or warrants *pro rata* to all of its existing owners of the same class of its own non-derivative equity instruments.

Pro rata distribution to all existing shareholders is a critical factor in this amendment as this indicates that the transaction is a transaction with owners. Therefore, no gain or loss should be recognised in profit or loss.

Illustrative example 1
Rights issue denominated in a currency other than the functional currency of the issuer

Facts
On 1 March 20X0, Entity A offered all of its existing shareholders rights to acquire one new ordinary share for every three ordinary shares held at a price of Singapore dollar (SGD) 1.00 per share.

A's functional currency is the Renminbi (RMB), and A has only one class of shares outstanding. There were a total of one million rights offered and they initially traded at SGD 0.15 each. The rights were subject to expiry on 15 March 20X0 and were fully subscribed on that date. The exchange rate of RMB to SGD is 5:1.

On 15 March 20X0, the share price was SGD 1.20 per share and the closing fair value of the rights was SGD 0.20 per share (i.e., SGD 1.20 – SGD 1.00).

Accounting treatment *prior* to the amendment:
The rights offered in SGD would have been accounted for as derivative liabilities.

On 1 March 20X0, a liability of RMB 750,000 (SGD 0.15 x 1 million x 5) would have been recognised with a corresponding debit to equity, representing the distribution of the rights to the shareholders.

On 15 March 20X0, the liability would have been re-measured at fair value, increasing to RMB 1 million (1 million x SGD 0.20 x 5), and a loss of RMB 250,000 (RMB 1 million – 750,000) would have been recognised in profit or loss.

On exercise of the rights, the cash proceeds of RMB 5 million (SGD 1 x 1 million x 5) and the closing fair value of the rights of RMB 1 million would have been credited to equity.

Accounting treatment *after* the amendment:
The rights offered in SGD would be classified as equity. Hence, no liability or gain or loss would be recognised in respect of the rights. On exercise of the rights, the cash proceeds of RMB 5 million would be credited to equity.

Effective date and transition

The amendment is applicable for annual periods beginning on or after 1 February 2010. Early application is permitted. The amendment, once effective, is to be applied retrospectively.

B. INT FRS 119 *Extinguishing Financial Liabilities with Equity Instruments*

To illustrate the application of INT FRS 119, let us look at the following typical scenario of a debt for equity swap.

Illustrative example 2
Accounting for debt for equity swap

Facts

In November 2009, Entity A breached the covenants stated in its five-year bond agreement. As a result, the outstanding bond became repayable on demand.

Entity A renegotiated with the bondholders and the bondholders agreed to accept Entity A's equity shares as full payment for the outstanding bond.

The equity shares were issued on 15 December 2009 and interest on the outstanding bond ceased to accrue from that date.

On 15 December 2009, the carrying amount (also the principal sum) and the fair value of the outstanding bond were SGD 50 million and SGD 45 million respectively and the fair value of the equity shares was SGD 55 million.

Question:

How should Entity A account for the debt for equity swap?

Before INT FRS 119 – Lack of guidance in FRSs

FRS 39.41 requires an entity to recognise in profit or loss the difference between the carrying amount of the financial liability extinguished and the consideration paid. The paragraph describes "consideration paid" as including non-cash assets transferred or liabilities assumed.

FRS 39 does not state specifically whether equity instruments issued in a debt for equity swap are also "consideration paid".

Furthermore, there is a lack of guidance in FRS 39 on the initial recognition and measurement of own equity instrument.

Therefore, in practice, a debt for equity swap is generally accounted for using one of the following methods:

Methods	Accounting entries based on facts in illustrative example 2
Measure the equity instruments ***at the carrying amount of the financial liability extinguished*** with no gain or loss recognised in profit or loss; or	Dr Bond liability $50 million Cr Share capital $50 million
Measure the equity instruments ***at the fair value of the financial liability extinguished*** and any difference between this amount and the carrying amount of the financial liability is recognised in profit or loss; or	Dr Bond liability $50 million Cr Profit or loss $ 5 million Cr Share capital $45 million
Measure the equity instruments ***at their fair value*** and any difference between this amount and the carrying amount of the financial liability is recognised in profit or loss.	Dr Bond liability $50 million Dr Profit or loss $ 5 million Cr Share capital $55 million

As you can see from the preceding table, the impact on the income statement of the debtor could vary significantly depending on the method applied.

After INT FRS 119

INT FRS 119 was issued to reduce the diversity noted in practice. It addresses the various issues surrounding the accounting by the debtor (i.e. Entity A in illustrative example 2 above) in a debt for equity swap.

In particular, INT FRS 119 clarifies that in a debt for equity swap:

(i) equity instruments issued to a creditor to extinguish all or part of a financial liability would be "consideration paid" in accordance with FRS 39.41.

(ii) the equity instruments issued would be measured initially at the fair value of the equity instruments unless that fair value cannot be reliably measured. In this case, the equity instruments should be measured to reflect the fair value of the financial liability extinguished.

(iii) any difference between the amount as determined in (ii) and the carrying amount of the financial liability would be recognised in profit or loss.

Therefore, on adoption of INT FRS 119, a debt for equity swap would be accounted for using method 3 unless the fair value of the equity shares issued cannot be reliably measured. In that case, an entity would account for the transaction using method 2. Method 1 will no longer be considered acceptable under INT FRS 119.

What is 'out-of-scope' of INT FRS 119?

INT FRS 119 only addresses the accounting by the debtor and does not address the accounting by the creditor in a debt for equity swap. In addition, the interpretation does not apply to the following transactions, where:

Scope exclusion	Illustrative example 3
The creditor is a shareholder and acting in that capacity	**Transaction with owner** **Facts** Holding Company A (Holdco A) has a wholly-owned subsidiary (Sub B). The subsidiary is funded partly by loan from Holdco A. The loan is quasi-equity in nature (i.e. Holdco A does not expect to recall the loan within the foreseeable future). To realise part of its investment in Sub B, Holdco A decides to launch an initial public offering (IPO) of Sub B's equity shares. As part of the restructuring for the IPO, Holdco A swaps its quasi-equity loan to equity shares of Sub B. **Analysis:** In this example, the creditor, Holdco A, is the sole shareholder of Sub B and the loan extended to Sub B is quasi-equity in nature. Therefore, it appears that Holdco A is acting in its capacity as a shareholder when it initiates the debt for equity swap. Hence, such swap will be out-of-scope of this interpretation.

Scope exclusion	Illustrative example 4
The two entities are under common control before and after the transaction and the substance of the transaction includes an equity contribution/ distribution	**Common control transaction** **Facts** Same facts as illustrative example 3, except that: Holdco A has another wholly-owned subsidiary (Sub C). Sub C is the treasury arm of the group and the quasi-equity loan is extended by Sub C (instead of Holdco A) to Sub B. As part of the restructuring for IPO of Sub B, Sub C swaps its quasi-equity loan to equity shares of Sub B. **Analysis** In this example, the creditor, Sub C, and the debtor, Sub B, are under common control of Holdco A before and after the swap and the loan extended to Sub B by Sub C is quasi-equity in nature. It appears that Sub C is acting on the instruction of Holdco A and the substance of the transaction includes an equity contribution/distribution. Therefore, such swap will be out-of-scope of this interpretation.

Scope exclusion	Illustrative example 5
The debt for equity swap is in accordance with the original terms of the financial liability	**Conversion of convertible notes** **Facts** Entity E issued convertible notes accounted for as a compound financial instrument under FRS 32 (i.e. debt component is classified as liability while the equity conversion option is classified as equity). On maturity, the noteholders exercised their equity conversion options in accordance with the original terms of the convertible notes. **Analysis** The conversion of the convertible notes by the noteholders to equity shares of Entity E, in accordance with the original terms of the convertible notes, will be out-of-scope of this interpretation. Instead, Entity E should account for the conversion in accordance with the current accounting treatment for conversion of a convertible note at maturity as prescribed in FRS 32.AG32.

Partial extinguishment of a financial liability under INT FRS 119

If only part of the financial liability is extinguished by the issuance of equity instruments, then an entity would need to assess whether some of the consideration paid relates to a modification of a part of the liability that remains outstanding.

If it does relate to a modification of the part of the liability that remains outstanding, then the entity should allocate the consideration paid between the part of the liability that is extinguished and the part of the liability that remains outstanding.

The consideration allocated to the part of the liability that remains outstanding should form part of the assessment of whether the terms of the remaining financial liability has been substantially modified from the terms of the original financial liability.

If the determination is made that the remaining financial liability has been substantially modified, then the entity would account for the modification as an extinguishment of the original financial liability. This would be recognised as a new financial liability, in accordance with the current accounting treatment for substantial modification of financial liability as prescribed in FRS 39.40.

Illustrative example 6
Partial extinguishment of a financial liability with equity shares and no modification of the remaining financial liability

Facts
Same facts as illustrative example 2, except that:

- Entity A re-negotiated with the bondholders and the bondholders agreed to accept Entity A's equity shares with fair value of SGD 15 million as payment to extinguish SGD 10 million of the outstanding principal.
- Entity A assessed that all equity shares issued to the bondholders are consideration paid to extinguish SGD 10 million of the outstanding principal.

Application of INT FRS 119:
Since all equity shares issued to the bondholders are consideration paid to extinguish part of the liability, the entire consideration is allocated to the part of liability that is extinguished. Entity A should account for the transaction as follows:

Dr Bond liability $10 million
Dr Profit or loss $ 5 million
Cr Share capital $15 million

The remaining liability of $40 million has not been modified and therefore, no further adjustment is required.

Illustrative example 7
Partial extinguishment of a financial liability with equity shares and modification of the remaining financial liability is not substantial

Facts
Same facts as illustrative example 6, except:
- At the same time, the bondholders agreed to increase the rate of interest payable on the remaining outstanding bond and to extend the repayment term of the remaining outstanding bond.
- Entity A assessed that part of the equity shares issued to the bondholders (with fair value of SGD 2 million) are consideration paid to modify the part of the liability that remains outstanding.
- Entity A determined that the terms of the remaining outstanding bond are not substantially modified in accordance with FRS 39.AG62.

Application of INT FRS 119
Since the equity shares issued to the bondholders are partly consideration paid to extinguish part of the liability and partly consideration paid to modify the terms of the liability that remains outstanding, Entity A should allocate the consideration paid between the part of the liability that is extinguished and the part of the liability that remains outstanding.

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Entity A should account for the part of the liability that is extinguished as follows:

Dr Bond liability $10 million
Dr Profit or loss $ 3 million
Cr Share capital $13 million ($15 million - $2 million)

The part of the liability that remains outstanding (principal and carrying amount of $40 million) has not been substantially modified. Therefore, all costs or fees incurred should be adjusted against the carrying amount of the liability. The accounting entries would be:

Dr Bond liability $2 million
Cr Share capital $2 million

The difference in the present value of estimated cash flows of the part of the liability that remains outstanding before and after the change in terms should be recognised as an adjustment to the effective interest rate and amortised over the remaining life of the liability.

Illustrative example 8
Partial extinguishment of a financial liability with equity shares and modification of the remaining financial liability is substantial

Facts
Same facts as illustrative example 7, except:

- Entity A determined that the terms of the remaining outstanding bond are substantially modified in accordance with FRS 39.AG62.
- At the date of modification, the fair value of the modified bond that remains outstanding was SGD 41 million.

Application of INT FRS 119
Since the equity shares issued to the bondholders are partly consideration paid to extinguish part of the liability and partly consideration paid to modify the terms of the liability that remains outstanding, Entity A should allocate the consideration paid between the part of the liability that is extinguished and the part of the liability that remains outstanding.

Entity A should account for the part of the liability that is extinguished as follows:

Dr Bond liability $10 million
Dr Profit or loss $ 3 million
Cr Share capital $13 million ($15 million - $2 million)

The part of the liability that remains outstanding (principal and carrying amount of $40 million) has been substantially modified. Therefore, Entity A should account for the transaction as an extinguishment of the original financial liability and recognise a new modified financial liability at its fair value at the date of modification. The accounting entries would be:

Dr Bond liability $40 million
Dr Profit or loss $ 3 million
Cr Share capital $ 2 million
Cr New Bond liability $41 million

Additional disclosure introduced by INT FRS 119

INT FRS 119 requires any gain or loss arising from the full or partial extinguishment of a financial liability as described above to be disclosed as a separate line item in the profit or loss, or in the notes.

Effective date and transition

INT FRS 119 applies retrospectively and is effective for annual periods beginning on or after 1 July 2010. Early application is permitted.

Singapore Exchange developments

In this section, we highlight three key developments in SGX regulations since our last issue in December 2009.

Development #1

Extension granted to Watch-List companies

On 10 February 2010, the SGX granted a 12-month extension to Watch-list companies to improve their financial performance and meet the requirements to exit from the Watch-list.

Listed companies are placed on the "Watch-list" if they register pre-tax losses for three most recently completed consecutive financial years and have an average daily market capitalisation of less than S$40 million over the last 120 market days.

Prior to the extension, Watch-list companies were given 24 months to restore its financial health to prescribed levels as stipulated in SGX-ST Listing Rule 1314.

A list of the Watch-list companies is available on the SGX website.

Development #2

Proposed revisions to the listing rules

Comment period closed on 3 February 2010

On 6 January 2010, the SGX issued proposed revisions to its Mainboard admission criteria.

The proposed revisions are:

1. Revised admission criteria for Mainboard listing.
2. Listing of Special Purpose Acquisition Companies (SPAC).
3. Formalising measures for secondary fund raising.

Raising the bar on admission criteria for the Mainboard

1. Revised admission criteria for Mainboard listing

SGX is proposing to raise the bar on its Mainboard (MB) admission criteria. Distinguishing between the larger and more established companies on the MB from the fast-growing companies on Catalist will be clearer.

The quantitative admission criteria under the current and the proposed listing rules are compared in the table below:

Current admission criteria	Proposed admission criteria
One of the three situations must be met by the MB listing applicant: (a) Pre-tax profits ≥ SGD 7.5 million for the last three years + pre-tax profit ≥ SGD 1 million for each of those three years or (b) Pre-tax profits ≥ SGD 10 million for the last one or two years or (c) Market capitalisation ≥ SGD 80 million*.	One of the two situations must be met by the MB listing applicant: (a) Must be profitable in the latest financial year + have an operating track record of three years + market capitalisation ≥ SGD 150 million* or (b) Must have generated operating revenue in the latest financial year + a market capitalisation ≥ SGD 300 million*.

- *Based on the issue price and post-invitation issued share capital.*

The proposed MB admission criteria will also apply to reverse takeovers. Catalist companies seeking a transfer to the MB must meet proposed criterion (a).

The SGX expects the proposed admission criteria to be implemented in the fourth quarter of this year.

Proposal to allow special purpose acquisition companies to raise funds

2. Listing of Special Purpose Acquisition Companies (SPAC)

SGX is also proposing the listing of SPACs.

SPACs are shell companies with no prior operating history seeking an initial public offering (IPO) to raise funds, and use those proceeds to acquire operating businesses sometime in the future. Since SPACs are listed vehicles with unique features, the SGX has formulated a separate listing framework with safeguards.

Some of the proposed criteria for listing a SPAC are:

- A minimum of 25 percent of their total number of issued shares have to be held by not less than 300 public shareholders.
- Market capitalisation of not less than S$150 million.
- To place at least 95 percent of their IPO proceeds in an escrow account. Funds cannot be drawn down except for purchase of business.
- To cap the equity interest to be given to SPAC's founding shareholders without an equity contribution equivalent to that of public shareholders to 10 percent of the SPAC's post-invitation issued share capital.
- To require founding shareholders to subscribe to at least 2 percent of the post-invitation share capital.
- Founding shareholders and their associates shall not be permitted to approve a business combination; approval shall be obtained by a majority of votes by independent shareholders.
- If the completion of a business combination exceeds a time frame of three years, the SPAC will be liquidated.
- The total value of the businesses or assets to be acquired by a SPAC should represent at least 80 percent of the SPAC's net asset value.
- To allow public shareholders who vote against the business combination to have an exit alternative, and have the right to redeem their shares for a pro-rata share of the cash in escrow in the event that the business combination is approved and completed.

Formally adopting measures to facilitate fund raising exercises

3. Formalising measures for secondary fund raising

SGX would like to formalise measures that had been temporarily introduced in early 2009 to facilitate secondary fund raising.

There are three measures that the SGX proposes to formally adopt:

i. **To reduce the required notice period** for a books closure date from 10 market days to five market days.

ii. **To clarify that an issuer may undertake a non-renounceable rights issues** if:
   - Specific shareholders' approval is obtained, or
   - By utilising a general mandate where the issue price of the rights share is at a discount of less than 10 percent.

iii. **To remove the requirement of shareholders' approval** for scrip dividend schemes and to clarify that these schemes must provide shareholders with a cash option.

Development #3

Proposed amendments to listing rules to strengthen corporate governance

Comment period closed on 15 January 2010

On 9 December 2009, the SGX issued a consultation paper on the proposed amendments to strengthen corporate governance in both the MB and Catalist listing rules. The proposals arose from SGX's annual rule reviews.

The proposed amendments are a positive step towards greater transparency and accountability. There are 36 proposed amendments touching various areas throughout the initial listing rules as well as the continuing listing obligations. We summarise the key proposed changes focusing on those having disclosure implications and those resulting in change in practice.

Amendments having disclosure implications

- **Confirming the suitability of the CFO and new director**
  The nominating committee (NC) will be required to provide a statement opining on the suitability of the CFO (along with the concurrence of the audit committee) when applying for listing on the SGX, and on a continuing basis whenever a new CFO is appointed. The NC is also required to provide similar assurances regarding the appointment of a new director.
- **Confirming the suitability of the appointed auditor**
  The issuer's directors must confirm that due consideration to the suitability of the accounting firm was exercised when first listed on the SGX, each year subsequently in its annual reports and whenever a new auditor is appointed.
- **Opining on the adequacy of internal controls**
  The Audit Committee will be required to provide their opinion on the adequacy of internal controls and risk management policies and systems in the annual report.
- **Disclosing audit fees paid**
  In addition to the current requirement to disclose non-audit fees paid to the auditors, the annual report shall also disclose the audit fees paid.
- **Unusual conditions in loan agreements involving shareholders**
  An issuer will be required to disclose any loan agreements or issue of debt securities that contain conditions making reference to the shareholding interests of any shareholder, or which places restrictions on any change in control of the issuer.
- **Disclosing pledging arrangements**
  Shareholders will be required to notify the issuer in writing when their shares in the company are pledged under circumstances where it may result in a possible change in control in the issuer, or may cause the issuer to breach its loan covenant. The issuer will then have to announce the details of the notification.

Amendments resulting in change in practice

- Joint sign-off by a Singapore-based accounting firm on the issuer's audited accounts when both the issuer's principal operations and its auditors are based in a foreign jurisdiction.
- The issuer's article of association must provide that there shall be at least one independent director remaining in office at all times.
- The issuer's principal subsidiaries that operate outside Singapore shall have at least one independent director who is resident in Singapore on their board of directors.
- The SGX will have the discretion to require the appointment of a governance advisor to help newly listed issuers.

Other key amendments

- Under specific circumstances such as where the issuer is the subject of an investigation of irregularities, the issuer will be required to obtain SGX approval for the appointment of directors, CEOs and CFOs.
- When shares are under a trading suspension, all transfers of shares will be restricted.

Disclosure of top five executives' remuneration is not mandatory for 2009 annual reports

The amendments issued by SGX in March 2009 mandates the Code of Corporate Governance requirement on the disclosure of the remuneration of directors and *top 5* executives (who are not also directors) in bands of $250,000. In *Financial Reporting Matters* – June 2009, we interpreted this as a mandatory disclosure.

It should be noted that this same requirement is also issued as part of the Consultation Paper (development #3 above) issued on 9 December 2009. The SGX has recently clarified that for the 2009 annual report, the disclosure is not mandatory and a "*disclose or explain*" regime will suffice. This means that if an entity does not disclose the remuneration of the top five executives, they would need to explain the reason for the non-disclosure.

For 2010 annual reports however, the disclosure will likely be required once the Consultation Paper on strengthening corporate governance is implemented.

Find out more

The consultation paper is available for download from the SGX's website at www.sgx.com

Other local developments

ACRA Taxonomy for XBRL financial statement filings

On 9 February 2010, ACRA announced changes to ACRA Taxonomy and FS Manager that will enhance the quality of XBRL financial statements and the corresponding copy of financial statements in PDF format stored in the registry.

We highlight two of these changes:

Notice of Error

When typographical or clerical errors are discovered in past XBRL filings, companies are required to file a Notice of Error (NOE) to rectify these errors in Bizfile.

New validation rules

The majority of the validation rules target errors in all XBRL financial statements. Companies should feel little impact of the implementation of the validation rules if the XBRL financial statements have been correctly prepared.

ASC issues amendments to INT FRS 114

*Prepayments of a Minimum Funding Requirement (*Amendments to INT FRS 114*: FRS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction)*

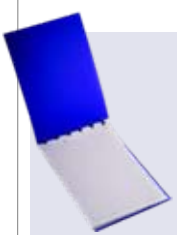
On 22 January 2010, the ASC published the amendments to INT FRS 114. The amendment to INT FRS 114, which is itself an interpretation of FRS 19 *Employee Benefits*, applies in the limited circumstances when an entity is subject to minimum funding requirements (MFR) and makes an early payment of contributions to cover those requirements. The amendment permits such early payment to be recognised as an asset rather than an expense on the basis that the entity has a future economic benefit from the prepayment in the form of reduced cash outflows in future years in which MFR payments would otherwise be required. The amendments shall be applied for annual periods beginning on or after 1 January 2011, with earlier application permitted.

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

The Financial Crisis Advisory Group (FCAG) reconvened in London, England on 15 December 2009 to review the IASB and the FASB's (the Boards) progress made on its recommendations contained in the July 2009 FCAG report.

Highlights from the 15 December 2009 FCAG meeting

The FCAG stated that they were encouraged by the Boards' progress to-date, but urged them to work harder on achieving convergence of financial accounting standards. Concerns stemmed from how differently the IASB and the FASB were developing the financial instruments accounting standard. The IASB addressed it in three different phases, while the FASB preferred to discuss all issues in one comprehensive document. According to the FCAG, convergence is more difficult to achieve in a timely manner when one Board publishes guidance before the other has had a chance to deliberate the issues and publish similar guidance.



What is the FCAG?

In 2008, the IASB and the FASB established the FCAG to advise the Boards about the standard-setting implications of the global financial crisis and potential changes to the global regulatory environment.

Members of the FCAG are senior leaders with broad international experience in financial markets. In July 2009, the FCAG issued a report recommending that the Boards make simplifying, improving and converging their standards on financial instruments their highest priority. Their next level of priority should be to converge and improve standards on consolidation and derecognition to address off-balance sheet issues.

To facilitate convergence, the Boards agreed to hold joint monthly meetings as opposed to tri-annually, and to provide quarterly progress reports on their activities. In addition, more efforts will be made to align the timing of projects in order to ensure, when possible, the publication of consistent proposals and /or standards.

The FCAG tentatively scheduled to hold another meeting in October 2010.

Noting that the IASB will be working together more closely with the FASB to achieve convergence, we summarise the IASB's progress on the following projects since our last update in December 2009 below:

1. Reducing the complexity of accounting standards for financial instruments.
2. Addressing issues surrounding rights issues in foreign currency and accounting for debt for equity swap.
3. Improving standards on fair value measurement.
4. Improving the accounting for off-balance sheet vehicles.

1. Reducing the complexity of accounting standards for financial instruments

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

Brief summary

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

The need to review IAS 39 *Financial Instruments: Recognition and Measurement* 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.

A complete replacement of IAS 39 is expected by the end of 2010

Progress to-date

The IASB adopted a timetable to complete a comprehensive review of IAS 39 by the end of 2010 in three phases:

- **Phase 1** replace classification and measurement requirements :
  1. Financial assets: final standard was published on 12 November 2009
  2. Financial liabilities: to be completed during 2010
- **Phase 2** replace the impairment requirements by the fourth quarter of 2010
- **Phase 3** simplify the hedge accounting requirements by the fourth quarter of 2010

Phase 1 - Classification and measurement

Phase 1 – financial assets

The IASB completed and issued the first phase of IFRS 9 *Financial Instruments* on the classification and measurement of *financial assets* on 12 November 2009. This represents the first chapters of the new standard on accounting for financial instruments. We summarised the key changes of IFRS 9 from the existing IAS 39 in *Financial Reporting Matters* – December 2009.

Phase 1 – financial liabilities

An ED on classification and measurement of *financial liabilities* is planned for issuance during the first quarter of 2010. This coincides with the timing of the FASB's comprehensive ED on financial instruments accounting.

Adoption of IFRS 9

Although the IASB quickly completed this phase of the project in time to allow companies to early-adopt in 2009, the European Union (EU) decided not to accelerate the endorsement process for IFRS 9 because it wanted to wait for the completed review of IAS 39. As a result, companies in the EU were not able to early-adopt IFRS 9 in 2009.

In Singapore, the ASC also decided to defer the adoption of IFRS 9. Although Phase I of IFRS 9 is considered to be complete, further amendments in the future may be made to it. The FASB has yet to issue their proposal on financial instruments accounting, which is expected in the first quarter of 2010. So far, the FASB's approach is different from the IASB's. If the final standards issued by the IASB and the FASB are significantly different, then both will need to work towards reducing the differences. It may be possible that the IASB will make additional changes to IFRS 9 in order to achieve convergence with U.S. GAAP. The ASC intends to re-deliberate its decision later during the year.

Phase 2 - Impairment of financial assets

Exposure draft open for public comment

The IASB issued ED/2009/12 *Financial Instruments: Amortised Cost and Impairment* for public comment by 30 June 2010. In Singapore , the ASC issued the same proposal for comment by 30 April 2010. A summary of the proposal can be found in *Financial Reporting Matters* – December 2009.

Expert panel to resolve practical issues for the proposed 'incurred loss' model

Following the issuance of ED/2009/12 in November 2009, the IASB formed an Expert Advisory Panel (the Panel) to advise the IASB on the operational aspects of implementing the IASB's proposed changes to requirements for recognising and measuring impairment of financial instruments measured at amortised cots. The Panel also will assist with field testing and identifying further practical expedients. The Panel includes representatives from large institutions, mainly from the financial sector, accounting firms and the FASB.

Convergence work with the FASB

With respect to working together on this issue, both Boards noted that while they are committed to forward-looking impairment models, the issue remains as to how far forward an entity should be looking. The FASB's current opinion is that the period of forecasting future losses should be reasonable and reviewable by prudential supervisors. The IASB plans to issue a request for comment on the FASB's proposals when issued and the Boards plan to finalise their standards together.

Phase 3 - Hedge accounting

Phase 3 deals with simplifying hedge accounting and increasing transparency in hedging activities. The IASB is working jointly with the FASB to address all hedge accounting issues together in the first quarter of 2010. The IASB is currently conducting outreach with its constituents and expects to issue an exposure draft on hedge accounting in first quarter 2010.

2. 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:

- 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.
- how an entity would recognise its 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.

Progress to-date

(i) The IASB published *Classification of Rights Issues (Amendment to IAS 32)* on 8 October 2009. This amendment addresses the accounting for rights issues (rights, options and warrants) that are denominated in a currency other than the functional currency of the issuer.

In Singapore, the ASC issued the equivalent amendment on 18 November 2009. This amendment is discussed in greater detail on page 9 of this publication.

(ii) The IASB published IFRIC Interpretation 19 *Extinguishing Financial Liabilities with Equity Instruments* on 26 November 2009 to provide guidance on how to account for the extinguishment of a financial liability by the issue by equity instruments.

In Singapore, the ASC issued the equivalent interpretation on 22 January 2010. This amendment is discussed in greater detail on page 9 of this publication.

3. Improving standards on fair value measurement

Brief summary

Currently, guidance on how to measure fair value is dispersed across standards and is in some cases, inconsistent.

Progress to-date

As agreed in the 15 December 2009 FCAG meeting, the IASB and the FASB will work towards eliminating difference between the IASB's ED on fair value measurement and the FASB *Accounting Standards Codification Topic 820 (Fair Value Measurements and Disclosures*).

A converged final standard on fair value measurement is expected in September 2010.

4. Improving the accounting for off-balance sheet vehicles

Brief summary

The **consolidation project** addresses situations where entities may not have accounted for all the entities they control, such as certain special purpose entities used for securitisation transactions.

The **derecognition project** addresses concerns that some entities may have stopped accounting for assets they still control.

Progress to-date

The consolidation project:

The IASB and the FASB deliberated issues on the consolidation guidance during the December 2009 and January 2010 joint meetings. The IASB will publish an updated draft of their proposal together with a request for comments on the FASB's ED at the same time as when the FASB proposals will be published. The FASB ED on consolidation is expected to be published in the second quarter of 2010. Both the IASB and the FASB plan to finalise their standards together by the end of 2010. We discussed the "single control model" in the proposed consolidation guidance in *Financial Reporting Matters* – March 2009.

The derecognition project:

During the December 2009 and January 2010 meetings, the IASB continued to discuss comments received from the public on the proposed guidance.

A final amendment of the derecognition guidance in IAS 39 is expected in the second half of 2010.

International developments

Limited Exemption from Comparative IFRS 7 *Disclosures for First-time Adopters* – Amendment to IFRS 1

On 28 January 2010, the IASB published the *Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters* – Amendment to IFRS 1.

The IASB decided to amend IFRS 1 to provide to first-time adopters the same relief from the requirement to provide comparative period disclosures for the information required to be presented by the Amendments to IFRS 7 *Financial Instruments – Improving Disclosures about Financial Instruments* as it had to existing IFRS reporters. In that way, first-time adopters are not disadvantaged as compared with current IFRS reporters.

As a consequence of the amendment to IFRS 1, the IASB decided to clarify the transition provisions of the Amendments to IFRS 7. In summary, the IASB clarified that information for comparative periods, i.e., periods before the Amendments to IFRS 7 become effective, including an opening statement of financial position as at a date before 31 December 2009, need not comply with the disclosures required by the Amendments to IFRS 7.

For illustrative examples of the clarified transition provisions, refer to *Briefing Sheet* – Issue 170.

The amendment to IFRS 1 is effective for annual periods beginning on or after 1 July 2010 with early application permitted.

In Singapore, the ASC has not yet issued the equivalent amendment.

ED/2010/1 *Measurement of Liabilities in IAS 37 – Proposed amendments to IAS 37*

On 5 January 2010, the IASB issued ED *Measurement of Liabilities in IAS 37 – Proposed amendments to IAS 37 (the 2010 ED)*. The 2010 ED is a follow-up to 2005 ED *Proposed Amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets and IAS 19 Employee Benefits*.

The 2010 ED focuses on the following aspects of the proposed measurement requirements for liabilities:

- A high-level measurement objective for liabilities and application of that measurement objective. As part of this project the IASB has decided to mandate the use of expected value to measure all liabilities, including single obligations (e.g. lawsuits), but the IASB is not inviting comments on this as part of the 2010 ED.
- Measuring obligations involving services (e.g., decommissioning) by reference to the price that a contractor would charge to undertake the service i.e. including a profit margin; this would be irrespective of the entity's intentions with regard to settling the obligation, i.e. irrespective of whether the entity intends that the work will be carried by an in-house team or external contractors.
- Continuing the current IAS 37 accounting for onerous contracts via a limited exception to the proposed measurement requirements.

The IASB has invited comments on this ED by 12 April 2010. In Singapore, the ASC has requested comments by 15 March 2010.

Find out more

For a more detailed update on these, you can access our website at:

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

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Common abbreviations

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

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