

# FINANCIAL REPORTING MATTERS

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In August 2012, the ASC announced that the mandatory effective date for the suite of consolidation standards will be pushed back to the beginning of 2014. This deferral reflects the significant challenges faced by entities in implementing these standards, and we strongly encourage entities to continue working on assessing the impact of these standards. We analyse situations where early adoption may be beneficial and examine what needs to be done when applying the standards for the first time. We also discuss changes in accounting for “joint ventures” arising from the new standard on joint arrangements.

The only mandatory change in accounting standards for the 2012 financial year relates to deferred tax on investment properties. We highlight a practical issue that arises when a tax planning strategy is employed by interposing holding companies to hold overseas investment properties.

For readers who are keen on financial reporting by unit trusts and REITs under the revised RAP 7, we have added a stand-alone supplement section in this issue to facilitate quicker access.

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We discuss the changes introduced by the revised RAP 7 and highlight our current interpretation of those changes.

# 1. Consolidation standards – Effective date and first-time application issues

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The Singapore Accounting Standards Council (ASC) has deferred the mandatory effective date of the suite of consolidation standards for a year to annual periods beginning on or after 1 January 2014. In this section, we discuss how this may impact you and what you should know when you adopt the consolidation suite for the first time.

## Why did the ASC delay the effective date?

On 31 August 2012, the ASC announced that it will allow stakeholders more time to implement the suite of consolidation standards, comprising FRS 110 *Consolidated Financial Statements*, FRS 111 *Joint Arrangements*, FRS 112 *Disclosure of Interests in Other Entities*, FRS 27 *Separate Financial Statements* and FRS 28 *Investments in Associates and Joint Ventures* (collectively the Relevant Standards).

The Relevant Standards were originally scheduled to be applied to annual periods beginning on or after 1 January 2013. The mandatory effective date has now been deferred for a year to annual periods beginning on or after 1 January 2014. Earlier application of the Relevant Standards continues to be permitted, subject to the requirements for earlier application as set out in the Relevant Standards.

The deferral of the mandatory effective date for the Relevant Standards is a departure from the IFRS consolidation suite which is effective for annual periods beginning on or after 1 January 2013. However, this is unlikely to result in significant differences between FRS and IFRS financial statements except for the annual periods in which the IFRS consolidation suite is applied for the first time.

*"In its ensuing engagement with stakeholders after the Relevant Standards were issued, the ASC has been apprised that the challenges faced by stakeholders in implementing the Relevant Standards were more significant than the stakeholders had anticipated and accordingly, more time would be required to effect the implementation plans that they had put together for the Relevant Standards."*

The ASC, 31 August 2012

## Insights – Should you early adopt?

### Situations where early adoption may be beneficial

#### Entities with group reporting requirements

Group reporting requirements may be particularly relevant when deciding whether or not to early adopt. For an entity that has to apply IFRS for group reporting purpose, the business case for early adoption will be more compelling since it would avoid the need to maintain two sets of parallel accounts (i.e. one in FRS for statutory reporting and another in IFRS for group reporting). Such entities would include Singapore-incorporated subsidiaries or Singapore branches of foreign companies.

### Situations where early adoption may *not* be beneficial

#### Entities that may qualify as investment entities

On the other hand, entities that are expected to be affected by the IASB's exposure draft *Investment Entities* would stand to benefit from the deferral. The exposure draft proposes to amend IFRS 10 to provide a consolidation exception for qualifying investment entities. Such entities would be required to recognise their investments in controlled entities at fair value through profit or loss, instead of consolidating them. The consolidation exception amendments are expected to be issued by the IASB in Q4 2012 and effective for annual periods beginning on or after 1 January 2014. This coincides with the deferred effective date of the Relevant Standards and avoids situations where an investment entity consolidates their controlled entities in FY2013 and then deconsolidates them in FY2014, for example.

## New transition rules

In June 2012, the IASB issued *Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance* (Amendments to IFRS 11, IFRS 11 and IFRS 12) effective for annual periods beginning on or after 1 January 2013. On 6 September 2012, the ASC issued identical transition amendments but with an effective date aligned with the Relevant Standards i.e. annual periods beginning on or after 1 January 2014.

Depending on the extent of comparative information provided in the financial statements, the transition amendments simplify the transition and provide additional relief from disclosures that could have been onerous.

Early adoption of the transition amendments is required in the event that the Relevant Standards are adopted early.

*"The amendments simplify the process of adopting IFRSs 10 and 11, and provide relief from the disclosures in respect of unconsolidated structured entities – disclosures that could have been onerous to make retrospectively."*

**Paul Munter, KPMG's global IFRS business combinations and consolidation leader**



**Making adoption of the consolidation suite easier**

*No retrospective application required if consolidation conclusion is unchanged at date of initial application*

*If consolidation conclusion changes, restatement of comparatives are required only for the immediately preceding period*

*Comparatives for disclosures relating to unconsolidated structured entities are not required*

**Clarification on date of initial application**

The date of initial application is now defined in FRS 110 as the beginning of the annual reporting period in which the standard is applied for the first time. At this date, an entity tests whether there is a change in the consolidation conclusion for its investees. If an entity with a calendar year end does not early adopt FRS 110, then the date of initial application is 1 January 2014.

If the consolidation conclusion for an investee remains unchanged at the date of initial application, then no adjustments to the previous accounting are required. This avoids the need to consolidate and then deconsolidate a controlling interest that was disposed of in the comparative period, for example.

The impact of consolidation/deconsolidation on the adoption of FRS 110 is explained in the illustrative examples below.

**Requirement to restate comparatives limited to one year**

If the consolidation conclusion changes at the date of initial application, retrospective adjustments have to be determined.

However, the amendments limit the restatement of comparatives to the immediately preceding period; this applies to the full suite of consolidation standards. Entities that provide comparatives for more than one period have the option of leaving additional comparative periods unchanged.

**Change in policy disclosures not required in current year**

Disclosure of the impact of the change in accounting policy is only required for the period immediately preceding the date of adoption i.e. for 2013 for an entity with a calendar year end that does not early adopt the Relevant Standards.

**Prospective disclosures for unconsolidated structured entities**

In addition to limiting the comparative information to be disclosed under FRS 112, all entities will benefit from further relief from the disclosures in respect of unconsolidated structured entities.

These disclosures may be made prospectively from the date of initial application i.e. from 1 January 2014 for an entity with a calendar year end that does not early adopt the Relevant Standards.

*Where the consolidation conclusion is the same at date of initial application, FRS 110 does not require any further analysis.*

*If it is impracticable to measure the net assets and NCI at the exact acquisition date, then the deemed acquisition date is the beginning of the earliest period for which it is practicable to do so. The immediately preceding period is restated unless the deemed acquisition date is the beginning of the current period.*

### Illustrative examples

These examples illustrate the impact of consolidation/ deconsolidation on the adoption of FRS 110 for an entity applying the Relevant Standards for the first time in the financial year ending 31 December 2014. The date of initial application is 1 January 2014 in the following examples.

#### **Example 1 – No change upon adoption of FRS 110**

##### **Facts**

Parent P has an involvement in Investee S (a business), which is not consolidated at present. P has a 31 December 2014 year end and presents comparative information for 2013.

As at 1 January 2014 (date of initial application of FRS 110), P's consolidation conclusion is the same i.e. S should not be consolidated.

##### **Analysis**

When the consolidation conclusion is the same at the date of initial application:

1. no adjustments to the previous accounting are required and comparatives are not restated
2. FRS 110 does not require an entity to test whether there is a change in consolidation conclusion prior to the date of initial application.

P is not required to assess under FRS 110 if S would have been consolidated prior to 1 January 2014 because P has already assessed that the consolidation conclusion is the same at 1 January 2014.

#### **Example 2 – Investee consolidated upon adoption of FRS 110**

##### **Facts**

Same facts as Example 1, except that S is not consolidated at present and as at 1 January 2014, P concludes that S should be consolidated.

##### **Analysis**

1. P determines that if FRS 110 had been effective, it would have obtained control of S on 16 May 2007.
2. Because control of S was obtained in 2007, the amendments allow P a choice of applying FRS 103 (2004) or FRS 103 (2009). P measures S's assets, liabilities and non-controlling interests (NCI) according to FRS 103 (2009) and determines goodwill as of 16 May 2007.
3. Next, P rolls these values forward to determine the carrying amounts of S's net assets and NCI as of 1 January 2013, as if S had been consolidated since 16 May 2007.
4. The difference between the newly determined carrying amounts at 1 January 2013 and the existing carrying amount of the investment in S at 1 January 2013 is recognised in equity at the beginning of 2013.

S restates 2013 comparatives and discloses the impact of change in accounting policy for 2013.

*If it is impracticable to measure the interest in the investee at the exact date of loss of control, then the investor applies FRS 110 for a loss of control at the beginning of the earliest period for which it is practicable. The immediately preceding period is restated unless the interest in the investee is measured at the beginning of the current period.*

### Illustrative examples (continued)

#### **Example 3 – Investee deconsolidated upon adoption of FRS 110**

##### **Facts**

Same facts as Example 1, except that S is consolidated at present and as at 1 January 2014, P concludes that S should be deconsolidated.

##### **Analysis**

1. P determines that if FRS 110 had been effective, then it would have lost control of S on 1 July 2009.
2. P measures its interest in S as of 1 July 2009 in accordance with FRS 110.
3. Next, P rolls that value forward to 1 January 2013 in accordance with the relevant FRS e.g. FRS 28 *Investments in Associates and Joint Ventures*.
4. The difference between the newly determined carrying amount of the investment in S at 1 January 2013 and the existing consolidated carrying amounts at 1 January 2013 is recognised in equity at that date.

S restates 2013 comparatives and discloses the impact of change in accounting policy for 2013.

## 2. Joint arrangements: No more proportionate consolidation?

This article is contributed by:



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Joint ventures are an important form of inter-organisational co-operation because they allow firms to share the risks for activities that are beyond the scope of the capabilities of a single organisation.

FRS 111 *Joint Arrangements* replaces FRS 31 *Interests in Joint Ventures* in providing guidance on accounting for such arrangements. FRS 111 is identical to IFRS 11, except that its effective date is deferred for one year, i.e. effective for annual periods beginning on or after 1 January 2014.

FRS 111 classifies a joint arrangement into two types:

1. Joint ventures, where the joint venturers must now always use the equity method of accounting, i.e. they are stripped of the free choice of using the equity method or proportionate consolidation.
2. Joint operations, where the joint operators account for their share of the underlying assets and liabilities, which is similar to proportionate consolidation.

Why is there a need to revise the accounting for joint arrangements?

FRS 31 established different accounting depending on whether the arrangements were structured through an entity. Such a ‘form-driven’ accounting outcome can lead to similar transactions being accounted for in different ways and therefore, can impair comparability of financial statements.



**Key**  
 JCO/JCA: Jointly controlled operations/Jointly controlled assets    JCE: Jointly controlled entities    JO: Joint operations    JV: Joint ventures

*“The IASB wanted to remedy two aspects of IAS 31 that impede high quality reporting of joint arrangements: first, in IAS 31 the structure of the arrangement was the only determinant of the accounting and second, an entity had a choice of accounting treatments for interests in jointly-controlled entities.”*

IFRS 11 Frequently asked questions prepared by IASB staff

**How does FRS 111 improve financial reporting?**

Under FRS 111, the accounting for joint arrangements will be driven by a **principle**: the rights and the obligations of the parties arising from the arrangement in the normal course of business determines the accounting.

*“In the (IASB) Board’s view, the accounting for joint arrangements should reflect the rights and obligations that the parties have as a result of their interests in the arrangements, regardless of those arrangements’ structure or legal form.”*

**IFRS 11 Basis for Conclusions BC9**



**How do I identify a joint arrangement?**

A joint arrangement is an arrangement over which two or more parties have joint control, being the contractually agreed sharing of control, i.e. unanimous consent is required for decisions about the relevant activities.

*In some situations, unanimous consent over the relevant activities can be implicit, i.e. the disposition of voting power among the parties may mean that the unanimous consent of specific parties is always required even though there is no shareholders’ agreement provision explicitly so stating.*

**Illustrative examples**

**Example 1 – Does joint control exist?**

**Facts**

75% of the votes are required to make decisions about the relevant activities of the arrangement.

| Scenario | The parties to the arrangement hold | Does joint control exist?   |
|----------|-------------------------------------|---|
| 1        | A – 50%<br>B – 30%<br>C – 20%       | Yes.<br>A and B must act together to direct the relevant activities. Implicitly, no decisions about the relevant activities of the arrangement can be made without both A and B agreeing.   |
| 2        | A – 50%<br>B – 25%<br>C – 25%       | No.<br>There is more than one combination, i.e. A and B, or A and C, that can agree to reach 75% of the voting rights.<br><br>To be a joint arrangement, the contractual arrangement between the parties would need to specify which combination of the parties is required to agree unanimously to decisions about the relevant activities of the arrangement. |

Although we do not expect changes to the identification of a joint arrangement, the following should be noted:

- Joint control has, in the first place, to meet the definition of control.
- FRS 111 provides more clarity as to the type of decisions that require the unanimous consent of the parties in order to determine that joint control exists, i.e. decisions about the relevant activities, while protective rights are ignored.

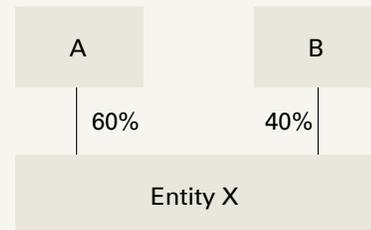
**Illustrative example**

**Example 2 – Does joint control exist?**

**Facts**

Joint venture agreement between A and B states that unanimous consent is required on the following:

- amendments to Entity X’s constitution
- pricing of related party transactions
- liquidation of Entity X; and
- share issue or repurchases.



Other decisions only require simple majority.

**Analysis**

It is unlikely that joint control exists in this arrangement. In this case, although unanimous consent is required for certain decisions, these might not be decisions about the relevant activities, i.e. those that significantly affect the returns of the arrangement. Decisions relating to fundamental changes in the activities of the arrangement, or applying only in exceptional circumstances (i.e. protective rights) are not considered in this assessment.

**How do I classify a joint arrangement as a joint operation or a joint venture?**

As discussed above, the rights and obligations of the parties arising from the arrangement determine the accounting of the joint arrangement.

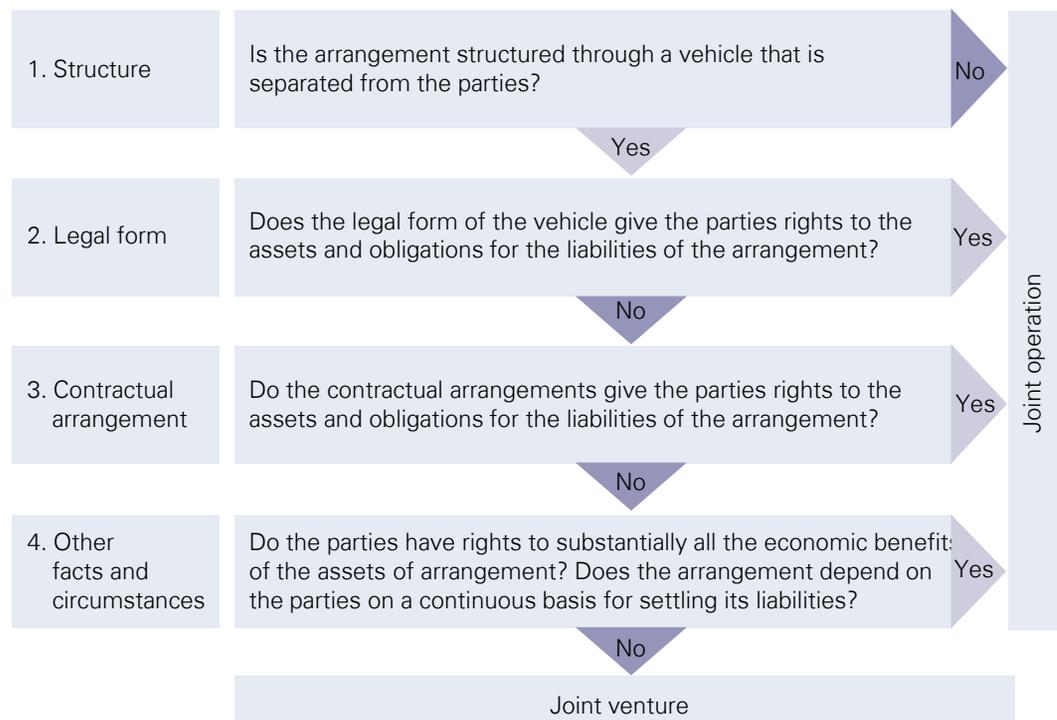
Determining the classification of a joint arrangement as either a joint operation or a joint venture can be summarised in a flowchart, as follows:

An entity determines the type of joint arrangement by considering:

- the structure
- the legal form
- the contractual arrangement
- other facts and circumstances

The concept is a distinction between:

- direct access/exposure to each individual underlying asset/liability (i.e. a joint operation); and
- exposure only to the net result of the assets and liabilities (i.e. a joint venture).



*IFRS 11 paragraph B16 (extract): A joint arrangement that is not structured through a separate vehicle is a joint operation.*

**Classification test 1: Structure**

A joint arrangement that is not structured through a separate vehicle can only be classified as a joint operation.

A separate vehicle is a separately identifiable financial structure, including separate legal entities or entities recognised by statute, regardless of whether those entities have a legal personality.

**Insights – Jointly controlled assets and jointly controlled operations will generally be joint operations under FRS 111**

Under FRS 31, jointly controlled assets and jointly controlled operations are not structured through a separate vehicle. Accordingly, they will be classified as joint operations under FRS 111. The accounting for those arrangements is broadly the same as under FRS 31, i.e. an entity accounts for its interests in the underlying assets and liabilities.

*If there is a separate structure, then the classification test looks at, broadly, whether any of the legal form of the structure, contractual terms or other facts and circumstances make that separation ineffective.*

**Classification test 2: Legal form**

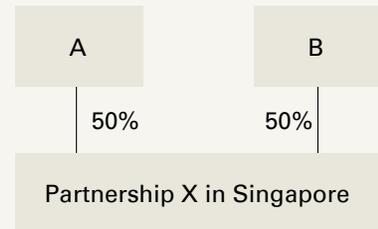
If the legal form of the separate vehicle does not confer separation between the parties and the separate vehicle, i.e. the assets and liabilities placed in the separate vehicle are the parties’ assets and liabilities, then the joint arrangement is a joint operation.

**Illustrative example**

**Example 3 – Classification test 2: Legal form**

**Facts**

A and B set up a partnership in Singapore. Contractual arrangement between A and B establishes the parties’ rights to the assets, responsibility for all operational or financial obligations and the sharing of profit or loss.



**Analysis**

This joint arrangement is likely to be a joint operation, because the legal form, i.e. as a partnership, does not confer separation between A and B, and the partnership.

In Singapore, the law does not treat a partnership as a separate legal entity from its partners. The partners collectively own the assets of the partnership and are each individually liable for the debts and liabilities of the partnership.

The fact that the parties have agreed to share profit/loss would not prevent the arrangement from being a joint operation.

**Classification test 3: Contractual arrangement**

The test at this step of the analysis is to identify whether, despite there being:

- a separate structure for the arrangement (classification test 1); and
- the legal form of the arrangement does not give the parties rights to the assets and obligations for the liabilities of the arrangement (classification test 2)

the contractual arrangement does give the parties rights to the assets and obligations for the liabilities of the arrangement, thus making that separation ineffective.

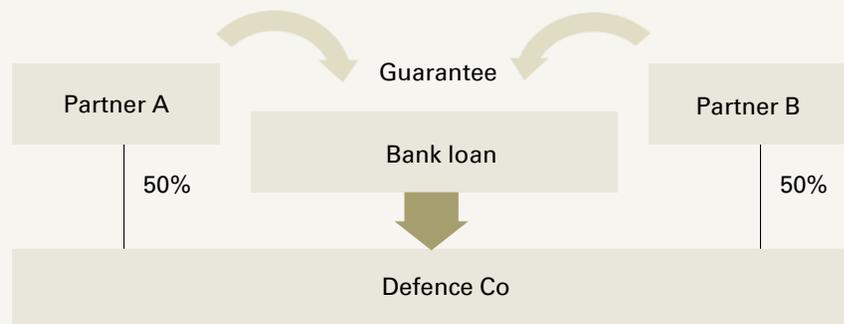
That is, the parties use the contractual arrangement to reverse or modify the rights and obligations conferred by the legal form of the separate vehicle.

**Illustrative example**

**Example 4 – Classification test 3: Contractual arrangement**

**Facts**

A and B each sell their defence contracting businesses to a jointly controlled, legally separate vehicle, Defence Co, for fair value. Defence Co funds the payment with bank debt guaranteed by A and B.



**Analysis**

This joint arrangement is likely to be a joint venture, where the equity accounting method should be applied.

To be a joint operation, they need to have both rights to the assets and obligations for the liabilities. The parties clearly don't have rights to the assets of Defence Co. The parties also do not have obligations for the liabilities, because Defence Co is still liable to the bank. It has not lost that liability.

Under FRS 111, a guarantee does not, in itself, determine that the parties have obligations for the liabilities of the separate vehicle. In this example, the recourse of the bank to the parties is only in the event of a default of the loan by Defence Co.

*The parties may use the contractual arrangement to reverse or modify the rights and obligations conferred by the legal form of the separate vehicle. In many jurisdictions, it might be quite difficult to achieve this reversal/ modification of legal form of a separate vehicle.*

*Therefore, we expect that relatively few arrangements conducted through a separate vehicle will become JOs as a result of the contractual arrangement test.*

Unlike the earlier three tests, this test is asking whether despite the parties not having rights to the actual assets and obligations for the actual liabilities of the vehicle, the arrangements are in substance the same as having such rights and obligations.

**Classification test 4: Other facts and circumstances**

The test at this step of the analysis is to identify whether, in spite of the legal form (classification test 2) and contractual arrangement indicating that the arrangement is a joint venture (classification test 3), other facts and circumstances:

- give the parties rights to substantially all of the economic benefits relating to the arrangement (asset side of the test); and
  - cause the arrangement to depend on the parties on a continuous basis for settling the liabilities (liability side of the test)
- and therefore the arrangement is a joint operation.

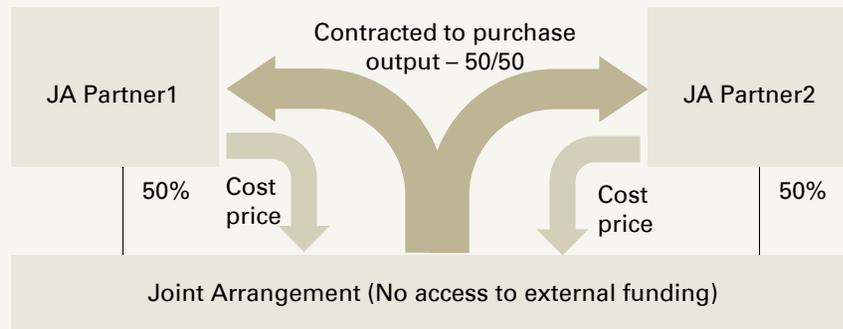
**Illustrative example**

**Example 5 – Classification test 4: Other facts and circumstances**

**Facts**

The partners have agreed the following in respect of this manufacturing arrangement:

- the manufacturing arrangement will produce Product P to meet the demand required by the parties
- the parties have committed themselves to purchasing the whole production in accordance with their ownership interests at a price that covers all production costs incurred; and
- any cash shortages are financed by the parties in accordance with their ownership interest.



**Analysis**

This joint arrangement is likely to be a joint operation.

In this case, the arrangement meets the asset side of the test because of the output off-take contract. The economic benefits of the vehicle’s assets are the output that they produce. If the parties take the entire output, then they are taking substantially all of the economic benefits of the assets.

The arrangement also meets the liability side of the test because of the output off-take contract. The parties have to pay for the output. Since the vehicle has no other sources of finance, then the parties’ payments are the only source of cash for paying off the liabilities. The vehicle depends on the parties cash payments, from day to day – not just in default situations – to pay its liabilities.

The output off-take case discussed in this example is a common one in capital-intensive industries, such as oil and gas, pharmaceutical and automotive industries. Whether there can be other cases that qualify as a joint operation as a result of facts and circumstances, and whether such cases would be more than exceptions, remains to be seen.

## Financial statements of joint controllers

The following table is an overview of the general accounting requirements for parties that share joint control over an arrangement:

|                 | Consolidated financial statements   | Separate financial statements                |
|-----------------|---|--|
| Joint venturers | Equity method in accordance with FRS 28 (2011).   | Choice between cost or as a financial asset. |
| Joint operators | Recognises its own assets, liabilities and transactions, including its share of those incurred jointly. |  |

*"...the most affected sub-group will be the majority of arrangements that are structured through separate vehicles and that are currently being proportionately consolidated but will be classified as 'joint ventures' by IFRS 11."*

IFRS 11 Effect analysis compiled by the staff of the IFRS Foundation

*When a joint operator has rights to a specified percentage of all assets and obligations for the same percentage of all liabilities, and also holds the same percentage of equity interests, the accounting for a joint operation and proportionate consolidation is likely to be similar.*

*In both its consolidated and separate financial statements, a joint operator recognises its assets, liabilities and transactions, including its share of those incurred jointly.*

*There is no exemption from this accounting, even if the entity is not required to prepare consolidated financial statements, or financial statements in which the equity method is used.*

### Insights – Accounting as a joint operation – Difference between proportionate consolidation and accounting for the underlying assets and liabilities

Under FRS 31, all joint arrangements that were structured as separate vehicles were classified as jointly controlled entities and therefore were afforded a choice of using either the equity method or proportionate consolidation.

However, in some jurisdictions, such as in Example 3 above, partnerships confer no separation between the parties and the vehicle itself. Such arrangements are classified as **joint operations** under FRS 111 and therefore the parties account for the underlying assets and liabilities of the arrangement.

#### Entities that had previously accounted for such arrangements using proportionate consolidation:

The IASB noted that there are two key differences between proportionate consolidation and accounting for the underlying assets and liabilities:

1. The rights and obligations, as specified in the contractual arrangement, that an entity has with respect to the assets, liabilities, revenues and expenses relating to a joint operation might differ from its ownership interest in the joint operation. For a joint operation, FRS 111 requires the joint operator to recognise (its share of) the assets, liabilities, revenue and expenses as determined and specified in the **contractual arrangement**, rather than based on the ownership interest.
2. For a joint operation, the parties' interests are recognised in their **separate financial statements**. These numbers will then flow through to the consolidated financial statements.

Under the previous version of FRS 28 and FRS 31, investors in associates and jointly-controlled entities are exempted from applying the equity method or proportionate consolidation if it meets certain criteria, such as when the investor is itself a wholly-owned subsidiary, and its parent produces consolidated financial statements for public use. Such exemption is not available for joint operators' accounting for its interests in a joint operation.

#### Entities that had previously accounted for such arrangements using equity accounting:

In Example 3 above, if the entity had previously accounted for the jointly-controlled entities under FRS 31 using the equity method, the requirements of FRS 111 would require the joint operators to account for its interests in each underlying item in its separate financial statements. This change can affect every line item in the financial statements.



**Financial statements of other parties to a joint arrangement**

FRS 111 specifies the accounting not only for those parties that have joint control, but also for those parties that participate in, but do not have joint control over, the arrangement (other parties).

Under FRS 111, other parties to the joint arrangement need to know what type of joint arrangement it is for the joint controllers. This determines their accounting, as follows:

|                                    | Consolidated financial statements  | Separate financial statements   |
|------------------------------------|--|---|
| Other parties to a joint venture   | If significant influence exists, then equity method as an associate; otherwise, as a financial asset.  | If significant influence exists, then choice between cost or as a financial asset; otherwise, as a financial asset. |
| Other parties to a joint operation | Recognises its own assets, liabilities and transactions, including its share of those incurred jointly, if it has the rights to the assets and obligations for the liabilities.<br><br>Otherwise, it accounts for its interest as an associate or financial asset, as the case may be. |   |

**When the revised standard is first adopted**

FRS 111 is effective for annual periods beginning on or after 1 January 2014, and generally requires retrospective application. Further details on first-time application issues are discussed in a separate article in this publication.



**Find out more**

*First Impressions: Joint Arrangements* is a publication produced by KPMG International Standards Group. Our First Impressions explains how the new joint arrangements standard (IFRS 11) works. We discuss its implications for business and highlight areas of ambiguity. Examples show its effects in practice.

This publication may be downloaded free of charge at:

<http://www.kpmg.com/global/en/issuesandinsights/articlespublications/first-impressions/pages/first-impressions-ja-ifs-11.aspx>

### 3. Larger deferred tax liability for entities holding overseas investment properties within corporate wrappers?

This article is contributed by:



Eng Chin Chin  
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Interposing holding companies to hold overseas investment property is a common tax planning strategy. However, under the current accounting standard, investors typically end up recording a tax liability much larger than the expected actual tax payable that is often reversed on eventual disposal of the structure.

For instance, the accounting tax liability may reflect an amount up to \$83 when the expected actual tax payable is \$20. This would completely fail to reflect the economics underlying the structure.

Affected entities often find it difficult to explain to their stakeholders the big discrepancy between the accounting tax liability and the expected actual tax payable that is eventually reversed on disposal of the structure, resulting in a huge tax credit in the income statement for that period.

The IFRIC is contemplating changes to the tax accounting rules to address this issue. Affected entities are encouraged to actively feedback their concerns on this issue to the IFRIC as this will likely help to expedite changes to more faithfully reflect the amount of tax liability that will materialise on eventual disposal of the property.

It is common for Singapore investors to acquire overseas investment properties by purchasing the shares of an overseas company holding the investment property rather than acquiring that property directly.

One of the reasons investors prefer to acquire the shares of the overseas holding company is due to the fact that it provides the investor with the flexibility, in the event of disposal, to sell the property directly (i.e. via an asset sale) or indirectly by disposing of the shares of the entity (i.e. via a share sale), whichever is the most tax efficient method of disposal.

Such forms of property acquisitions are commonly used by investors to optimise their tax position in jurisdictions where gains on sale of shares are taxed at a rate lower than the rate that would apply if the properties are disposed of directly.

The IFRIC was recently asked to clarify the deferred tax accounting under IAS 12 *Income Taxes* (which is identical to FRS 12) arising from such type of transactions. Using an example, we examine the deferred tax accounting arising from such type of transactions, as discussed by the IFRIC.

The example we use illustrates a structure where one level of overseas holding company (Subsidiary B) is interposed to hold the investment property so as to achieve tax efficiency on eventual disposal of the property. As it is also common to have two or three levels of overseas holding companies interposed to hold the investment property, the ensuing discussion applies equally to such structures.

### Illustrative example

#### Year 1

Singapore Parent Company A purchases an investment property for \$800 by using Subsidiary B as the property holding company.

Subsidiary B is incorporated with \$800 share capital and is set up solely to hold the investment property.

The investment property is accounted for using the fair value model under FRS 40 *Investment Property*.

#### Year 2

At the end of year 2, the fair value of the property is \$1,000. The fair value gain of \$200 is recognised in the income statement.

#### Management's intention

A plans to hold the investment property to earn rental income and will dispose of the investment property if a good return on the property can be realised.

A's purpose of establishing B is to provide a corporate wrapper to the property, such that any transfer of ownership of the property could be achieved in a tax efficient manner by disposing of its equity interest in B instead of selling the investment property directly.

It is the management's intention to determine that any disposal of the property would be done by disposing of its equity interest in B instead of selling the investment property directly.





### Deferred tax accounting under FRS 12

FRS 12 is the accounting standard that deals with the accounting for income taxes, including deferred tax.

Under FRS 12, the presumption is that the carrying amount of an asset on the statement of financial position represents gross future economic benefits that will flow to the entity in future periods.

When the taxable economic benefits (rental income or disposal proceeds) represented by the carrying amount of an investment property exceed the amount that will be allowed as a deduction for tax purposes (the tax base), this results in a taxable temporary difference and a corresponding obligation to pay the resulting income taxes in future periods. FRS 12 requires this obligation to pay income taxes in future period to be recorded as a deferred tax liability at the reporting date, with some limited exceptions.

If the tax consequences differ depending on whether the asset is sold or is used to generate income from operation, FRS 12 generally requires the deferred tax liability (asset) to be measured based on the management's expectation as to whether the carrying amount of the asset will be recovered through sale or through use or a combination of both.

However, in the case of an investment property that is accounted for at fair value, arising from the recent amendments to FRS 12 *Deferred Tax: Recovery of Underlying Assets*, entities holding such investment properties have to account for the deferred tax liability based on the tax consequence that would follow on the rebuttable presumption that the carrying amount of the investment property will be recovered through sale. (For more information on the amendments, please refer to KPMG's [June 2011](#) issue of Financial Reporting Matters.)

**Deferred tax arising from the asset within the subsidiary**

In the example, the management expects the property to be divested at a later date by selling entity B if opportunity to profit from capital appreciation arises.

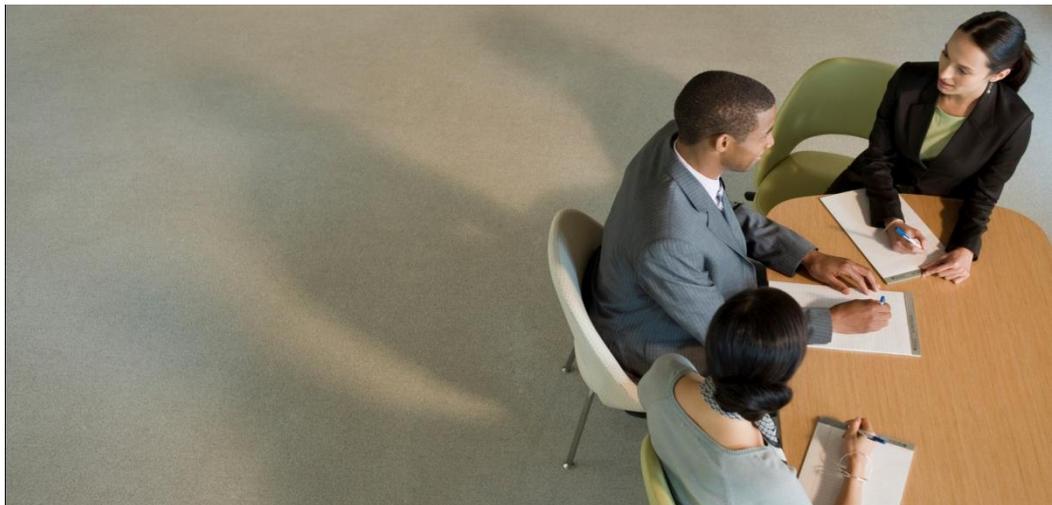
In the consolidated financial statements, B is consolidated by A and the investment property is reflected as the asset of the Group.

Assuming that:

1. the gain on disposal of B's shares is subject to a 10 percent withholding tax while the gain on disposal of the investment property is subject to a 35 percent capital gain tax in Country X
2. the amount deductible for tax purposes (tax base) on disposal of B's shares and on disposal of investment property is \$800; and
3. both the gain on disposal of B's shares and the gain on disposal of the investment property are not subject to further tax in Singapore.

When accounting for the deferred tax liability arising from the fair value uplift of the investment property in A's consolidated financial statements, a question arises as to whether the asset is the investment in B's shares or the asset within Subsidiary B (i.e. the investment property).

- a. If the conclusion is that asset is the investment in B's shares, any deferred tax liability is measured based on the tax consequence that will arise on disposal of B's shares.
- b. However, if the conclusion is that the asset is the investment property, any deferred tax liability is measured based on the tax consequence that will arise on disposal of the investment property, assuming that the sale presumption is not rebutted.



The potential accounting outcomes at the end of Year 2 in A's consolidated financial statements are as follows:

|  | (a)                                  | (b)                                 |
|--|--------------------------------------|-------------------------------------|
|  | Disposal of the equity interest in B | Disposal of the investment property |
|  | \$                                   | \$                                  |
| Carrying amount of the investment property, also the net assets of B (X) | 1,000                                | 1,000                               |
| Tax deductible amount (Tax base)   | (800)                                | (800)                               |
| Taxable temporary difference   | 200                                  | 200                                 |
| Applicable tax rate  | 10%                                  | 35%                                 |
| Deferred tax (liability) (Y)   | (20)                                 | (70)                                |

**Is the asset the investment in B's shares or the investment property?**

Based on the discussion at the IFRIC level, if the tax law considers the investment property inside Subsidiary B and B's shares held by A as two separate assets (for instance, if A and B file separate tax returns), it appears that the staff interpreted that IAS 12 currently requires deferred tax liability in the consolidated financial statements to be measured based on the tax consequence that will arise on disposal of the investment property within the subsidiary B.

What this means is that a deferred tax liability of \$70, as calculated under (b) in Table 1, has to be recorded in A's consolidated financial statements.

### Deferred tax for the withholding tax payable on disposal of B's shares

At the same time, where the tax law considers the investment property inside Subsidiary B and B's shares held by A as two separate assets, it appears that the staff supporting the IFRIC further interpreted that IAS 12 currently requires a parent to recognise an additional deferred tax liability for the tax consequence that will arise on disposal of the equity interest in B (refer to the withholding tax payable on disposal of the B's shares in our example).

A parent company, however, could still apply the current exemption under IAS 12 and does not need to provide for this additional deferred tax liability if both of the following conditions are satisfied:

- a. the investor is able to control the timing of the disposal and distribution; and
- b. it is probable that the disposal and the distribution will not occur in the foreseeable future.

In the case of a subsidiary, condition (a) is often met as a parent company is able to control both the timing of disposal of the subsidiary and the distribution of profits. Therefore, no provision for deferred tax liability is required if a parent has determined that it is probable that it will not dispose of the subsidiary nor distribute the undistributed profits in the foreseeable future.

Conversely, if it is probable that the disposal/distribution will occur in the foreseeable future, a parent will have to record a deferred tax liability for the withholding tax payable on disposal/distribution.

In our example, if it becomes probable that A Group will dispose of B's shares in the foreseeable future to realise the fair value gain, based on the discussion at the IFRIC level, an additional deferred tax liability of \$13 has to be recorded for the withholding tax payable of 10 percent on gains on disposal of B's shares (see Table 2 below).

| <b>Table 2: Deferred tax on investment in B</b>  |       |
|--|-------|
|  | \$    |
| Carrying amount of the net assets in B (X) – (Y) | 930   |
| Tax deductible amount (Tax base)                 | (800) |
| Taxable temporary difference                     | 130   |
| Applicable tax rate                              | 10%   |
| Deferred tax (liability)                         | (13)  |

**Current tax accounting fails to portray an entity's tax planning strategy**

Overall, based on the discussion at the IFRIC level, potentially a deferred tax liability of up to \$83, representing an effective tax rate of 41.5 percent, has to be recorded in A's consolidated financial statements. This is so even though \$20, representing an effective tax rate of 10 percent, more faithfully represents A Group's tax planning strategy and the expected tax consequence that will follow on the eventual disposal of the property. Moreover, a significant portion of the deferred tax liability is often reversed in the event of disposal, resulting in a huge tax credit in the year of disposal.

This issue is particularly relevant to investors with investment properties located in jurisdictions such as China and Japan, where gains on sale of shares are taxed at a rate lower than that applicable on disposal of the properties directly. To achieve tax efficiency, investors typically sell their investment properties indirectly by selling the shares of the company holding the properties. Affected entities often find it difficult to explain the huge discrepancy between the expected actual tax payable and the accounting tax liability to their stakeholders. This discrepancy is eventually reversed on disposal of the structure, resulting in a huge tax credit in the income statement for that period.

In our example, the deferred tax liability on the underlying investment property of \$70 in Table 1 is based on the assumption that the carrying amount of the investment property is recovered through sale (sale presumption). Under FRS 12, this sale presumption is rebutted if the investment property is depreciable (i.e. building and/or leasehold land) and is held within a business model whose objective is to consume substantially all of the investment property's economic benefits over the life of the investment property. We are aware that in certain instances, the sale presumption is rebutted for investment properties located in jurisdictions where the income tax rate is lower than the capital gain tax rate. If the sale presumption is rebutted, this would certainly reduce the extent of overprovision.

*Is there a possibility of an amendment to IAS 12?*

In May 2012, while discussing this issue, the IFRIC considered concerns raised by commentators in respect of the application of the requirements in current IAS 12 for this type of transactions. At that meeting, the IFRIC decided not to recommend changes by way of an annual improvement to the IASB but to explore further options to address this issue that would result in a different accounting.

*Affected entities are encouraged to actively feedback to IFRIC.*

This may mean that the IFRIC likely requires a longer time to research the issue prior to recommending any amendments. Affected entities are encouraged to be active in their feedback regarding their concerns to the IFRS Interpretations Committee. This will likely help to expedite changes to current accounting to more faithfully reflect the amount of tax liability that will materialise on the eventual disposal of the property.

## 4. International developments



### Proposed guidance on put options written on non-controlling interests

On 31 May 2012, IFRIC published for public comment proposed guidance on the accounting for a put option written by a parent entity on the shares of its subsidiary held by a non-controlling-interest (NCI) shareholder.

If a parent entity is obliged to purchase the shares of its subsidiary for cash or for another financial asset, the parent must recognise a financial liability in its consolidated financial statements at the present value of the option exercise price.

The proposed guidance deals with the subsequent measurement of the financial liability as diversity exists in practice. IFRIC has proposed that all changes in the measurement of that financial liability should be recognised in profit or loss.

The draft Interpretation DI/2012/2 *Put Options Written on Non-controlling Interests* is open for public comment until 1 October 2012.

In Singapore, the ASC issued the equivalent draft interpretation on 4 June 2012. The comment period for the ASC has closed.

*"The accounting for NCI put liabilities has been a contentious issue in a number of countries, with the policies adopted by different companies (profit or loss vs equity) having a significant impact on the comparability of financial statements."*

**Paul Munter, KPMG's global IFRS business combinations and consolidation leader**

### Proposed guidance on accounting for levies

Following the 2008 global financial crisis, many of the world's financial institutions were bailed out by their national governments. Subsequently, various countries such as the France, Germany, the US and the UK, have started to implement bank levies to prevent excessive employee bonuses and to discourage risky borrowings.

Against this backdrop, IFRIC had proposed to clarify that an entity recognises a liability for a levy when and only when the triggering event specified in the relevant legislation occurs. An entity does not recognise a liability at an earlier date, even if it has no realistic opportunity to avoid the triggering event.

For example, if an entity is liable to pay a levy if it generates revenues in a specific market on 1 January 2013, then it does not recognise a liability for the levy at 31 December 2012. This is the case even if the entity is economically compelled to operate in 2013 and prepares financial statements on a going concern basis.

The draft Interpretation DI/2012/1 *Levies Charged by Public Authorities on Entities that Operate in a Specific Market* was published by IFRIC on 31 May 2012. The comment period has closed.

In Singapore, the ASC issued the equivalent draft interpretation on 4 June 2012. The comment period for the ASC has closed.

*"Levies have become more common in recent years with public authorities in a number of jurisdictions introducing levies to raise additional income. The key accounting question for those who pay the levy is when to recognise a liability."*

Phil Dowad, KPMG's global IFRS revenue recognition and provisions leader





### Lease accounting update

In June 2012, the IASB and the Financial Accounting Standards Board (FASB) (collectively the Boards) tentatively decided that lessees and lessors would apply dual lease accounting models. A new lease classification test will be used to determine which lease accounting model to apply. Lessees and lessors will use the same lease classification test.

For lessees, the lease classification test would determine whether lessees apply a model resulting in a straight-line pattern of expense recognition, or an accelerated pattern of expense recognition. Under both models, lessees would recognise a right-of-use asset and a lease liability for each lease within the scope of the proposals, meaning that all leases would be on-balance sheet for lessees.

For lessors, the lease classification test would determine whether the receivable and residual (R&R) model or the operating lease model applies. Under the R&R model, the lessor would recognise a lease receivable and a residual asset on lease commencement, with an accelerated pattern of income recognition. The operating lease model is similar to current operating lease accounting under IAS 17 i.e. the lessor would continue to recognise the underlying asset, would recognise the lease payments on a straight line basis over the lease term and would not recognise a lease receivable at lease commencement.

The Boards plan to release a joint exposure draft in the fourth quarter of 2012.

For more information, you may refer to:

KPMG's international publication [IFRS Newsletter: Leases – June 2012, Issue 11](#).

*"The boards have reached agreement on a proposed approach to put leases over one year on the balance sheet. We will publish our proposals for public comment, with a view to completing this important convergence project during 2013."*

**Hans Hoogervorst, Chairman of the IASB**  
**IASB and FASB agree on lease accounting approach, 13 June 2012**

## Revenue update

In July 2012, the Boards began substantive redeliberations of the proposals in the November 2011 exposure draft *Revenue from Contracts with Customers* discussing four items:

| Item   | Outcome   |
|--|---|
| Recognition of onerous obligations                       | The Boards decided to exclude proposed requirements for identifying and measuring onerous performance obligations in the revenue standard. Instead, entities would apply the existing requirements of IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i> .  |
| Identification of separate performance obligations       | The new revenue standard will contain a systematic approach and more detailed guidance on how and when to break down a contract into smaller units.   |
| Criteria for when revenue should be recognised over time | An entity would recognise revenue over time if any one of the following three criteria is met: <ul style="list-style-type: none"> <li>• the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced</li> <li>• the customer receives and consumes the benefit of the entity's performance as the entity performs; or</li> <li>• the entity's performance does not create an asset with an alternative use to the entity, and the entity both has a right to payment for performance completed to date and expects to fulfil the contract as promised.</li> </ul> |
| Licensing and rights to use                              | The Boards had different initial views on accounting for licensing and rights to use and will therefore undertake further work on how the transfer of control concept applies to licences.  |

The Boards aim to conclude redeliberations by December 2012 and issue a new standard in the first half of 2013.

For more information, you may refer to:

KPMG's international publication [IFRS Newsletter: Revenue – July 2012, Issue 1](#) .

In Singapore, the ASC issued the equivalent exposure draft on 17 November 2011. The comment period for the ASC has closed.

*"In a welcome move, the IASB and FASB began their redeliberations by agreeing to focus on revenue - contract losses and liabilities are out."*

**Phil Dowad, KPMG's global IFRS revenue recognition leader**



### Hedge accounting update

On 7 September 2012, the IASB issued a draft of its forthcoming IFRS on general hedge accounting that will be added to IFRS 9 *Financial Instruments*.

The proposals would not fundamentally change the current types of hedging relationships or the current requirement to measure and recognise ineffectiveness; however, the proposals would mean that more hedging strategies used for risk management would qualify for hedge accounting. The proposals would result in the following, for example:

- hedge accounting would become available for a broader range of hedging strategies, for instance, risk components of non-financial items and non-contractually specified inflation risk
- more judgement would be required in assessing the effectiveness of the hedging relationship
- voluntary termination of otherwise qualifying hedging relationships would no longer be permitted
- cash instruments would qualify as hedging instruments in more cases
- additional disclosure requirements on risk management and hedging activities

The proposals would be effective for annual periods beginning on or after 1 January 2015. Early application would be permitted only if all existing IFRS 9 requirements are applied at the same time or have already been applied.

The IASB is not seeking comments on the draft, which is being made available for information purposes to enable constituents to familiarise themselves with the document. The draft will remain on the website until early December 2012 after which time the IASB intends to proceed to finalise the draft document.

For more information, you may refer to:

KPMG's international publications [In the Headlines – September 2012, Issue 12](#) and [New on the Horizon: Hedge accounting](#).

In Singapore, the ASC has yet to issue the equivalent of IFRS 9.

*“Many preparers will support these revised proposals. It appears that in redeliberating the December 2010 exposure draft, the IASB has responded to stakeholder requests for conceptual clarifications and more ‘meat on the bone’ for the new concepts.”*

**Enrique Tejerina, KPMG's global IFRS Financial Instruments deputy leader**

**Post-implementation review of IFRS 8 *Operating Segments*** In 2007, the Trustees of the IFRS Foundation, responsible for governance and oversight of the IASB, introduced a requirement for the IASB to conduct a post-implementation review of each new standard or major amendment of a standard, two years after the effective date.

The Standard on Operating Segments is the first to be reviewed under this new process. On 19 July 2012, the IASB began the public part of its review of IFRS 8 *Operating Segments* by publishing for comment a Request for Information (RFI) on the effect of implementing the standard.

The review seeks feedback on whether the standard is functioning as intended, as well as more practical information on the challenges and costs associated with implementing the standard. The IASB will use this review to refine its methodology for undertaking future reviews, with its Business Combination Standard being the next review planned.

In addition to the RFI, the IASB is also undertaking a broad range of outreach activities internationally to gather further feedback on the effect of implementing IFRS 8.

The RFI is open for comment until 16 November 2012.

In Singapore, the ASC issued the equivalent RFI on 24 July 2012. The comment period for the ASC has closed.

*“Post-implementation reviews allow the IASB to make sure that major new standards are working as intended. We want to make sure that the standard is being implemented on a consistent basis and to understand any unintended consequences arising from its introduction.”*

**Hans Hoogervorst, Chairman of the IASB**

**IASB begins public consultation on post-implementation review of IFRS 8, 19 July 2012**

## Common abbreviations



|         |   |
|---------|---|
| ASC     | Accounting Standards Council in Singapore                   |
| ACRA    | Accounting & Corporate Regulatory Authority                 |
| CPF     | Central Provident Fund                                      |
| 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                       |
| LM      | Listing Manual of the Singapore Exchange                    |
| SGX     | Singapore Exchange  |

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