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FINANCIAL REPORTING MATTERS

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In keeping with our tradition of providing an overview of changes on financial reporting matters in our year-end issue, we summarise the changes in the areas of financial reporting standards, income taxes, and legal and regulatory. These are areas that you should consider when finalising your financial statements for the year 2012.

In a welcome move, the IASB has provided an exception to consolidation for investment entities. Such entities will instead recognise their investments in controlled investees at fair value. We discuss which entities are able to use this exception and the financial statements effect of this amendment. We also analyse another amendment relating to the presentation of financial assets and financial liabilities in the financial statements.

Internationally, there had also been various discussions on changes to the auditors' report. We look at how these proposals may affect the interactions between preparers of financial statements and their auditors.

Contents

Supplement article

Update on RAP 7 (2012), the recommended accounting practices for unit trusts and REITs in Singapore

We highlight the latest developments on the interpretation of RAP 7 (2012) since we first published our September 2012 Supplement on *Revision to RAP 7, the recommended accounting practices for unit trusts and REITs in Singapore.*

1. Overview of 2012 changes – Financial Reporting Standards

This article is contributed by:

Reinhard Klemmer
Partner, Professional Practice

In this section, we summarise the more significant changes in FRS that are effective for the first time for an entity with an annual period beginning on 1 January 2012. We have also included changes in FRS that have been issued, but are not yet effective, so that entities could consider any necessary disclosures required in 2012's financial statements. Entities could also use this discussion of future changes to plan and consider the implication on subsequent financial periods.

A. New FRSs effective for annual periods beginning on 1 January 2012

Amendments to FRS 12 *Deferred Tax: Recovery of Underlying Assets*

Effective: Annual periods beginning from 1 January 2012

Refer to *Financial Reporting Matters* – June 2011 and September 2012 for details

The amendments to FRS 12 *Income Taxes – Deferred Tax: Recovery of Underlying Assets* provide an exception to the current measurement principles of deferred taxes arising from investment property measured using the fair value model in accordance with FRS 40 *Investment Property*. The exception also applies to investment properties acquired in a business combination accounted for in accordance with FRS 103 *Business Combinations*, provided the acquirer subsequently measures these assets under the fair value model.

In these specified circumstances, the measurement of deferred tax assets and liabilities is based on a rebuttable presumption that the carrying amount of the underlying asset will be recovered entirely through sale. This presumption is rebutted only if the investment property is depreciable and held within a business model whose objective is to consume substantially all of the asset's economic benefits over the life of the asset.

The amendments to FRS 12 are to be applied retrospectively. Earlier application is permitted.

Subsequent to the issue of this amendment and arising from feedback from preparers of financial statements, IFRIC is contemplating changes to the above tax accounting rules. This arises because when companies interpose holding companies to hold overseas investment property as a tax planning strategy, the companies typically end up recording a tax liability much larger than the expected actual tax payable under the current accounting standard. This payable often gets reversed on eventual disposal of the structure.

Amendments to FRS 107 *Disclosures – Transfers of Financial Assets*

Effective: Annual periods beginning from 1 July 2011

Refer to *Financial Reporting Matters – June 2011* for details

The amendments to FRS 107 enhance the disclosures required for transferred financial assets that remain on the books (i.e. on-balance sheet exposures). The amendments also introduce new disclosures on transferred financial assets that were derecognised in their entirety, but for which the entity retains some form of continuing involving (i.e. off-balance sheet exposures).

The definition of transferred financial assets in the amendments to FRS 107 scopes in more transferred financial assets transactions into the disclosure requirements.

Entities are not required to provide the new or enhanced disclosures for any period that begins before the date of initial application of the amendments.

Earlier application is permitted.

Other amendments

Other amendments that are also effective for the first time but expected to have limited application impact are:

- Conceptual Framework for Financial Reporting: *Chapter 1: The objective of general purpose financial reporting* and *Chapter 3: Qualitative characteristics of useful information*
- Amendments to FRS 101 *Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters*

B. New FRSs not yet effective for annual periods beginning on 1 January 2012

When an entity has not applied a new FRS or an amendment to FRS that has been issued but is not yet effective, the entity shall disclose this fact and known or reasonable estimable information relevant to assessing the potential impact that the application of the new FRS or amendment will have on the entity's financial statements.

Amendments to FRS 1 – *Presentation of Items of OCI*

Effective: Annual periods beginning from 1 July 2012

Refer to *In the Headlines – Issue 2011/19* for details.

The amendments introduce changes to enhance the presentation of items of other comprehensive income (OCI):

- Preserve the option to present profit or loss and OCI in two statements;
- Require that items of OCI that may be reclassified to profit or loss in the future be presented separately from items that would never be reclassified to profit or loss; and
- Change the title of the *statement of comprehensive income* to the *statement of profit or loss and other comprehensive income*. However, an entity is still allowed to use other titles.

The amendments to FRS 1 are to be applied retrospectively. Earlier application is permitted.

FRS 19 *Employee Benefits* (revised 2011)

Effective: Annual periods beginning from 1 January 2013

Refer to *Financial Reporting Matters – June 2012* for details

The primary reason for issuing FRS 19R is to improve the accounting for defined benefit plans by:

- eliminating the option to defer recognition of re-measurement gains and losses (known as the 'corridor method'); and
- requiring re-measurements to be presented in other comprehensive income, so as to separate these changes from the results of an entity's day-to-day operations.

As the Central Provident Fund state plan that most Singapore entities participate in is a form of defined contribution plan, the change is expected to have limited impact in Singapore.

Other changes that may have wider implications to Singapore entities include changes in the distinction between short-term and other long-term employee benefits, as well as changes in the recognition rules for termination benefits.

The amendments generally apply retrospectively, with the exception of two areas of transitional provisions. Earlier application is permitted.

Amendments to FRS 32 *Financial Instruments: Presentation* and FRS 107 *Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities*

Effective: Annual periods beginning from :

1 January 2013 (FRS 107)

1 January 2014 (FRS 32)

Details are covered in this issue

The amendments to FRS 32 clarify that the right of set-off must not be contingent on a future event, and must be legally enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and its counterparties. The amendments further clarify situations where settlement on a gross basis that does not occur simultaneously (e.g. settlement through central counterparties or clearing houses) may satisfy the offsetting criteria.

The amendments to FRS 107 require entities to disclose information on financial assets and financial liabilities that are offset on the face of the balance sheet and those that are presented gross on the face of the balance but are subject to enforceable master netting arrangements or similar agreements.

Both amendments are to be applied retrospectively. Earlier application of the FRS 32 amendments is permitted if an entity also makes the disclosures required under the amendments to FRS 107.

FRS 110 *Consolidated Financial Statements* and FRS 27 *Separate Financial Statements*

Effective: Annual periods beginning from 1 January 2014

Refer to *Financial Reporting Matters* – December 2011 and June 2012 for details

FRS 110 *Consolidated Financial Statements* replaces the existing consolidation requirements under FRS 27 (2009) *Consolidated and Separate Financial Statements* and INT FRS 12 *Consolidation – Special Purpose Entities*.

FRS 110 changes the definition of control such that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with its investee and has the ability to affect those returns through its power with the investee. A single control model is applied in the assessment for all investees, including special purpose entities that are currently within the scope of INT FRS 12.

FRS 110 carries forward the existing consolidation procedures from FRS 27 (2009).

FRS 111 *Joint Arrangements* and FRS 28 *Investments in Associates and Joint Ventures*

Effective: Annual periods beginning from 1 January 2014

Refer to *Financial Reporting Matters* – September 2012 for details

FRS 111 *Joint Arrangements* replaces the existing accounting for joint ventures (now joint arrangements) under FRS 31 *Interests in Joint Ventures* and INT FRS 13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*. FRS 28 (2011) *Investments in Associates and Joint Ventures* was also issued to make limited amendments to the accounting for associates.

FRS 111 prescribes the accounting for joint arrangements in both consolidated and separate financial statements. The adoption of this standard would require entities to re-assess and classify its joint arrangement as either joint ventures or joint operations based on the rights and obligations arising from the joint arrangements, rather than based on the structure of the arrangement as currently prescribed by FRS 31.

FRS 111 requires joint ventures to be accounted for using the equity method and removes the existing accounting policy choice of proportionate consolidation under FRS 31; while joint operations are required to apply line-by-line accounting for their share of the underlying assets and liabilities, which is similar to proportionate consolidation.

FRS 112 *Disclosure of Interests in Other Entities*

Effective: Annual periods beginning from 1 January 2014

Refer to *In the Headlines* – Issue 2011/16 May 2011 for details.

FRS 112 *Disclosure of Interests in Other Entities* integrates the disclosure requirements for all interests held in other entities into a single disclosure standard. The type and extent of disclosure information to be presented are prescribed by the standard, and are consistent across all interests held in subsidiaries, joint arrangements, associates and unconsolidated structured entities. These disclosure requirements prescribed by FRS 112 are also more extensive as compared with those in the respective existing standards.

Reporting entities are encouraged to provide information required by FRS 112 earlier than the effective date. Providing some of the disclosures required by FRS 112 does not compel the entity to comply with all the requirements of FRS 112 or to early adopt the entire consolidation suite (i.e. FRS 110, FRS 111, FRS 112, FRS 27 (2011) and FRS 28 (2011)).

Note that internationally, the consolidation suite is effective one year earlier, i.e. for annual periods beginning on or after 1 January 2013.

Transition Guidance (Amendments to FRS 110, FRS 111 and FRS 112)

Effective: Annual periods beginning from 1 January 2014

Refer to *Financial Reporting Matters* – September 2012 for details

These amendments simplify the transition to the consolidation suite and provide additional relief from disclosures, for example:

- 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 the consolidation conclusion remains unchanged at the date of initial application, then no adjustments to the previous accounting are required.
- Restatement of comparatives is limited to the immediately preceding period; this applies to the full consolidation suite.

Early adoption of the transition amendments is required in the event that the consolidation suite is early adopted. The amendments to the individual FRSs in the consolidation suite can be early adopted provided the entire consolidation suite is adopted at the same time.

FRS 113 *Fair Value Measurement*

Effective: Annual periods beginning from 1 January 2013

Refer to *Financial Reporting Matters* – March 2012 for details

FRS 113 *Fair Value Measurement* replaces the fair value measurement guidance contained in individual FRSs with a single source of fair value measurement guidance. FRS 113 does not extend the use of fair value accounting, but provides guidance on how it should be applied where its use is already required or permitted by other standards within FRSs.

To improve consistency of reporting, FRS 113 provides a definition of fair value, establishes a framework for measuring fair value and sets out the disclosure requirements for fair value measurements.

FRS 113 is to be applied prospectively.

Improvements to FRS 2012

Effective: Annual periods beginning from 1 January 2013

Refer to *IFRS Newsletter The Balancing Items – May 2012* for details

The fourth batch of annual improvements encompass six amendments to five standards. The amendments are mainly minor clarifications or removals of unintended inconsistencies between FRSs.

The amendment to FRS 1 *Presentation of Financial Statements* may be of particular interest. The amendment clarifies that in the event of a change in accounting policy, reclassification or restatement, a third balance sheet (as at the beginning of the preceding period) is only required if the change has a material effect on the information in the third balance sheet. In addition, related notes to the third balance sheet need not be presented.

The amendments are to be applied retrospectively.

Other Amendments

Amendments to FRS 101 *First-time Adoption of FRSs – Government Loans* is expected to have limited application impact in Singapore.

C. IFRSs not yet adopted in Singapore

IFRS 9 *Financial Instruments*

Effective: Annual periods beginning from 1 January 2015

Refer to the following publications for details:

- *IFRS Newsletter Financial Instruments*
- *New on the Horizon* - September 2012 and December 2012
- *First Impressions* – December 2009 and December 2010

IFRS 9 *Financial Instruments* is part of the IASB's plan to replace IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 currently does not deal with impairment of financial assets and hedge accounting.

To date, the key changes as compared to IAS 39 include:

- IFRS 9 contains only two primary measurement categories for financial assets: amortised cost and fair value; the existing "held to maturity", "loans and receivables" and "available for sale" categories for financial assets under IAS 39 are eliminated.
- If a financial asset is measured at fair value, then all changes in fair value are recognised in profit or loss, with one exception: for equity instruments which are not held for trading, an entity can choose to recognise fair value changes in OCI with no recycling to profit or loss.

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

Investment Entities (Amendments to IFRS 10 , IFRS 12 and IAS 27)

Effective: Annual periods beginning from 1 January 2014

Details are covered in this issue

Investment Entities defines an "investment entity" and provides an exception for such entities to consolidate their subsidiaries. Instead, investment entities are required to recognise their investments in controlled investees at fair value through profit or loss. In addition, in all instances permitted by IFRS, investment entities are required to account for substantially all investments under the fair value model, including investments in associates and joint ventures and investment property.

The amendments are to be applied retrospectively with certain transitional provisions, including specific requirements to simplify restatements. Early adoption is permitted provided that the entire consolidation suite is adopted at the same time.

2. Overview of 2012 changes – Income taxes

This article is contributed by:

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During the Budget Speech in February 2012, the Minister of Finance announced a number of changes to income taxes. In this section, we highlight the salient tax changes that might impact businesses for the financial year ended 31 December 2012.

From the accounting perspective, these tax changes should be taken into consideration when measuring the amount of deferred tax to be provided for in the financial statements. We have included in this article our recommended accounting treatments for these salient tax changes to help you navigate through the complexity of deferred tax accounting under FRS 12 *Income Taxes*.

Productivity and Innovation Credit

In the Singapore Budget Speech 2012, the Minister for Finance announced further enhancements to the Productivity and Innovation Credit (PIC) and the main changes are summarised below.

1. Research & Development (R&D)

- Expenditure incurred on R&D cost-sharing agreements may qualify as expenditure on R&D and enjoy PIC deduction. The qualifying expenditure is deemed to be 60 percent of the shared costs and will count towards the expenditure cap for R&D activity.
- For development of computer software to qualify for PIC deduction, there is no longer a need for businesses to develop such software with the intention to sell, rent, lease or hire the software to two or more unrelated parties (the "multiple sales requirement"). However, software that is developed for internal routine administration of businesses would still not qualify as R&D activity.

[Refer to issues 7 and 13 of KPMG Tax Alerts (April and July 2012 respectively) for more details. To access our Tax Alerts, click here.]

2. Training

- In-house training expenditure incurred up to $10,000 per year of assessment (YA) would now qualify for PIC deduction even if the courses are not accredited/approved or certified by the Singapore Workforce Development Agency or the Institute of Technical Education. Where in-house training expenditure incurred exceeds $10,000, such excess may qualify for PIC benefits if the courses are accredited/approved or certified by the Singapore Workforce Development Agency or the Institute of Technical Education.
- The expenditure incurred by a principal to train its agents may qualify for PIC deduction, subject to the following conditions being met:
  - there is a regular working or contractual relationship between the principal and agent;
  - the principal bears (and does not charge or recover from the agent) the training expenses;
  - the training expenses are not claimed by the agent as a relief or expense, and
  - the principal shares the risks and rewards of the agent.

3. Cash payout option

- Eligible businesses can now elect to convert 60 percent (up from 30 percent previously) of up to $100,000 of qualifying expenditure into a non-taxable cash payout, amounting to $60,000 per YA.
- Qualifying automation equipment acquired on hire purchase with the repayment schedule straddling two or more financial years would also now be eligible for the cash payout option.

The above changes are effective for YA 2012 to YA 2015 except for the cash payout option (effective for YA 2013 to YA 2015).

[Refer to Issue 5 of KPMG Tax Alert – March 2012 for a discussion of whether to "To Claim Enhanced Tax Deductions or Cash Out?"]

Recommended accounting treatment

Where the expenditure qualifies for PIC deduction, the enhanced deduction (i.e. the amount of deduction in excess of the expenditure) may be accounted for as an income tax credit under FRS 12 or as a government grant under FRS *20 Accounting for Government Grants and Disclosure of Government Assistance*.

[Refer to Financial Reporting Matters – March 2011 for a detailed discussion on what factors to consider when assessing whether to account for the enhanced deduction as an income tax credit or as a government grant and the recommended accounting entries under both approaches.]

In cases where the cash payout is expected to be elected, the quantum of cash payout is no longer limited to the amount of income taxes payable by the entity. Therefore, the amount of cash payout would be accounted for as a government grant under FRS 20.

[Refer to Financial Reporting Matters – March 2011 for a detailed discussion on the recommended accounting entries for cash payout accounted for under FRS 20.]

Disposal Gains from Equity Investments – Tax Certainty

In a move that would provide greater certainty for corporate groups (including Singapore domestic groups) based in Singapore, gains arising to Singapore companies on the disposal of ordinary shares during the period from 1 June 2012 to 31 May 2017 would not be subject to income tax where the following conditions are met:

a) The divesting company holds a minimum shareholding of 20 percent in the company being disposed of; and
b) The divesting company had maintained the minimum 20 percent shareholding in the company being disposed of for a minimum of 24 months prior to disposal.

This is effective for disposals of shares on/ after 1 June 2012.

[Refer to Issue 11 of KPMG Tax Alert – June 2012 for details.]

Recommended accounting treatment

Where a company holds a minimum of 20 percent shareholding, the investee is likely to be accounted for as a subsidiary, an associate or a jointly-controlled entity in the financial statements of the company.

Separate financial statements
Investments in subsidiaries, associates and jointly-controlled entities are typically accounted for at cost less impairment in the separate financial statements. Investments in subsidiaries, associates and jointly-controlled entities usually do not give rise to temporary differences in the separate financial statements as the tax base (the amount deductible for tax purposes when the carrying amount of the investment is recovered) is often equal to the cost of the investment.

Consolidated financial statements (or financial statements where the associate/jointly-controlled entity is accounted for using the equity-method)
In the consolidated/equity-accounted financial statements, the inclusion of the undistributed profits and other reserves of the subsidiary, associate or jointly-controlled entity typically will give rise to a taxable temporary difference.

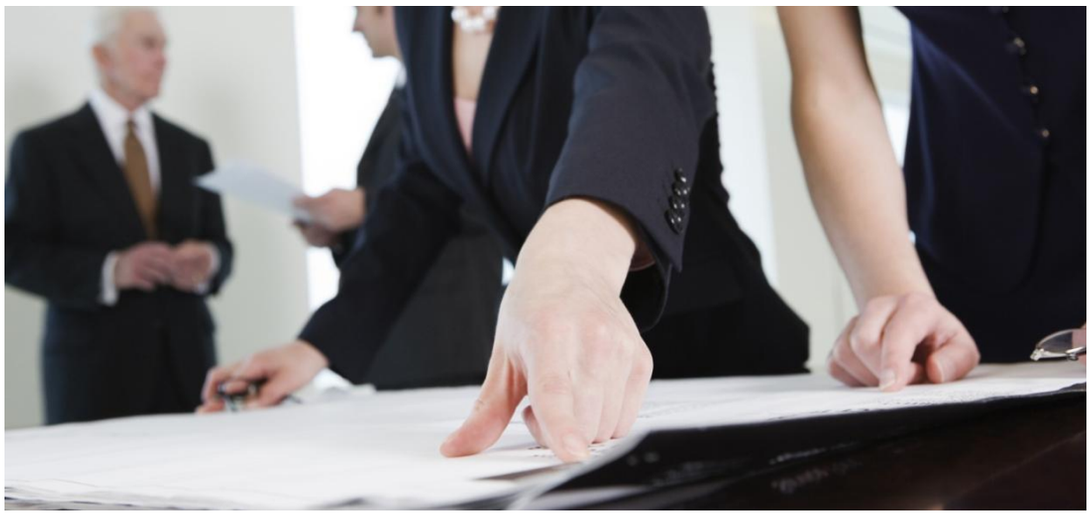
FRS 12.39 requires an entity to recognise deferred tax liabilities for all taxable temporary differences associated with investments in subsidiaries, associates and jointly-controlled entities, except to the extent that both the following conditions are satisfied:

- The parent company, investor or venturer is able to control the timing of the reversal of the temporary difference; and
- It is probable that the temporary difference will not reverse in the foreseeable future.

If any of the two conditions above are not met, deferred tax liabilities are measured based on:

- The expected manner the investor expects to recover the carrying amount of the investment (e.g. through disposal or dividend distribution); and
- The tax rate expected to apply when the carrying amount of the investment is recovered.

With the new tax measure that accords tax certainty on disposal gains from equity investments, parent company, investor or venturer that expects to divest the investments during the period from 1 June 2012 to 31 May 2017 could measure the deferred tax liabilities arising from the taxable temporary differences using a nil tax rate resulting in a deferred tax liability of nil. This may be the case if the specified conditions under the certainty of non-taxation rule are expected to be met and the disposal gains are not subject to tax in foreign jurisdictions.



Merger & Acquisition Scheme

The Merger & Acquisition (M&A) scheme was further enhanced as follows:

- There would now be 200 percent tax allowance on the transaction costs incurred on qualifying M&A, subject to an expenditure cap of $100,000 per YA.
- Qualifying M&As would now include acquisitions of the shares of target companies through multiple tiers of wholly-owned subsidiaries, instead of through just one tier. Furthermore, the relevant conditions that have to be satisfied under the scheme may be satisfied by any of the subsidiaries within the multiple tiers.
- The M&A scheme would be available for existing Headquarter incentive schemes, on a case-by-case basis.

This enhancement applies to qualifying M&As completed from 17 February 2012 to 31 March 2015.

[Refer to Issue 21 of KPMG Tax Alert – October 2011 for a discussion of the M&A scheme which was introduced in Budget 2010 and enhanced in Budget 2011.]

[Refer to Financial Reporting Matters – December 2011 for the recommended accounting treatment for the M&A allowances.]

Integrated Investment Allowance Scheme

Under the Integrated Investment Allowance (IIA) scheme, an allowance would be provided based on a percentage of approved fixed capital expenditure incurred on or after 17 February 2012 for productive equipment placed overseas on approved projects. To be eligible for IIA, the fixed capital expenditure must be incurred within the qualifying period of up to five years, or up to eight years for purchase of qualifying equipment on hire purchase, The IIA is to be set off against chargeable income derived from the approved project and is granted in addition to capital allowances. However, no investment allowances or enhanced deduction under PIC can be granted in respect of any capital expenditure on which IIA is granted.

The IIA scheme, administered by the Economic Development Board, is effective from 17 February 2012 and will run for five years.

We will be discussing the key features of the Integrated Investment Allowance Scheme and the recommended accounting treatment in a future issue of Financial Reporting Matters.

Enhancement to Renovation and Refurbishment Deduction

With effect from YA 2013, businesses can claim an increased deduction up to an expenditure cap of $300,000 ($150,000 for YA 2009 to 2012) for qualifying renovation and refurbishment costs for every three-year period. From YA 2013, any remaining unutilised deduction can be transferred under the Group Relief system, subject to qualifying conditions.

IRAS published a circular on "Tax Deduction for Expenses Incurred on Renovation or Refurbishment Works Done to Your Business Premises" on 6 June 2012. This circular is available on IRAS website. Interested readers could access the circular to find out more about this scheme.

Recommended accounting treatment

Renovation and refurbishment costs are typically recognised as property, plant and equipment in the financial statements and depreciated over their estimated useful lives.

Deferred tax accounting is not required for non-tax deductible renovation and refurbishment costs due to the initial recognition exemption under FRS 12.

For renovation and refurbishment costs that qualify for the renovation and refurbishment deduction, the tax depreciation for qualifying renovation and refurbishment costs is claimed based on the tax useful life of three years as prescribed under the Income Tax Act. Following the prescribed useful life, the renovation and refurbishment costs would usually be depreciated at a faster rate for tax purposes than for accounting purposes.

The acceleration of tax depreciation allows businesses to enjoy the tax deductions in the earlier years. However, in the later years where the tax depreciation is fully utilised, businesses would have to pay higher taxes as their accounting depreciation is not tax deductible.

From the accounting perspective, the acceleration of tax depreciation creates a temporary difference on a year–on-year basis as the total accounting and tax depreciation will eventually be the same at the end of the accounting useful life of the qualifying renovation and refurbishment costs.

Under FRS 12, the effect of the difference in the depreciation rate for accounting and tax purposes gives rise to temporary differences as the net book value (NBV) of the qualifying renovation and refurbishment costs in the financial statements will differ from its tax written down value (TWDV) in the tax return.

A deferred tax liability has to be recognised in full for all taxable temporary differences and the amount is calculated by multiplying the temporary differences (the difference between the NBV and the TWDV) with the applicable tax rate that is expected to apply when the carrying amount of the renovation and refurbishment costs is recovered.

3. Overview of 2012 changes – Legal and regulatory

This article is contributed by:

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In this section, we highlight key developments in Singapore legislation and other regulatory developments that affect current and future reporting.

ACRA Matters

Implementation of enhanced XBRL filing system in 2013

On 14 May 2012, ACRA released a consultation paper – "ACRA XBRL Revamp 2012", with a comment period ended on 11 June 2012. Thereafter, ACRA released a Response Paper which classified the feedback received and its response into the following categories:

- Revised XBRL filing requirements;
- ED ACRA Taxonomy 2012 and minimum tagging list; and
- How ACRA can facilitate preparation and submission of XBRL Financial Statements

What is coming in 2013?

- *Q1 2013:* Conduct focus group testing and public consultation on new XBRL preparation tool
- *Q2 2013:* Public release of revised XBRL filing requirements, ACRA Taxonomy 2012 and new XBRL preparation tool
- *Second half of 2013:* Implement enhanced XBRL filing system (including the revised filing requirements)

Are you required to adopt this enhanced XBRL filing system?

Singapore-incorporated companies

Yes, all Singapore-incorporated companies (unless exempted) submitting financial statements with financial periods ending on or after 30 April 2007 are required to file a full set of financial statements in XBRL.

Companies which are banks, registered insurers and finance companies regulated by MAS or allowed by law to prepare financial statements in accordance with accounting standards other than SFRS, SFRS for Small Entities and IFRS

No. However, there is now a requirement to append the Financial Statements Highlights together with the full set of financial statements in PDF.

You can access this Response Paper here.

MAS Matters

Revised Singapore Code on Take-overs and Mergers

On 23 March 2012, the MAS issued a revised Code on Take-overs and Mergers (the "Take-over Code"), which is administered by the Securities Industry Council (the "SIC"). The Take-over Code's primary objective is fair and equal treatment of all shareholders in a take-over or merger situation.

As highlighted in the MAS press release dated 23 March 2012, changes made to the Take-over Code (effective from 9 April 2012) serves to codify existing practices, keep pace with product innovation and market developments, enhance disclosure and provide flexibility. You can access the MAS press release here.

This Take-over Code applies to:

Corporations with a primary listing of their equity securities, business trusts with a primary listing of their units in Singapore and REITs.

All offerors, whether they are natural persons, corporations or bodies unincorporate; and extends to acts done or omitted to be done in and outside Singapore.

This Code does not apply to:

Unlisted public companies and unlisted business trusts, or private companies.

You can access this Take-over Code here.

New Risk Governance Guidance for Listed Boards

On 10 May 2012, the Corporate Governance Council of MAS released a Risk Governance Guidance for Listed Boards (the Guidance).

This Guidance, with a prime focus on risk management, serves to complement the Code of Corporate Governance and enhances the framework for corporate governance of companies listed on the Singapore Exchange. It is not meant to be a new rulebook or to prescribe additional standards. Its purpose is to enhance the awareness of Board members, and spur them to work towards strong corporate governance in their companies.

You can access this Guidance here.

MOF Matters

Review of Singapore Companies Act completed

On 3 October 2012, the MOF announced the completion of its review of the Singapore Companies Act (the "Act"). This comprehensive review is a major step forward in Singapore's corporate regulatory framework.

Of the 217 recommendations proposed by the Steering Committee for the Review of the Companies Act (the "SC"), the MOF has accepted 192 recommendations, modified 17 of them, while 8 remained unaccepted.

What is coming in 2013?

In implementing the 209 recommendations, MOF will be implementing the changes and re-writing the Act in two phases:

- *Phase 1:* Public consultation on a draft amendment bill to the Act in early 2013, expected to be tabled at Parliament by end of 2013
- *Phase 2:* Undertake a rewrite of the Act to rationalise the provisions and improve the clarity.

In our next issue, we will be covering in depth on how the re-write of the Act would affect you.

You can access the "Ministry of Finance's Response to the Report of the Steering Committee for Review of the Companies Act" here.

SGX Matters

Revised Code of Corporate Governance

On 2 May 2012, the MAS issued a revised Code of Corporate Governance (the "2012 Code"). The 2005 Code continues to be applicable to the listed companies for this coming financial year end (i.e. 31 December 2012).

Are you required to comply with the 2012 code?

Companies listed on the Singapore Exchange Securities Trading Limited (the "SGX-ST")

Yes, all companies listed on the SGX-ST with financial years beginning on or after 1 November 2012 are required to disclose their corporate governance practices in their annual reports in accordance with the 2012 Code. Where there are deviations, explanations must be provided.

REITs and Business Trusts registered the Business Trusts Act with a primary listing on the SGX-ST

Yes, these entities should comply with the 2012 Code with necessary adaptations.

What is expected in 2013 and after?

	Effective dates	For 31 Dec year-end listed entities	For 30 June year-end listed entities
The 2012 Code (except for Board composition)	Effective from financial years beginning on or after 1 Nov 2012	Effective from financial year beginning on 1 Jan 2013	Effective from financial year beginning on 1 July 2013
Board composition changes (except for changes due to Chairman-CEO issues)	Changes to be made at the AGM following the end of the financial year beginning on or after 1 Nov 2012	Changes to be made latest by 30 April 2014 (i.e. at the AGM following the financial year ending 31 Dec 2013)	Changes to be made latest by 31 Oct 2014 (i.e. at the AGM following the financial year ending 30 Jun 2014)
Board composition changes due to Chairman-CEO issues	Changes to be made at the AGM following the end of the financial year beginning on or after 1 May 2016	Changes to be made latest by 30 April 2018 (i.e. at the AGM following the financial year ending 31 Dec 2017)	Changes to be made latest by 31 Oct 2017 (i.e. at the AGM following the financial year ending 30 Jun 2017)

You can access the 2012 Code here.

Proposal to review the SGX Listing Manual

On 3 August 2012, the SGX announced that it has commenced meetings with market practitioners and stakeholders including the Association of Banks in Singapore (ABS) Corporate Finance Committee in early July 2012 to establish a working committee to review the SGX Listing Manual, which was revised in 2005, 2006, 2009 and 2011. This is part of SGX's continuing efforts to improve the Singapore securities market and keep pace with the developments in corporate governance standards worldwide.

This coming review will take a comprehensive look at the listing manual and dovetails well with SGX's initiatives to transform the marketplace. This working committee will be looking into the various components of the SGX Listing Manual such as the listing criteria, corporate governance, voting rights, among others, for the primary market. In the secondary market, these include ensuring it continues be conducted "effectively and efficiently in line with international best practices to ensure Singapore remains as a competitive financial centre."

ABS's involvement in this review allows for the practitioner's point of view to be considered in addressing practical issues and arriving at workable solutions. Similarly, SGX will also consider the recent proposals made by the Securities Investors Association (Singapore). SGX welcomes proposals from market participants, both professional and the public.

4. Consolidation relief for investment entities

This article is contributed by:

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Investment funds have long sought relief from consolidation, arguing that fair value information is more meaningful to a fund's investors. In a welcome move, the IASB has responded by providing an exception to consolidation for qualifying investment entities. Instead, investment entities are required to recognise their investments in controlled investees in a single line item in the balance sheet, measured at fair value through profit or loss (FVTPL). We hope this article helps you better understand the amendments and assess whether your organisation qualifies as an investment entity.

On 31 October 2012, the IASB published *Investment Entities* (Amendments to IFRS 10 *Consolidated Financial Statements*, IFRS 12 *Disclosures of Interests in Other Entities* and IAS 27 *Separate Financial Statements*) effective for annual periods beginning on or after 1 January 2014.

The IASB has acknowledged that this amendment deviates from its usual policy of avoiding industry-specific requirements; however, it believes that in this instance an industry-specific approach could bring multiple benefits, and might see more investment funds adopting IFRS. While this is a significant, positive change, the IASB's decision that a parent that is not an investment entity will still be required to consolidate all subsidiaries may result in such entities not jumping onto the IFRS bandwagon.

Insights – Adoption for Singapore entities

As we go to print, the amendments have not yet been issued in Singapore. However, we expect the ASC to issue identical amendments in the near future, with the same effective date of 1 January 2014. This would coincide with the effective date of the consolidation suite in Singapore. Refer to the September 2012 issue of this publication for more information on the deferral of the consolidation suite effective date.

Early adoption

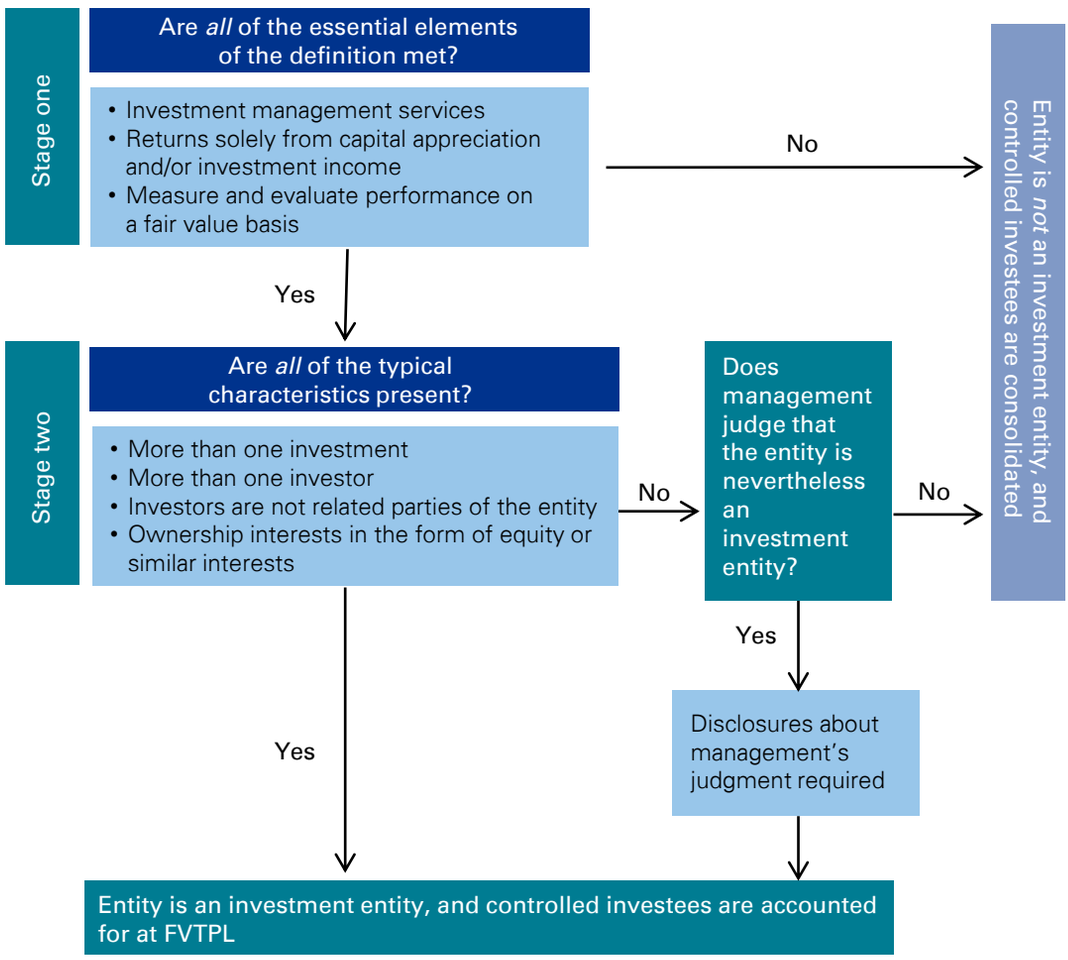
Simple investment funds that require little or no analysis under the amendments may consider early adoption once the amendments are issued in Singapore. However, such funds will also need to assess the consequential amendments made to standards other than FRS 110 (e.g. the FRS 112 disclosures) to ensure that full compliance is possible in a short period.

Two-stage approach in assessing qualification as an investment entity

In determining whether an entity qualifies as an investment entity, management needs to consider all facts and circumstances, including the purpose and design of the entity. To qualify as an investment entity, an entity needs to meet *all* of the essential elements of the definition of an investment entity and is expected – but *not* required - to display the typical characteristics of such an entity. We refer to this as the 'two-stage approach', as presented in the diagram below.

All essential elements of the definition must be met

Not necessary for all typical characteristics to be present



STAGE ONE

First essential element

Investment management services

An investment entity obtains funds from investors to provide those investors with investment management services. The IASB believes that providing these services is necessary to distinguish an investment entity from other types of entities. There is no further application guidance in the amendments regarding this particular requirement, but we expect assessment of this element to be generally straightforward.

Second essential element

Returns solely from capital appreciation and/or investment income

An investment entity commits to its investors that its business purpose is to invest for returns solely from capital appreciation and/or investment income. This commitment could, for example, be included in the offering memorandum, investor communications and/or other corporate or partnership documents. For an entity to show that its business purpose is to invest for returns solely from capital appreciation and/or investment income, the entity:

- Must document **potential exit strategies** for substantially all investments
- Must *not* obtain other benefits from its investees that are not available to other parties that are not related to the investees ("**prohibited benefits**")

Potential exit strategies

A documented potential exit strategy is required for *substantially all* investments that *could* be held indefinitely; this also means that debt securities with set maturities do not require exit strategies. The table below provides examples to illustrate this requirement.

Exit strategies not required for investments with fixed maturities

Investment	Exit strategy required?
Equity investments	Yes
Investment property	Yes
Debt instruments with a set maturity	No
Perpetual debt instruments	Yes
Debt instruments with equity conversion feature	Yes

Exit strategies that are put in place only for default events - such as breach of contract or non-performance - are not considered exit strategies for the purposes of this assessment.

Exit strategies can be at portfolio level

A potential exit strategy is not required for each investment, but rather for each type or portfolio of investments. The following are examples of exit strategies for financial and non-financial investments.

Debt securities	Equity investments	Investment property
• Private placement • Converting debt to equity with subsequent sale	• Private placement • Initial public offering • Distribution of ownership interests	• Private placement • Sale on the open market

Substantive exit time frame required

As an investment entity does not plan to hold its investments indefinitely, it is critical that the exit strategies include a *substantive* time frame for exiting the investments. An investment entity must therefore document both how *and* when it expects to exit its investments.

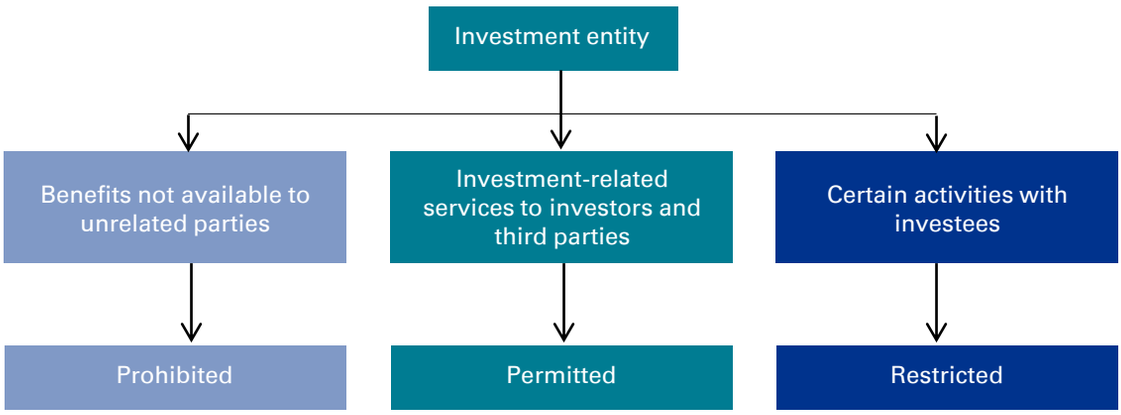
Prohibited benefits

The amendments include examples of relationships and transactions that preclude an entity from qualifying as an investment entity because they indicate that the entity is investing to earn benefits other than capital appreciation and/or investment income.

Examples of prohibited benefits

- Acquiring, using, exchanging or exploiting intangible assets, technology or processes of an investee - e.g. an option to buy an asset if its development is successful.
- Participation as a joint controller in a joint arrangement, the purpose of which is to develop, produce, market or provide products or services (see our September 2012 issue of this publication for guidance on the concept of a joint arrangement).
- Obtaining a guarantee or collateral from an investee over the entity's borrowings; however, this does not preclude an investment entity from using its investment in an investee as collateral for borrowings.
- A related party of the investment entity holding an option to acquire ownership interests in the investee from the entity.
- Other transactions:
  - with terms that are not available to investors that are not related parties;
  - that are not at fair value; or
  - that represent a significant portion of the business activities of the investee.

The amendments also include specific guidance on certain relationships, transactions and services that are permitted or restricted.

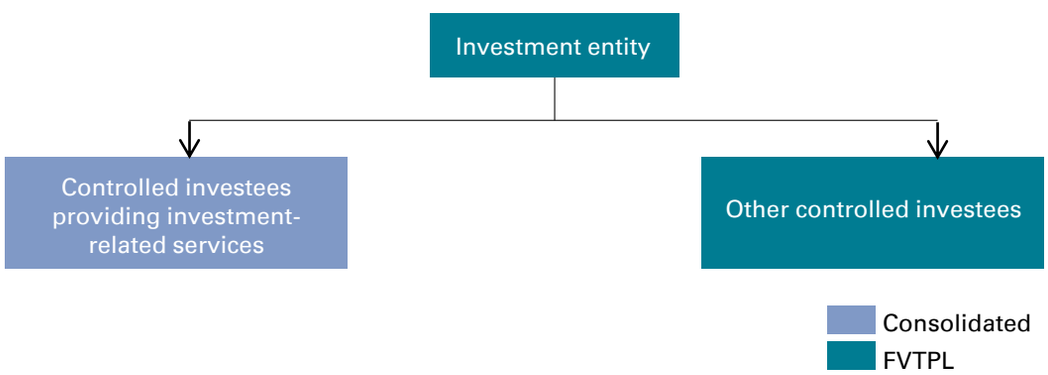


Permitted services

These can represent a substantial business activity of an investment entity

As part of its activities, an investment entity is permitted to provide investment-related services to investors. Such services could include, for example, investment advisory services, investment management, investment support and administrative services. Even if the investment-related services are substantial and are also provided to third parties, this does not preclude an entity from qualifying as an investment entity, as such services are simply an extension of an investment entity's investing activities.

Permitted investment-related services may be provided directly or through a subsidiary. As shown in the diagram below, subsidiaries providing such services will be consolidated.



Restricted services

These cannot represent a substantial business activity of an investment entity

However, providing management services or strategic advice to the investee, or providing financial support to the investee - e.g. through a loan, capital commitment or guarantee - is prohibited, unless these activities:

- do not represent a substantial business activity or a separate substantial source of income of the entity; and
- are undertaken to maximise the investment return from the investee.

Insights – Private equity funds set to be the major beneficiaries

The decision to allow investment-related services was a result of late re-deliberations by the IASB, and was intended to benefit private equity funds. Although management will need to exercise judgement, specifically when restricted activities are performed, there is an expectation that such funds will often qualify as investment entities.

Third essential element

Investments are required to be measured at fair value

Non-investments assets and financial liabilities are not required to be measured at fair value

Measure and evaluate performance on a fair value basis

The final element of the definition of an investment entity is the measurement and performance evaluation of *substantially all* investments on a fair value basis. Therefore in addition to measuring its subsidiaries at FVTPL, an investment entity has to meet the following requirements:

- in all instances permitted by IFRS, investments should be accounted for under the fair value model, including:
  - investment property should be measured at fair value under IAS 40 *Investment Property*;
  - financial assets should be measured at fair value under IFRS *9 Financial Instruments* or IAS 39 *Financial Instruments: Recognition and Measurement*; and
  - investments in associates and joint ventures should be measured at fair value under IAS 28 (2011) *Investments in Associates and Joint Ventures*; and
- fair value information should be used by key management personnel as the primary attribute in evaluating the performance of investees and in making investment decisions.

Non-investment assets - e.g. own-use property and equipment under IAS 16 *Property, Plant and Equipment* - and financial liabilities need not be measured at fair value.

Insights – Fair value changes in other comprehensive income permitted

The amendments require an investment entity to measure its investments in subsidiaries, associates and joint ventures at FVTPL. A question arises as to whether this would preclude an investment entity from measuring its financial assets within the scope of IFRS 9 or IAS 39 at fair value through other comprehensive income (FVTOCI) e.g. available-for-sale financial assets.

While it may appear counter-intuitive to permit financial assets to be measured at FVTOCI but at the same time require investments in subsidiaries, associates and joint ventures to be measured at FVTPL, the basis for conclusions notes that the recognition of fair value changes in OCI does not preclude an entity from qualifying as an investment entity [IFRS 10.BC251].

Insights – Fair value for venture capitalists maintained

For venture capital organisations and similar entities that do not qualify as investment entities, the exemption from equity accounting remains. Such entities may therefore still choose to measure all of its investments in associates and joint ventures at FVTPL.

Insights – Unit of account

There is no guidance on the basis on which to measure fair value - e.g. whether an investment entity should measure its investment in a controlled investee on the basis of the value of an individual share, or whether a control premium should be included in the valuation. The IFRIC is expected to consider the issue in the near future.

Insights – Judgement required in assessing 'substantially all' and 'substantive'

An investment entity is required to have a 'substantive' exit time frame for 'substantially all its investments and to measure and evaluate 'substantially all' its investments on a fair value basis. However, there is no specific guidance on the threshold required for an investment entity to conclude that it meets these tests, and management will need to use its judgement.

An entity may account for investment property under the fair value model, but some properties might be accounted for under the cost model because fair value cannot be determined reliably. In that case, the entity will assess the extent of its investment property accounted for under the cost model to determine if the 'substantially all' test is met.

Applying the definition of an investment entity

Illustrative example

The following example is derived from the illustrative examples published with, but not forming an integral part of, the amendments.

Scenario

- A Real Estate Fund (REF) develops, owns and operates retail, office and other commercial property through its wholly owned subsidiaries, each holding a separate property.
- Property investments held within the subsidiaries are accounted for by REF and each of its subsidiaries at fair value under IAS 40.
- REF does not have a set time frame for disposing of its property investments, but uses fair value to identify the optimal time for disposal. REF and its investors also consider other factors (e.g. expected cash flows) in making their decisions.
- Although fair value is a key performance indicator, key management personnel do not consider it a key attribute in assessing performance.
- REF undertakes property and asset management activities, including property management, capital expenditure and tenant selection, which it outsources to third parties. These are a substantial part of REF's business.

Analysis

REF does not qualify as an investment entity for any of the following reasons - i.e. any one of the following precludes REF from qualifying as an investment entity.

- REF has a separate substantial business activity (property and asset management) - i.e. its activities go too far beyond earning returns from capital appreciation and/or investment income.
- REF does not have exit strategies for its investments in real estate.
- Fair value is one of the performance indicators used by REF. However, it is not the primary attribute used by key management personnel in evaluating performance and making investment decisions.

Insights

The wording of the illustrative example on real estate funds suggests that the IASB intends very few real estate funds to qualify as investment entities.

In our experience, while real estate funds may be set up in various ways in different jurisdictions, most real estate funds do not have a set time frame for disposing of their investment properties and do not use fair value as a primary attribute in assessing performance. In certain jurisdictions, real estate funds may also be involved in construction or redevelopment, and it is common for them to be involved in operations.

Judgement is required to evaluate, using the facts and circumstances for each case, whether a real estate fund qualify as an investment entity.

STAGE TWO

Typical characteristics

The absence of one or more of these typical characteristics does not immediately disqualify an entity from being classified as an investment entity

An investment entity is expected to display the following typical characteristics. However, it is possible for an entity to have none of these characteristics and still qualify as an investment entity. In such cases additional judgement is required by management in determining whether the entity qualifies. An investment entity is required to disclose its reasons for concluding that it is nevertheless an investment entity when one or more of these characteristics is not met.

Typical characteristics	Comment
Holds more than one investment	While not typical, an investment entity might hold a single investment in the following situations, for example: • a start-up or wind-up period; or • when its purpose and design is to provide investors with access to an investment that they would not otherwise have access to - e.g. a feeder fund.
Has more than one investor	While an investment entity is generally expected to have multiple investors, in some cases a single investor is entirely credible, for example: • a pension fund, government investment fund or family trust representing a wider group of investors • a single feeder fund in a master-feeder structure • temporarily during the investment entity's start-up or wind-up period
Has investors that are not related parties	Another typical characteristic of an investment entity is having investors that are not related parties (as defined in IAS 24 *Related Party Disclosures*) to the entity.
Has ownership interests in the form of equity or similar interests	Each unit of ownership in an investment entity typically represents a specifically identifiable proportionate share in its net assets. However, it is also acceptable for an investment entity to have multiple classes of investors with separate investment pools per class or differential rights in the share of net assets - e.g. in a waterfall structure. An investment entity may have significant ownership interests that are classified as liabilities under IAS 32 *Financial Instruments: Presentation*, as long as debt holders are exposed to variable returns from changes in the fair value of the entity's net assets.

New disclosures

For investments in subsidiaries, associates and joint ventures accounted for at FVTPL under the amendments, the following disclosures apply: IFRS 7 *Financial Instruments: Disclosures*, IFRS 12 IFRS 13 *Fair Value Measurement* and IAS 24.

The IFRS 7 disclosures are likely to be the most significant; for example, the sensitivity analysis disclosures now apply to the investee as a whole rather than to its underlying investments on a consolidated basis.

Parents of investment entities

Parent is an investment entity

The investment entity consolidation exception is mandatory for the parent of an investment entity that itself meets the definition of an investment entity. In addition, because the parent is an investment entity, any investments in associates and joint ventures are required to be accounted for at FVTPL.

Parent is not an investment entity

The consolidation exception is not carried through to the consolidated financial statements of a parent that is not itself an investment entity - i.e. the parent is nevertheless required to consolidate all subsidiaries.

Insights – Potentially broad consequences

Although many investment entities will have a parent that is an investment entity - which means that the exception will be carried through - in our experience, some will have a parent that is a non-qualifying bank or an insurance company or another non-investment entity. In such situations, any cost saving will be lost because consolidation will still be required, but at a higher level.

Effective date and transition

The effective date of the amendments is for annual periods beginning on or after 1 January 2014. Earlier application is allowed, provided IFRS 10 and the rest of the consolidation suite are also applied at the same time.

An entity tests whether it is an investment entity at the 'date of initial application' of the amendments which is 1 January 2014 for an entity with a calendar year end that does not early adopt. Comparative information is restated unless impracticable. However, like IFRS 10, the requirement to present restated comparatives is limited to the immediately preceding period.

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Find out more

First Impressions: Consolidation relief for investment funds is a publication produced by KPMG International Standards Group. The *First Impressions* covers the amendments in greater detail, including examples on initial application, changes in investment entity status and a comparison to US GAAP.

This publication may be downloaded at:
http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/first-impressions/Pages/first-impressions-consolidation-relief.aspx

5. Offsetting financial assets and financial liabilities

This article is contributed by:

Reinhard Klemmer
Partner, Professional Practice

The amendments to FRS 32 *Financial Instruments: Presentation* and FRS 107 *Financial Instruments: Disclosures* on offsetting financial assets and financial liabilities, issued on 26 March 2012, clarify the existing criteria for net presentation on the face of the balance sheet and introduce new disclosure requirements that provide information on both the gross and the net amounts of financial assets and liabilities that are subject to legally enforceable netting arrangements.

These amendments are equivalent to the amendments issued by the IASB on 16 December 2011.

Why is this project on the IASB's agenda?

US GAAP currently allows companies the option to offset and present net on the face of the balance sheets, financial assets and financial liabilities that are subject to legally enforceable netting arrangements where the rights of set-off are only available following a specified event of default or bankruptcy. Under IFRS, netting of financial assets and financial liabilities that are subject to such rights is prohibited.

Although netting is an accounting option under US GAAP, it is commonly applied by financial institutions to offset derivative assets and liabilities that are subject to master netting agreements where the rights of set-off are available only in the event of default or bankruptcy. This accounting difference, alone, constitutes the single largest quantitative difference in reported numbers between IFRS and US GAAP.

Following requests from users of financial statements and recommendations from the Financial Stability Board, the IASB and the FASB (the Boards) added a project to establish a common approach to offsetting of financial assets and financial liabilities on their respective agendas in June 2010.

Arising from this, an exposure draft was jointly issued by the Boards in January 2011 that proposed a converged offsetting model. The proposals in the exposure draft were nearer to the offsetting model under IFRS and were expected to have a far more significant impact on entities reporting under US GAAP. Affected entities, predominantly financial institutions, reporting under US GAAP were faced with the prospect of grossing up their balance sheets, which would have a direct impact on critical ratios like the Basel leverage ratio and regulatory capital requirements like the capital adequacy ratio.

After considering feedback on the proposals, the IASB and the FASB decided to preserve their current offsetting models and deal with this difference by way of having a set of converged disclosure requirements that are designed to allow users to reconcile the financial statements prepared under both GAAPs.

What is the issue?

When an entity (Company A) has an outstanding amount due from (a receivable asset) Company B and an outstanding amount due to (a payable liability) Company B, can Company A present the two amounts net on the face of its balance sheet?

What are the criteria for net presentation?

Under FRS 1, assets and liabilities should not be presented net unless another FRS permits net presentation. Where the assets and liabilities in question are financial instruments, specific guidance is available in FRS 32 on when an entity should offset a financial asset and a financial liability and present the net amount on the face of the balance sheet.

Under FRS 32, an entity is required to offset a financial asset and a financial liability and present the net amount on the face of the balance sheet when the following two offsetting criteria are met:

1. the entity currently has a legally enforceable right to set off the amounts; and
2. the entity intends to settle the financial asset and the financial liability on a net basis or to realise the financial asset and settle the financial liability simultaneously (i.e. at the same moment).

In the above example, the receivable and payable are presented net on the face of the balance sheet only if the two offsetting criteria under FRS 32 are satisfied. This would usually be the case if there is a legally enforceable agreement between Company A and Company B that requires the two amounts to be set off on settlement date and the two amounts fall due on the same date.

Why did the IASB amend IAS 32?

Through various outreach activities on the exposure draft, the IASB observed that there were inconsistencies in practice on the application of the two offsetting criteria.

IAS 32 was therefore amended to clarify:

1. the meaning of *"currently has a legally enforceable right of set off"* in offsetting criterion 1 above; and
2. the situations where settlement on a gross basis that does not occur simultaneously (e.g. settlements through central counterparties or clearing houses) would be considered equivalent to net settlement and therefore satisfy offsetting criterion 2 above.

Meaning of *"currently has a legally enforceable right of set off"*

Under the amendments, an entity "currently has a legally enforceable right to set off" if that right is:

- not contingent on a future event; and
- enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and all counterparties.

The amendments clarify that, in order to qualify for offsetting, the right needs to be exercisable when the amounts are due and payable. They also clarify that the availability of a right of set-off cannot be contingent or conditional on a future event, because that right of set-off would not exist until, or would only exist up to, the occurrence of the contingency or the future event. In addition, it is made clear that the passage of time, and uncertainties in the amounts to be settled, are not considered contingencies.

The following examples illustrate the application of the amendments.

Example 1 – Right of set-off arises at a future date

Facts

As at 31 December 20X1, Company A has an outstanding amount of $9,000 due from (a receivable asset) Company B and an outstanding amount of $10,000 due to (a payable liability) Company B. Both amounts are due and payable on 31 March 20X2. The two transactions are subject to a right of set-off that requires net settlement of amounts due and payable on the same date in all circumstances.

Question

Can Company A present the two amounts net in its balance sheet as at 31 December 20X1?

Analysis

Before the amendments – Likely yes

Offsetting criterion 1: FRS 32 does not have extensive guidance on whether a right of set-off that will arise only at a future date would satisfy the "currently has a legally enforceable right to set off" criterion. In practice, it is generally interpreted that such right would satisfy offsetting criterion 1 so long as the right is exercisable during the periods when the amounts are due and payable.

Offsetting criterion 2: The two transactions both fall due for settlement on 31 March 20X2 and the right of set-off ensures that settlement will be on a net basis. Therefore, this criterion is satisfied.

After the amendments – Yes

Offsetting criterion 1: This criterion is satisfied. The amendments clarify that the passage of time does not preclude an entity from currently having a legally enforceable right of set-off. Therefore, the fact that payments subject to the right will only arise at a future date is not itself a contingency or condition that precludes offsetting.

Offsetting criterion 2: Same analysis and conclusion as above.

Example 2 – Right of set-off is set aside on bankruptcy of the counterparty

Facts

Same facts as Illustrative Example 1.

Except that based on the local laws and regulations in Company B's jurisdiction, on bankruptcy of Company B, the right of set-off is set aside.

Question

Can Company A present the two amounts net in its balance sheet as at 31 December 20X1?

Analysis

Before the amendments – Diversity in practice

Offsetting criterion 1: FRS 32 does not have guidance on whether a right of set-off that is set aside on bankruptcy of the counterparty would satisfy the "currently has a legally enforceable right to set off" criterion. If Company B is not at risk of going into bankruptcy, some may have interpreted that such right of set-off that is enforceable in the normal course of business satisfies this criterion.

Offsetting criterion 2: Provided that Company B is not at risk of going into bankruptcy, this criterion is satisfied as the two transactions both fall due for settlement on 31 March 20X2 and the right of set-off ensures that settlement will be on a net basis in the normal course of business.

After the amendments – No

Offsetting criterion 1: This criterion is not satisfied. The amendments clarify that the right of set-off must be enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and **all counterparties**. Given that the right of set-off is set aside on bankruptcy of the counterparty Company B, such right does not satisfy this criterion after the amendments.

Offsetting criterion 2: Analysis is not required since criterion 1 is not satisfied.

Example 3 – Right of set-off is set aside on bankruptcy of the reporting entity

Facts

Same facts as Illustrative Example 1.

Except that based on the local laws and regulations in Company A's jurisdiction, on bankruptcy of Company A, the right of set-off is set aside.

Question

Can Company A present the two amounts net in its balance sheet as at 31 December 20X1?

Analysis

Before the amendments – Diversity in practice

Offsetting criterion 1: FRS 32 does not have guidance on whether a right of set-off that is set aside on bankruptcy of the reporting entity would satisfy the "currently has a legally enforceable right to set off" criterion. Some may have interpreted that such right of set-off would satisfy this criterion to be consistent with the going concern basis that underlies preparation of Company A's financial statements.

Offsetting criterion 2: Provided that Company A's financial statements are prepared on a going concern basis, this criterion is satisfied as the two transactions both fall due for settlement on 31 March 20X2 and the right of set-off ensures that settlement will be on a net basis in the normal course of business.

After the amendments – No

Offsetting criterion 1: This criterion is not satisfied. The amendments clarify that the right of set-off must be enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of **the entity** and all counterparties. Given that the right of set-off is set aside on bankruptcy of the reporting entity, Company A, such right does not satisfy this criterion after the amendments.

Offsetting criterion 2: Analysis is not required since criterion 1 is not satisfied.

Insights

The clarifications above are not expected to increase the level of offsetting achieved currently. Instead, transactions that are currently netted off in the balance sheets may be at risk of failing the offsetting criteria after the advent of the amendments as illustrated in the above examples.

Entities will need to reassess existing transactions that are netted off to determine whether the current application of the offsetting criteria is consistent with the amendments. In making the determination, both the contractual terms and the laws (for example: statutes, regulations, court rulings) in the respective jurisdictions, including the bankruptcy regime, which govern the contract, must be considered.

It may be difficult to evaluate whether a right of set-off exists, and whether and when it is legally enforceable. Specialist knowledge may be required, especially if the laws of multiple jurisdictions are relevant. It may also be necessary to obtain the opinion of legal experts.

Gross settlement system that is equivalent to net settlement

Settlements through clearing houses are widely accepted as always meeting the simultaneous settlement criterion even though the settlement of two positions by exchanging gross cash flows through clearing houses at exactly the same moment rarely occurs in practice due to processing constraints and time zone differences.

Given that some gross settlement systems are designed to achieve what is economically considered to be netting, FRS 32 was amended to clarify the features a gross settlement system must have in order to satisfy offsetting criterion 2.

Under the amendments, gross settlement mechanisms that have features that eliminate or result in insignificant credit and liquidity risk and process receivables and payables in a single net settlement process or cycle would satisfy offsetting criterion 2 as they are, in effect, equivalent to net settlement.

The amendments further state, for example, that a gross settlement system with all of the following features would be equivalent to net settlement.

a. Financial assets and financial liabilities eligible for set-off are submitted at the same point in time for processing.
b. Once the financial assets and financial liabilities are submitted for processing, the parties are committed to fulfil the settlement obligation.
c. There is no potential for the cash flows arising from the assets and liabilities to change once they have been submitted for processing (unless the processing fails—see (d) below).
d. Assets and liabilities that are collateralised with securities will be settled on a securities transfer or similar system (for example, delivery versus payment), so that if the transfer of securities fails, the processing of the related receivable or payable for which the securities are collateral will also fail (and vice versa).
e. Any transactions that fail, as outlined in (d), will be re-entered for processing until they are settled.
f. Settlement is carried out through the same settlement institution (for example, a settlement bank, a central bank or a central securities depository); and
g. An intraday credit facility is in place that will provide sufficient overdraft amounts to enable the processing of payments at the settlement date for each of the parties, and it is virtually certain that the intraday credit facility will be honoured if called upon.

Insights

Although there is a general expectation that most settlements through clearing houses would continue to meet the offsetting criteria after the amendments, a detailed assessment of the characteristics of the settlement systems would still be required to determine whether the current application of the offsetting criteria is consistent with the amendments.

Given that the amendments are effective for annual periods beginning 1 January 2014 (with retrospective application), we would encourage entities with transactions that are cleared through clearing houses or central counterparties to start the assessment earlier rather than later.

Additionally, the Monetary Authority of Singapore (MAS) has proposed to mandate central clearing of over-the-counter (OTC) derivative trades at regulated central counterparties. The proposal by MAS is consistent with the global trend towards the use of central counterparties for more types of financial instruments. Entities that are affected by the MAS proposal could consider working together in advance to ensure that the characteristics of the gross settlement systems ultimately set up at the regulated central counterparties are considered equivalent to net settlement based on the amendments, thereby allowing net presentation of those centrally cleared derivatives in the balance sheets.

Amendments to FRS 107 require disclosure of both the gross and the net amounts of financial assets and liabilities that are subject to legally enforceable netting arrangements

The amendments to FRS 107 require entities to disclose information on financial assets and financial liabilities that are offset on the face of the balance sheet and those that are presented gross on the face of the balance sheet but are subject to enforceable master netting arrangements or similar agreements.

The illustration below is an example of the quantitative information required to be disclosed.

Illustrative quantitative disclosure – By type of financial instrument

This illustrative disclosure only illustrates the quantitative information required to be disclosed for financial assets. A separate table showing the required information for financial liabilities is also required.

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at 31 Dec 20XX	(a)	(b)	(c) = (a) – (b)	(d)		(e) = (c) – (d)
				Related amounts not set off in the statement of financial position		
	Gross amounts of recognised financial assets	Gross amounts of recognised financial liabilities set off in the statement of financial position	Net amounts of financial assets presented in the statement of financial position	(d)(i),(d)(ii) Financial instruments	(d)(ii) Cash collateral received	Net amount
Description						
Derivatives	200	(80)	120	(80)	(30)	10
Reverse repurchase, securities borrowing and similar agreements	90	-	90	(90)	-	-
Other financial instruments	-	-	-	-	-	-
Total	290	(80)	210	(170)	(30)	10

Extract from: FRS 107.IG40D

The amendments set out the following information that should be disclosed at the minimum:

Column (a)	The gross amounts of those recognised financial assets and recognised financial liabilities that are offset on the face of the balance sheet and those that are presented gross on the face of the balance sheet but are subject to enforceable master netting arrangements or similar agreements.
Column (b)	The amounts that have been offset on the face of the balance sheet in accordance with the offsetting criteria in FRS 32.
Column (c)	The net amounts presented in the statement of financial position – i.e. the difference between (a) and (b). These amounts should be reconciled to the line item amounts presented in the balance sheet.
Column (d)	The amounts subject to enforceable master netting arrangements or similar agreements that do not qualify for offsetting under FRS 32, including: i. the carrying amounts of recognised financial instruments that do not meet the offsetting criteria; and ii. the fair values of financial collateral (including cash collateral) actually pledged or received. • The total amount disclosed should be limited to the amount in (c) for the related financial instrument to which the right of set-off applies and should take into account the effects of over-collateralisation (i.e. over- collateralisation should be eliminated). • For recognised financial assets and financial liabilities, with the exception of financial collateral that does not meet the offsetting criteria, the amounts disclosed should be based on their carrying amounts. A description of differences due to different measurement requirements should be disclosed, if any. • The disclosures should also include a description of the types and nature of the rights under those arrangements. For instruments subject to rights of set-off that are not contingent on a future event but that do not meet the remaining offsetting criteria in FRS 32, the reason(s) why the criteria are not satisfied should also be disclosed
Column (e)	The net amount after deducting the amounts in (d) from the amounts in (c) above.

It should be noted that:

- The amendments require the quantitative information to be presented in a tabular format, separately for financial assets and financial liabilities, unless another format is more appropriate. If the information is disclosed in more than one note in the financial statements, cross-reference between these notes would generally be expected.
- In terms of how to group the quantitative information, the disclosures could be grouped by type of financial instrument (as illustrated in the previous page) or transaction (e.g. derivatives, repurchase and reverse repurchase agreements or securities borrowing and securities lending agreements). Alternatively, (c) to (e) could be grouped by counterparty. If the disclosures are grouped by counterparty, the names of counterparties need not be disclosed. However, the designation of counterparties (Counterparty A, Counterparty B, Counterparty C etc.) must be consistent from year to year for the years presented to maintain comparability. Furthermore, individually significant counterparties should be disclosed separately.

Insights

The above disclosure requirements are all new as they are intended to provide information on the gross and net amounts that are necessary for reconciling between the US GAAP and IFRS financial statements. We expect financial services entities to be most affected by these new disclosure requirements. Affected entities can refer to the amendments for example that illustrates the possible ways to disclose the information to meet the minimum disclosure requirements.

Affected entities should also take note that:

- The information on the financial collateral required to be disclosed in (d)(ii) is different from the disclosure of the financial effects of collateral held as security currently required under FRS 107.36(b). The purpose of the disclosure in FRS 107.36(b) is to ascertain the reporting entity's net exposure to credit risk. Therefore, under FRS 107.36(b), the collateral held includes both financial and non-financial collateral and extend to collateral yet to be received. The disclosure in (d)(ii) above is only limited to financial collateral that is actually received, given that the objective of the amendments (on offsetting) is to have a set of disclosures that would help users of financial statements to understand the actual and potential effects of netting arrangements on the reporting entity's financial position.
- Where a transferred financial asset is not derecognised because the transfer fails to meet the derecognition criteria under FRS 39, that financial asset and the associated liability do not fall within the scope of these disclosure requirements. Instead, they would be within the scope of the new disclosure requirements introduced by the amendments to FRS 107 *Disclosures – Transfers of Financial Assets* issued on 23 February 2011. Details of the amendments were discussed in our June 2011 issue of Financial Reporting Matters.

Effective dates and transition

The amendments to FRS 107 are effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods.

The amendments to FRS 32 are effective for annual periods beginning on or after 1 January 2014 and interim periods within those annual periods. Earlier application is permitted if an entity also makes the disclosures required under the amendments to FRS 107.

Both amendments are to be applied retrospectively.

Insights

FRS 1 requires an entity to present as a minimum two balance sheets – i.e. one at the end of the current period and one at the end of the previous period. However, when an entity applies the amendments retrospectively, FRS 1 may require the presentation of a third balance sheet. In our view, a third balance sheet is required when the amendments have a material impact on the comparative balance sheet at the beginning of the earliest comparative period.

Find out more

First Impressions: Offsetting financial assets and financial liabilities is a publication produced by KPMG International Standards Group. This publication discusses the IASB's clarification of the offsetting model. It also highlights the newly issued common offsetting disclosure requirements by the IASB and FASB.

This publication may be downloaded free of charge at:
http://www.kpmg.com/global/en/issuesandinsights/articlespublications/first-impressions/pages/first-impressions-offsetting.aspx

6. Auditors' report changes: Different interactions between entities and auditors?

This article is contributed by:

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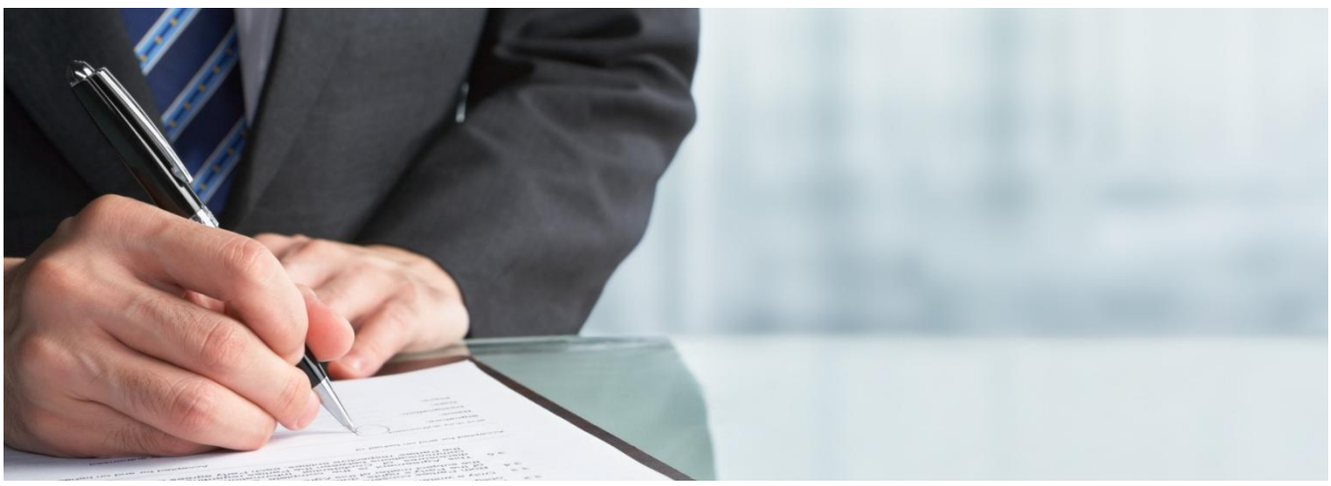


We summarise the key proposed changes to auditors' reports and how they may impact the interaction between entities and their auditors.

Increasing the value of auditor reporting

The IAASB is proposing that auditors should provide commentary in their reports on issues of greatest interest to users of financial statements, explicit statements on going concern and whether the auditor spotted material inconsistencies between financial statements and other information.

The IAASB's proposed changes are driven by users' request for more insight into audited entities and their financial statements. Investors and financial analysts are calling for more information from auditors to assist in their decision-making in today's global business environment with increasingly complex financial reporting requirements. Although the auditors' "pass-fail opinion" is valuable, they would like more transparency about what the auditor does on an audit and the results of that work in the auditor commentary.

The IAASB published their Invitation to Comment: Improving the Auditor's Report (the ITC) on 22 June 2012. The IAASB sought stakeholders' inputs on the IAASB's indicative direction and proposed changes on how the auditors' report could be made more useful to users (especially to investors, but also regulators, preparers and others) in the aftermath of the global financial crisis.

> *"We support the IAASB's initiative to enhance the quality, relevance and value of auditor reporting and agree that users can benefit from auditor insights."*
>
> *"It is important that the proposals relating to auditor commentary are developed using robust criteria which will enable auditors to provide meaningful commentary that is responsive to users' needs."*
>
> Joachim Schindler, Global Head of Audit (In the Headlines, June 2012, Issue 2012/10)

We aim to actively participate in providing our inputs to IAASB in order to make the result practicable and relevant. *We expect changes will come and we expect more qualitative disclosures in the auditors' report that will move away from boiler-plate opinions.* Arising from auditors' commentary that require significant professional judgement in commenting on company-specific accounting and auditing issues, such judgements will be subject to discussions with the management of the auditee. Differences in economic and operating environments, accounting and auditing issues, and even auditing procedures and application of professional judgements will result in variations amongst companies and year-on-year. This is as succinctly pointed out by Jim Sylph, Executive Director for Professional Standards at the International Federation of Accountants, "We are going to a potential model where two very successful companies that are both very profitable and very viable in the same industry could have different audit reports. This is a big change."[1]

The requirement for the auditor to communicate directly information about the company would likely affect the way in which auditors, management and those charged with governance (TCWG) interact. The right levels of interaction with management and TCWG is required to avoid "dueling information" that conflicts with management's disclosures. We can expect iterative dialogue on the matters and wordings in the auditor commentary.

[1] IAASB Calls for Commentary in Audit Report, Compliance Week, 26 June 2012

Timeline

- **22 June 2012** Issued invitation to all interested parties to comment
- **8 October 2012** Comment period ended
- **June 2013** Exposure draft expected
- **June 2014** Final revised standard expected

Key proposals in the June 2012 ITC
• Explicit statements on going concern: - auditor to conclude on whether management's use of the going concern assumption is appropriate; and - auditor to state if material uncertainties have been identified or not.

• Auditor commentary:
- intended to provide transparency about matters that are, in the auditors' judgement, likely to be most important to users' understanding of the audited financial statements or the audit.
- no specific criteria for identifying items to include but matters to be considered as a minimum are:
  - areas of significant management judgement;
  - significant or unusual transactions; and
  - matters of audit significance, including significant auditor judgment in conducting the audit (e.g. difficult or contentious matters, other significant issues related to audit scope or strategy).
- proposed auditor commentary to be required for public interest entities (PIEs), at a minimum, listed entities.
- current discussion for inclusion to be expanded to other PIEs.

• Disclosure of the name of the engagement partner
• Expanded disclosure of the responsibilities of management and those charged with governance (TCWG): - oversight of the financial reporting process (TCWG); - assessment of the appropriateness of the going concern assumption; and - awareness and disclosure of material uncertainties relating to the entity's ability to continue as a going concern.
• Explicit statement that the auditor has read the other information in the annual report containing the audited financial statements and identified no material inconsistencies

• Other changes to improve transparency:
- expanded disclosures to clarify auditor responsibilities in areas such as:
  - risk of fraud versus risk of error;
  - overall presentation, structure and content of financial statements;
  - group audits; and
  - communication with TCWG (listed entities only).
- disclosure of the involvement of other auditors.

Our views

Overall

KPMG submitted its comment letter, representing the views of the KPMG network, to the IAASB on 8 October 2012. We strongly support the IAASB's initiative to explore options to enhance the quality, relevance and value of auditor reporting.

The ITC proposals offer a practical basis for developing a response to user needs without changing the scope of today's audit, provided:

- Management and TCWG remain the primary source of information presented to users of financial statements.
- Users are not expected to have to sort through various sources of information provided separately by management, TCWG and independent auditors in order to form a complete understanding of the financial reporting.

We agree that change is required to respond to the needs of investors and other users. We believe that for such change to be effective it would be best achieved through a more holistic approach involving other parties, such as the IASB, the PCAOB, securities regulators and analysts to bridge the expectations and needs of users with the current financial reporting and auditing standards. For example, to consider:

- improvements to the relevance and informational value of financial statement disclosures;
- the nature and quality of other information that may be provided by management or TCWG including business risks and how they are managed; and
- exploring changes to the current scope of the audit and role of the auditor to more fully address the needs of investors and other users to help close the expectations gap by, for example, providing assurance on other information presented outside the financial statements, such as management discussion and analysis.

We also believe changes and additions are required to the proposals for them to be effective.

Auditor commentary

We believe there may be value in objective and fact-based auditor commentary intended to draw users' attention to matters disclosed in the financial statements that the auditor believes are of greatest interest to users. This may increase communication between the auditor and TCWG around such issues and may result in improved management disclosures. The auditor commentary should not however, undermine the overall opinion on the financial statements taken as a whole. Any requirement for such auditor commentary should be supported by additional guidance in auditing standards of agreed criteria to achieve some degree of consistency between issuers.

However, we question the value of requiring auditor commentary on specific procedures relating to parts of the audit. Users may not be able to place the procedures and the results into context as regards the auditors' opinion on the financial statements as a whole or to properly understand the interaction of procedures performed on related audit areas.

Mandatory auditor commentary will inevitably result in additional time and cost to both the auditor and the entity. We expect management and TCWG to take significant interest in the auditor commentary resulting in increased time for engagement teams, in particular partners and engagement quality control reviewers.

Going concern

We are very supportive of initiatives aimed at clarifying users' misunderstanding and enhancing current reporting requirements around going concern. However, to fully address users' needs, changes are required to existing financial reporting and auditing requirements:

- IAASB should work with IASB, PCAOB and other regulators to update requirements and guidance (including definitions of key terms such as *material uncertainties* and *significant doubt*) relating to the assessment of the going concern assumption applicable to both preparers of the financial statements and auditors.
- To ensure that management and TCWG are the originator of information about the entity, the statement that "no material uncertainties have been identified" should be provided by management, with the auditor commenting on this statement based on the audit.

We believe it would benefit all stakeholders if preparers had a requirement to perform a going concern assessment under all circumstances and a requirement to make an explicit statement on the results of their assessment and to disclose identified going concern uncertainties. We believe preparers should also be required to disclose their consideration of operational and business risks and their impact on going concern. As such information is forward looking and beyond the scope of financial statements, we recommend that it be disclosed in information accompanying the financial statements. The auditor could then provide assurance on such disclosures presented outside of the financial statements. Hence, we also recommend that regulators, users and the IAASB assess the benefits and costs of having auditors add credibility to non-financial information.

Specific considerations relating to financial institutions, in particular banks, which are clearly different from other entities in that confidence in a bank's solvency and liquidity is what sustains the business model – any fear about the future viability and solvency of a bank can give rise to a bank run and immediate liquidity concerns. Any expanded going concern disclosure requirement therefore needs careful consideration with banking regulators given the wider systemic contagion risks that can ensue.

What Singapore is saying

In Singapore, the IAASB's ITC was released by ICPAS on 17 July 2012, with comment period closed on 16 August 2012. In providing its comment letter dated 5 October 2012, ICPAS has solicited feedback through focus group sessions held with key stakeholders in Singapore, which included preparers and users of financial statements, audit firms and regulators.

Key points from the ICPAS comment letter includes:

- Imperative that the auditors' report is not used to comment on matters not disclosed in the financial statements.
- Auditors should not comment on entity-related information, which falls under the responsibility of management and TCWG.
- Management is primarily responsible for ensuring that the entity carries on as a going concern, not the auditors.

What is coming our way?

Globally, the IAASB's comment period has closed on 8 October 2012. The roundtables planned for were also successfully held on 10 September 2012, 14 September 2012 and 8 October 2012 in New York, Brussels and Kuala Lumpur respectively.

The feedback obtained from the public consultation and roundtables will be considered in developing the exposure drafts of revised standards for auditor reporting by June 2013, with an objective to issue the final standards a year thereafter.

What it means for preparers?

The proposed changes require auditors to present additional information about the entity. For example, auditors would be required to comment on the entity's going concern assumption and include, in the auditor commentary, information that auditors consider likely to be "most important" to users' understanding of the financial statements or the audit. We believe that preparers of financial statements will be keen in disclosing such information as otherwise, the auditors would be the only source of information and the auditors would have discretion on how to word it. We expect preparers would want their own voice being heard, either through additional disclosures within, or beyond the financial statements or through other means. For example, to address users' needs around the going concern assumption and adhere to the principle that management and TCWG are the original source of information about an entity, we believe it would benefit all stakeholders if preparers:

- perform a going concern assessment under all circumstances, and discuss with TCWG; and
- make an explicit statement on the results of their assessment; and disclose any identified going concern uncertainties, in the financial statements.

Under today's standard, management's going concern assessment is simply premised on the basis that management does not intend to liquidate the entity or cease trading, or has no realistic alternative but to do so. This in itself says nothing more about the entity's ongoing viability. To enhance the value of management reporting with respect to going concern and liquidity risk issues that entities may be facing, we believe it is time to consider requiring preparers to disclose, beyond the financial statements, forward-looking information on their consideration of operational and business risks and their impact on going concern.

We expect that the proposed additional information required in the auditors' report will result in increased interaction between the entities and the auditors. We expect senior levels of the entity such as executive management and TCWG to take significant interest in the matters included in the auditor commentary and wordings used. For the reporting requirement changes to be implemented effectively, stakeholder communication is key and the outreach and education programme on the purpose and requirements of the key changes should be extended to stakeholders such as directors' institutes.

Find out more

KPMG's international publication In the Headlines June 2012, Issue 2012/10
IAASB Invitation to Comment: Improving the Auditor's Report
ICPAS's comment letter to the ITC, 5 October 2012
KPMG's comment letter to the ITC, 8 October 2012
IAASB's Auditor Reporting Project Summary and Roundtables

7. International developments

IASB maps out future programme of work following conclusion of three-yearly public Consultation

In December 2012, the IASB rounded off its far-reaching public consultation on its future agenda by releasing a Feedback Statement that maps out its future priorities.

In response to an appeal for a period of relative calm, the IASB is shifting its focus from developing new standards to revising the conceptual framework and addressing matters related to the practical application of existing IFRSs.

For details, refer to In the Headlines – December 2012: Shaping the Future of IFRS

The Conceptual Framework project no longer aims at convergence with US GAAP but focuses on the following five topics:

- the reporting entity
- presentation (including other comprehensive income)
- disclosure
- elements (including the definitions of an asset and a liability)
- measurement.

The IASB plans to release a discussion paper (DP) covering all five topics in June 2013.

The IASB will continue its post-implementation reviews of existing standards; the next project in the pipeline is the business combinations standard.

The IASB has identified eight priority research projects to investigate issues causing practical challenges in application of existing standards. It plans to start work on them over the next 18 months. These issues include:

- business combinations under common control
- equity method of accounting
- financial instruments with characteristics of equity.

> *"A new agenda and a new approach – the plan is clear, now it's all about execution."*
>
> Mark Vaessen, KPMG global IFRS network leader

IASB launched Disclosure survey and will host public Disclosure Forum

The IASB will be hosting a public Disclosure Forum ("Forum") in January 2013 to consider the challenging area of disclosure overload.

It is a widely-held view that not all of the information presented in financial statements is equally useful. Some are critical of what they see as overly burdensome financial reporting requirements. Others point to the application of 'boilerplate' disclosure statements by companies, a 'checklist' approach used by auditors or a need to meet the perceived 'compliance' requirements of regulators.

The Forum is intended to foster dialogue between preparers, auditors, regulators, users of financial statements and the IASB about how to improve the usefulness and clarity of financial disclosures. The output from the Forum will impact the IASB's work on its Conceptual Framework.

To assist the IASB to gain a clearer picture on the perceived "disclosure problem" in advance of the IASB's forthcoming public Discussion Forum, it has launched a survey on disclosures. The survey can be accessed via IASB's website and closes on 15 January 2013.

> *"It has become increasingly clear that we are suffering from disclosure overload. However, there are many reasons why this is the case. Standard-setters are not blameless, but neither are preparers, auditors or regulators. So, the idea is to get everybody in a room and see what we can do to address this topic."*
>
> Hans Hoogervorst, Chairman of the IASB (IASB Press Release, 12 November 2012)

IASB completed substantive deliberation on a new accounting standard on Revenue

The IASB and the FASB (the Boards) are working towards a converged standard that would supersede most existing IFRS and US GAAP guidance on revenue recognition.

In December 2012, the boards completed their re-deliberations of the recognition and measurement principles in the November 2011 ED. They will re-deliberate the remaining topics, including scope, disclosure and transition, in 2013. The IASB targets to issue the final IFRS in the first half of 2013.

For details, refer to IFRS Newsletter – Revenue Issues 1 to 4.

Highlights of the matters discussed during the IASB's September to December 2012 meetings were:

- Practical issues around measuring contract progress that are of particular importance to construction companies and contract manufacturers. The Boards largely reaffirmed their previous proposals.
- Recognising revenue from licensing agreements – there would be a new approach, under which licences would be characterised into two categories with different revenue profiles. Entities would use indicators to determine whether a licence transfers a right at a point in time or provides access to intellectual property over time.
- Collectibility – revenue would be recognised at the amount that an entity is entitled to receive, with no reduction for credit risk and no collectibility threshold. Entities would present credit loss adjustments as an expense.

> *"The Boards agreed on a new approach to licences, which could have a significant impact on many sectors, including software, media and pharmaceuticals. "*
>
> Phil Dowad, KPMG's global IFRS revenue recognition leader

Proposed improvements to IFRS – 2011-2013 cycle

On 20 November 2012, the IASB published *Exposure Draft ED/2012/2 Annual Improvements to IFRSs – 2011-2013 Cycle* as part of its annual improvements process to make non-urgent but necessary amendments to IFRS. The exposure draft includes proposed improvements to four reporting standards. Some of the proposals are:

For details, refer to IFRS Newsletter – The Balancing Items Issue 4.

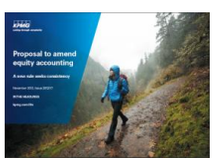
- *Does IFRS 3 apply to the formation of joint operations in IFRS 11 Joint Arrangements?*
  The IASB has proposed to clarify that:
  - IFRS 3 *Business Combinations* does not apply to accounting for the formation of all types of joint arrangements (including joint operations), and
  - this scope exclusion applies to the financial statements of the joint arrangements themselves, rather than those of the parties to the arrangements.

- *Is the acquisition of an investment property an acquisition of a business?*
  Under the proposals, IAS 40 would be amended to clarify that IFRS 3, and not IAS 40, should be referred to when making a judgement about whether an acquisition of an investment property is a business combination.

The proposals would be effective for annual periods beginning on or after 1 January 2014. Comments to the IASB are due by 18 February 2013. Comment deadline to the Singapore ASC had closed on 28 December 2012.

Proposal to amend equity accounting

It is currently unclear how an investor should account for some changes in the net assets of an equity-accounted investee that are recognised directly in equity by the investee ('other' net assets).



For details, refer to IFRS Newsletter – Proposal to amend equity accounting Issue 2012/17.

Examples of such changes include:

- those arising from movements in the share capital of the investee (for example, when an investee issues additional shares to third parties or buys back shares from third parties); and
- movements in other components of the investee's equity (for example, accounting for an equity-settled share-based payment transaction).

In response to this lack of clarity, on 22 November 2012 the IASB issued *Exposure Draft Equity Method: Share of Other Net Asset Changes* (the ED). The ED proposes a rule that would provide consistency by requiring the effect of changes in other net assets of the investee to be recognised directly in equity by the investor.

Comments to the IASB are due by 22 March 2013, and comments to the Singapore ASC closes on 25 January 2013.

> *"Of course a rule would provide consistency, but is it the best answer in all cases?"*
>
> Paul Munter, KPMG's global IFRS business combinations and consolidation leader

Proposal to ban revenue-based amortisation

For details, refer to In the Headlines 2012/19.

Revenue-based methods are sometimes used to amortise intangible assets in certain industry sectors, such as the media sector, because films and video games often generate higher revenues in the earlier years of their life; this means that revenue-based amortisation tends to accelerate expense recognition in these cases.

Under revenue-based methods, the profile of amortisation expense reflects the profile of revenues generated through use of the asset.

The IASB proposes to amend IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* to state explicitly that revenue-based methods of amortisation (and depreciation) cannot be used.

Comments to the IASB are due by 2 April 2013, and comments to the Singapore ASC closes on 8 February 2013.

Transfer of a subsidiary to an associate or JV

For details, refer to In the Headlines – Issue 2012/21.

A conflict arises when a parent loses control of a subsidiary in a transaction with an associate or joint venture (JV); this could occur on formation of a JV, for example.

Consolidated standard	Standard on associates and JVs
Requires the parent to recognise the full gain on the loss of control.	Requires the parent to eliminate that portion of the gain that corresponds to its interest in the associate or JV.
Note: The proposal deals equally with a loss. However, in the case of a loss, it is recognised in full if the underlying assets are impaired.	

In response to this conflict and the resulting diversity in practice, on 13 December 2012 the IASB issued Exposure Draft *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (the ED).

The ED proposes that the full gain would be recognised only when the assets sold or contributed meet the definition of a business in accordance with IFRS 3 *Business Combinations*. The accounting is illustrated in the following example.

Fact pattern

- Company P sells its wholly owned subsidiary S to its 30% associate A for cash of 9,000
- The carrying amount of S's net assets (including goodwill) in P's consolidated financial statements is 5,500.

How the proposal applies

S is a business	S is a collection of assets
• P would recognise a gain in profit or loss of 3,500 on the loss of control (9,000 – 5,500).	• Because P has a 30% interest in A, it would eliminate 30% of the gain – i.e. a gain of only 2,450 (3,500x70%) would be recognised.

Comments to the IASB are due by 23 April 2013, and comments to the Singapore ASC closes on 15 February 2013.

Business combination accounting for interests in a joint Operation

For details, refer to In the Headlines 2012/22.

There has been some confusion regarding whether the business combinations standard applies when an entity acquires an interest in a **joint operation** that meets the definition of a business under IFRS 3 *Business Combinations*.

In response to the diversity in practice, on 13 December 2012 the IASB issued Exposure Draft *Acquisition of an Interest in a Joint Operation* (the ED).

The proposal would require business combination accounting to be applied to acquisitions of interests in a joint operation by joint controllers.

Comments to the IASB are due by 23 April 2013, and comments to the Singapore ASC closes on 15 February 2013.

Common abbreviations

ASC	Accounting Standards Council in Singapore
ACRA	Accounting and 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
MAS	Monetary Authority of Singapore
MOF	Ministry of Finance
PCAOB	Public Company Accounting Oversight Board
REIT	Real Estate Investment Trust
SGX	Singapore Exchange

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