KPMG
cutting through complexity

FINANCIAL REPORTING MATTERS

JUNE 2013 ISSUE 43 | MICA (P) 127/11/2011

In May 2013, the new proposal on the lease accounting standard made it to the front page of the Business Times. Despite being controversial, the IASB and FASB are again proposing to bring most leases on-balance sheet for lessees. This issue, we take a look at the proposals in depth and how this will affect you.

The consolidation suite of standards, including FRS 110 Consolidation will be effective from 1 January 2014, with retrospective application required. This means that the time to get ready is now! What are the top five questions you should be asking yourself in preparing for the transition? We help you find out.

On the corporate reporting front, Integrated Reporting is now fast becoming the new buzz word. Find out more in our article if you are looking to improve the quality of your narrative reporting as a basis for a better dialogue with your investors and stakeholders.

In the last issue, we gave you a heads-up that the requirement to file your financial statements in XBRL is imminent. ACRA announced on 27June 2013 that the revised XBRL filing requirements will be implemented from October 2013. What do you have to do to get ready? Find out in our article.

Last but not least, we bring to you a roundup of the latest accounting developments on the international front.

Contents

1. Leases: A Controversial Proposal

This article is contributed by:

Kenny Tan
Partner, Audit

Denny Hanafy
Director, Accounting Advisory Services

On 16 May 2013, IASB and FASB jointly issued the much anticipated and highly contentious lease accounting proposal. Consistent with the original goal of the standard setters, under the proposal most leases will be treated on-balance sheet for lessees.

The impacts of the proposal will be greatly felt across industry sectors on all types of lease transactions – ranging from leases of 'big-ticket' items such as manufacturing facilities, vessels, aircrafts, to leases of office space and smaller items such as company cars and computers.

The changes will fundamentally alter the impact of leases on an organisation's income statement and balance sheet – gone is the distinction between finance and operating leases, along with the off-balance sheet treatment for lessees in the latter. Instead, the proposal introduces a new lease classification test and a 'dual model' for income/expense recognition for both lessees and lessors.

In this article, we provide a summary of the proposal and how it will affect you.

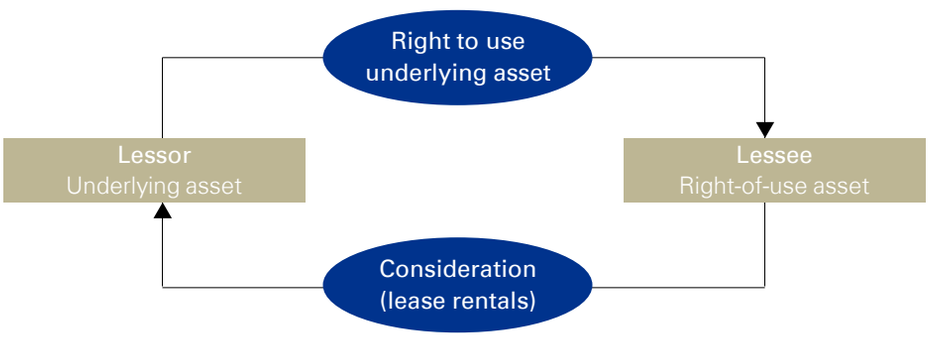
> "Capitalising real estate and equipment leases on balance sheets to recognise the rights and obligations of lessees has always been the ultimate goal. However, we question whether these proposals represent a sufficient improvement over existing standards in providing clarity to justify the considerable cost and complexity of implementation."
>
> Reinhard Klemmer
> Partner, KPMG in Singapore

Key Impacts

- Companies leasing high-value assets, such as ships, aircrafts and other transport assets will see large increases in reported liabilities
- Companies with large volumes of lower-value leases could face high implementation costs
- The proposal introduces a dual measurement model for both lessees and lessors with different impacts to profit or loss over the life of the lease
- New estimates and judgements would be required to identify, classify and measure leases
- Key judgements would need to be reassessed and lease balances may need to be remeasured at each reporting date, introducing more volatility into the balance sheet
- The proposal requires full retrospective or modified retrospective application when it becomes effective

Identifying a lease

The proposal defines a 'lease' as "a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration".



A lease would exist when both of the following conditions are met:

- fulfillment of a contract depends on the use of an identifiable asset; and
- the contract conveys the right to control the use of the identifiable asset for a period of time in exchange for consideration – i.e. the customer is able to direct the use of the asset and derives benefits from its use throughout the term of the contract.

Identifying whether an agreement is, or contains, a lease would be a key judgement when implementing the proposal, particularly for lessees. The new definition of leases is, in effect, a new bright-line between treating the contract on-balance sheet (leases under the proposal) and off-balance sheet (service contracts under revenue recognition standard).

Let's take for example a time charter arrangement in the shipping industry. Part of the contract would meet the definition of a lease under the proposal as it conveys the right to control the use of the vessel (an identifiable asset) for a period of time. Part of the contract also includes ship management and crew support services which is a service contract and does not fall under lease accounting. Separating between the two components will become more imperative as the portion under lease accounting will be treated on-balance sheet.

How will this affect you?

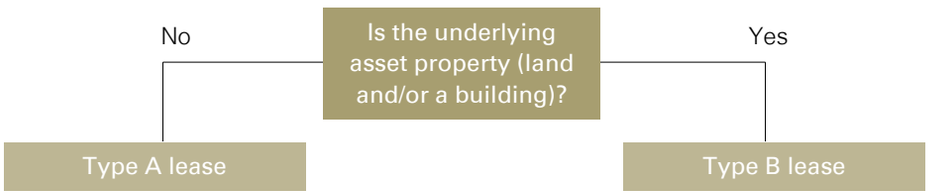
You will need to revisit all of your existing agreements to assess whether they are, or contain, a lease. This exercise would require new judgements to be made in many cases.

As a result of the re-assessment, contracts that are currently under lease accounting may not be under the proposal, while contracts that are currently not under lease accounting may be considered under the proposal's definition. This adds complexity in particular on transition.

For example, some power purchase agreements that are identified as leases under IFRIC 4 *Determining whether an Arrangement contains a Lease* may not be leases under the proposal. This is because the proposal's approach to control has a greater focus on the purchaser's ability to direct the use of the underlying asset than IFRIC 4.

Lease classification

The biggest change since the previous version of the proposal is the introduction of the dual lease accounting model and a new lease classification test to assess whether a lease is a Type A lease or a Type B lease. Both lessors and lessees will need to determine which type each lease contract is. To determine this, the entity first considers the nature of the underlying asset in the lease, i.e. whether the underlying asset is property (land and/or a building) or non-property. In many cases, this will determine the lease classification.



The presumption that a lease of non-property is a Type A lease is rebutted if:

- the lease term is for an insignificant part of the total economic life of the underlying asset; or
- the present value of the lease payments is insignificant relative to the fair value of the underlying asset.

The presumption that a lease of property is a Type B lease is rebutted if:

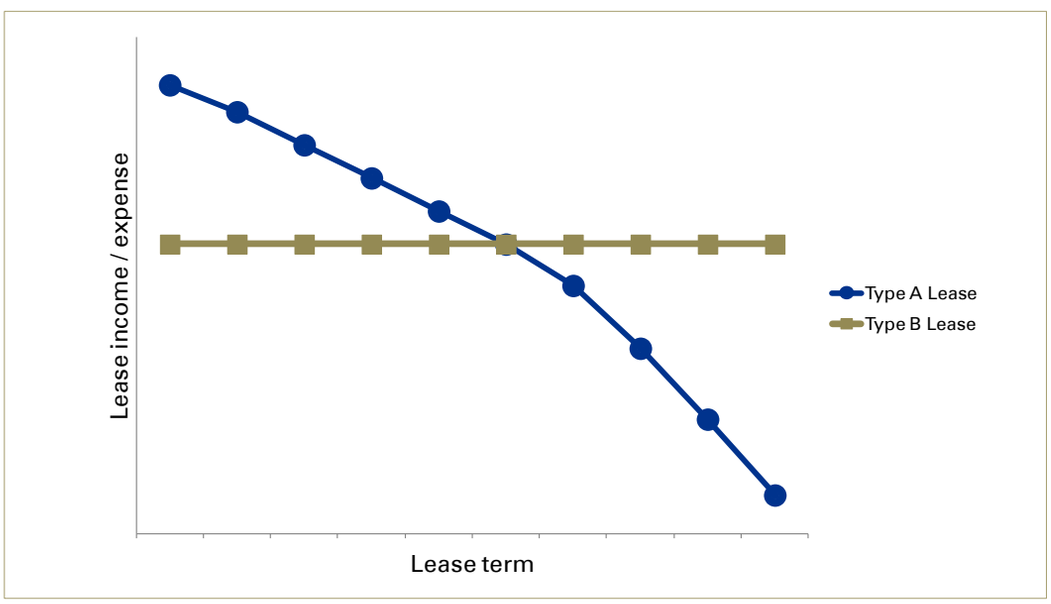
- the lease term is for the major part of the remaining economic life of the underlying asset; or
- the present value of the lease payments accounts for substantially all of the fair value of the underlying asset.

However, in all cases, if the lessee has a significant economic incentive to exercise an option within the lease to purchase the underlying asset, then the lease is classified as a Type A lease.

For a lessee, unlike the current lease accounting standard, the outcome of the classification test will no longer determine whether a lease is recognised on-balance sheet – the proposal requires both Type A and Type B leases to be recognised on-balance sheet. Instead, it will affect the profile of lease expense recognised over the lease term.

How will this affect you?

You will need to perform the classification test upon transition and at inception of each lease contract. As there are no bright-lines, significant judgement is required. The result of the test will determine whether lease income/expense recognition is on a front-loaded or straight-line basis.



Lessee Accounting

The proposal requires lessees to account for both Type A and Type B leases on-balance sheet by recognising a Right-of-Use (ROU) asset and a lease liability.

	Statement of financial position	Statement of profit or loss	Profile of total lease expense
Type A leases (non-property)	ROU asset Lease liability	Amortisation of ROU asset (operating expense) Interest expense on lease liability (finance expense)	Front-loaded
Type B leases (property)	ROU asset Lease liability	Lease expense (operating expense)	Straight-line

Initial measurement

The proposal requires that the lessee initially measures its lease liability at the present value of the future lease payments. Future lease payments would take into account assumptions on lease term, residual value guarantees, purchase options, term option penalties, among others. These cash flows are then discounted using the rate that the lessor charges the lessee, or if it cannot be readily determinable, the lessee's incremental borrowing rate.

On the other hand, the ROU asset is initially measured at cost, which equals:

- the lease liability, plus
- any initial direct costs, plus
- any pre-paid lease payments, less
- any lease incentives received.

No bright-lines are provided – entities will have to exercise significant judgements and estimates in measuring the lease liability and ROU asset. For example, for an office space lease of five years with an extension option of three years, the lessee's conclusion on whether it has a significant economic incentive to exercise the option will have a significant impact on the amount of liability and ROU asset to be recognised at the inception of the lease.

How will this affect you?

Companies that are lessees in a lease arrangement will be significantly impacted by the proposal as most of the contracts will now need to be recognised on-balance sheet, resulting in a bigger balance sheet. Key performance ratios (e.g. debt/equity ratios, tangible asset ratios) are likely to be affected and consequently the ability to satisfy debt covenants or any other balance sheet-based KPIs. If you are currently negotiating debt arrangements, you may wish to seek flexibility in determining the appropriate debt covenants to minimise the impact of the proposal when it becomes effective.

Subsequent measurement

Lease Liability

After initial recognition, the lessee would measure its lease liability at amortised cost using the effective interest rate method. At each reporting date, the lessee is required to reassess whether facts and circumstances indicate a change in certain assumptions previously taken. If there is a change, the entity will need to remeasure the lease liability.

ROU Asset

After initial recognition, the lessee would measure the ROU asset at amortised cost, or alternatively under the FRS 16 *Property, Plant and Equipment* revaluation model or the FRS 40 *Investment Property* fair value model, if applicable.

Amortisation of the ROU asset differs depending on the classification of the lease.

For Type A leases, the ROU asset would be amortised on a straight-line basis, unless another systematic basis is more representative, over the shorter of the lease term and the useful life of the ROU asset.

For Type B leases, the lessee would calculate amortisation of the ROU asset as a balancing figure such that the total lease cost (amortisation plus interest) would be recognised on a straight-line basis over the lease term.

ROU assets would be subject to the impairment requirements of FRS 36 *Impairment of Assets*.

How will this affect you?

The dual model approach as well as the reassessment requirement will increase balance sheet volatility for lessees. At each reporting date, the reassessment may result in an increase or decrease of balance sheet size, making it less predictable.

Lessor Accounting

The proposal introduces a dual model for lessors depending on the lease classification. For Type A leases, the lessor would apply a complex new accounting model under which it would derecognise the underlying asset and recognise a lease receivable and residual asset. For Type B leases, the lessor would apply a model similar to the current operating lease accounting under FRS 17 *Leases*.

	Statement of financial position	Statement of profit or loss	Profile of total lease expense
Type A leases (non-property)	Lease receivable Residual asset	Profit on lease commencement Interest income on lease receivable Interest accretion on residual asset	Front-loaded
Type B leases (property)	Underlying asset	Lease income	Straight-line

Lessor Accounting for Type A leases

On lease commencement, a lessor would derecognise the underlying asset and recognise:

- a lease receivable, representing its right to receive lease payments; and
- a residual asset, representing its interest in the underlying asset at the end of the lease term.

The lessor would initially measure the lease receivable at the present value of the estimated future lease payments (similar to the way in which a lessee measures its lease liability), discounted at the rate that the lessor charges the lessee, plus any initial direct costs.

The lessor would initially measure the residual asset as:

- the present value of the amount that the lessor expects to derive from the underlying asset at the end of the lease term, discounted at the rate that the lessor charges the lessee, adjusted for
- the present value of expected variable lease payments and unearned profit arising on lease commencement.

Subsequent to initial measurement, the lease receivable will be measured at amortised cost using the effective interest method and subject to impairment in accordance with FRS 39 *Financial Instruments: Recognition and Measurement*. The residual asset will be accreted using the rate that the lessor charges the lessee and subject to impairment in accordance with FRS 36 *Impairment of Assets*.

How will this affect you?

This model is essentially a variation of the current finance lease accounting. However, the model is more complex than current finance lease accounting, in part due to additional issues that arise on accounting for the residual asset. With the added complexity, lessors will need to develop their own calculation and reassessment methods and processes.

Lessor Accounting for Type B leases

A lessor would follow an accounting model similar to operating lease accounting under FRS 17 – i.e. it would recognise:

- lease payments as lease income, on a straight-line basis or another systematic basis if that basis is more representative of the pattern in which income is earned from the underlying asset;
- initial direct costs as an expense on the same basis as it recognises lease income; and
- variable lease payments as income when earned.

Similar to operating lease accounting under FRS 17, the lessor continues to recognise the underlying asset.

How will this affect you?

Given that the accounting is similar to operating lease accounting under FRS 17, the impact under the proposal would be minimal.

Transition

Both lessor and lessee would be required to retrospectively apply the proposal's requirements upon application. However, the proposal provides an option for a modified retrospective approach that allows for certain practical expedients. The standard setters did not state an expected effective date. In view of the timeline for redeliberations, we do not expect a final standard in 2013.

How will this affect you?

Applying the proposal for the first time would be a time consuming and costly process for many companies. You would be required to gather key inputs for nearly all leases, especially for those currently classified as operating leases under FRS 17.

You should evaluate whether they have sufficient resources available to identify and record data from all lease agreements in a timely manner upon transition to the proposed standard.

What to do next?

Given the potential impact this proposal may have to many companies, we recommend you to get familiar with the detailed requirements of the proposal through trainings or other education programs and to start thinking about the potential impact the proposal will have by performing a high level impact assessment. Due to the retrospective application requirements, long term leases entered into today may have an impact on future financial statements when the proposal becomes effective.

To the extent that you have specific concerns over the proposal, we recommend you to put in your comment letters either locally through the Accounting Standards Council (ASC) or internationally directly to the IASB. Comment letters to ASC are due by 19 July 2013; comment letters to IASB are due by 13 September 2013.

How can we help?

Does your company have the information and processes needed to implement these proposals? If not, now is the time to start looking at the effect of these proposals on your lease agreements – both current and future.

KPMG has experience in applying the new requirements across many sectors, and can help you consider the impact on your business from accounting, tax and regulatory perspectives, as well as the impact on your systems and processes, business and people.

Speak to your usual KPMG contact or Denny Hanafy (dhanafy@kpmg.com.sg)

2. Getting ready for transition: FRS 110 *Consolidation*

This article is contributed by:

Reinhard Klemmer
Partner, Professional Practice

Chan Yen San
Senior Manager, Professional Practice

The effective date of 1 January 2014 is fast approaching ...

New approach, new intricacies

Some businesses may already have analysed the impact of adopting the new consolidation standard FRS 110 *Consolidated Financial Statements*. Others may be putting it off until the period of adoption – perhaps with other seemingly more pressing issues taking precedence.

But those who believe that the impact on your business will be minimal may be in for a surprise, because the impact of consolidating more subsidiaries may run contrary to your asset light strategy and may distort your performance matrices and ratios.

Many old concepts have been given a new twist under the new standard. The new standard requires a broader understanding of the circumstances in assessing control. Most importantly, the current bright line of 'more than 50 percent' will be gone. As new benchmarks are set, previously disregarded facts could become relevant and could tilt the balance of the overall analysis under the new standard.

Those who have stayed in front of the curve would benefit from pushing for clarity and consensus with their auditors and within their industry to level the playing field.

Above all, getting consensus early will give you sufficient time to either prepare your internal processes and your stakeholders (boards, analysts, bankers, investors) for the imminent change or to avoid the change by paring down your interests or by restructuring the affected vehicles.

Even if the consolidation conclusion does not change, the related disclosure standard, FRS 112 *Disclosure of Interests in Other Entities*, has its own challenges and may require additional data collection on your relationships with other entities – whether or not consolidated.

In this article, we list the five top questions you should be considering while you prepare for transition to FRS 110.

1. Do you hold potential voting rights such as options, warrants and convertible notes?

You might have less than half of the voting rights over an investee, but hold options over shares or debts that are convertible to shares of the investee.

Instead of simply considering whether the potential voting rights are currently exercisable, the test is now whether they are "substantive".

Under FRS 110, potential voting rights are "substantive" if you could exercise them when decisions about the relevant activities need to be made and you have the practical ability to exercise them.

This means that the potential voting rights need not be exercisable when the analysis is performed. Furthermore, you are required to evaluate the relevant facts and circumstances at each reporting date.

Relevant facts and circumstances include:

1. Your purpose for holding the potential voting rights.
2. How the transaction is designed, including the rights and obligations under the contract and other relevant contracts.
3. Whether there are any economic, operational, legal or regulatory barriers that will prevent you from exercising the rights.
4. The benefit you could get from exercising the rights.
5. The number of parties that have to agree with you before you can exercise those rights.

As you can see, the analysis is more holistic and certainly more judgemental. Therefore, if your rights are deeply out of the money, they are considered not substantive.

2. Do you hold a dominant (but not majority) shareholding in an investee?

You might be the dominant shareholder of an investee, but do not currently consolidate because you do not hold the majority of the voting rights.

Under FRS 110, you will need to consolidate such an investee if you have de facto control over the investee.

Even if you have applied the current standard on the basis of de facto control, you will still need to go through the analysis under the new standard as the concept of de facto control in FRS 110 may differ from how it is being applied currently.

The existence of de facto control under the new standard relies, in part, on the actions or inactions of other investors. Therefore, the higher the shareholding in the investee held by you and the greater the dispersion among the rest of the vote holders, the higher the possibility that you have de facto control over the investee.

For example, a 48% shareholder with the remaining 52% shareholdings widely dispersed and no other shareholders holding more than 1%, is likely to have de facto control and will therefore need to consolidate the investee.

Bearing in mind that you do not have legal control as a dominant (but not majority) shareholder, you should carry out a holistic assessment of all facts and circumstances if after looking at the size of your shareholding relative to the size and dispersion of remaining shareholdings, you are still unclear whether you have de facto control over the investee.

Additional facts and circumstances include:

1. The number of vote holders present and voting at previous shareholders' meetings (past voting patterns).
2. Whether you can appoint or approve the investee's key management personnel who have the ability to direct the relevant activities even though you do not have the contractual right to do so.
3. Whether you can direct the investee to enter into, or can veto any changes to, significant transactions for your benefit even though you do not have the contractual right to do so.
4. Whether you can dominate either the nominations process for electing members of the investee's governing body or the obtaining of proxies from other holders of voting rights.
5. Whether the investee's key management personnel are related to you (for example, the chief executive officer of the investee and your chief executive officer are the same person).
6. Whether the majority of the members of the investee's governing body are parties related to you.
7. Whether the investee's key management personnel are your current or previous employees.
8. Whether the investee is economically dependent on you.
9. Whether a significant portion of the investee's activities either involve or conducted on behalf of investor.
10. Whether you have disproportionate exposure to returns as compared to your voting rights.

In considering voting patterns at previous shareholders' meetings, the key factor is the number of vote holders present and voting; not whether they voted in agreement with you. Generally, the more inactive the vote holders, the higher the possibility that you have de facto control over the investee.

However, past voting patterns may not always be representative of the voting patterns at future shareholders' meetings. For example, the nature of the resolutions being voted on at past meetings could be administrative in nature or the composition of vote holders has been subject to high turnover over the years. In such situations, past voting patterns may not provide conclusive evidence that you have the continuing ability to secure the majority of votes at future meetings.

The good news is that if after considering all facts and circumstances including past voting patterns, it is still unclear whether you have de facto control over the investee, you do not consolidate the investee.

However, as the assessment under FRS 110 is continuous, you should consider all facts and circumstances including past voting patterns on an ongoing basis.

If the facts and circumstances including past voting patterns provide persuasive evidence that you have de facto control over the investee, you will have to consolidate the investee.

3. Do you have a close customer or supplier relationship with your investee?

You might have a close business relationship with a supplier or a customer that goes beyond what would be considered a usual supplier-customer relationship.

Contractual arrangement and holding of a minority equity stake may establish your control over a key supplier or key customer and lead to consolidation under FRS 110.

However, holding an equity stake which gives rise to ownership returns is no longer a pre-requisite for consolidation under FRS 110 as the definition of returns is broader than under the current standard.

Under FRS 110, the returns of the investee might be only positive, only negative, or either positive or negative. Sources of other forms of returns include the following, which illustrate that the definition of returns is very broad:

- economic benefits, such as interest from debt securities
- remuneration for servicing the investee's assets or liabilities
- fees and exposure to loss from providing credit or liquidity support
- tax benefits; and/or
- ability to use the investee's assets to achieve economies of scale, cost savings or other synergies.

The concept of variable returns under FRS 110 is also not limited to returns that will vary in their calculation – e.g. dividends or fees that vary based on performance. Instead, even fixed returns will expose the investor to variability, because they are subject to the risk that the investee will default on payment.

While economic dependence by itself is generally not the basis for consolidation under FRS 110, you will need to take a broader look at these relationships and the returns e.g. tax benefits, fees, ability to use assets to achieve economies of scale and other synergies derived from these relationships.

4. Are you involved with vehicles set up to securitise assets (e.g. trade receivables, loan receivables, credit card receivables, properties)?

You may be involved with a special purpose vehicle that has been set up to securitise your assets.

These special purpose vehicles usually were designed so that voting and similar rights are not the relevant factor in deciding control. Such structures are known as structured entities under FRS 110.

If you find the risks and rewards analysis for special purpose vehicle under the current standard challenging, you will be glad that the new analysis is no longer focused on whether you have the majority of risks and rewards.

Instead, you will need to perform a different analysis of your relationship with the securitisation structure under FRS 110. The new analysis focuses on identifying the party that has power over the limited activities of the securitisation structure.

Securitisation structures that appear to run on extreme auto-pilot are likely to be the most challenging to analyse and therefore require the most judgement by you.

Being involved in the design and set up of the securitisation structure is only indicative that you had the opportunity to obtain rights sufficient to give you power. You may not have continuing involvement with the structure nor be exposed to variable returns from the structure after its initial set up. Hence, involvement in the design will not on its own be sufficient to conclude that you have power.

An understanding of the purpose and design of the securitisation structure is nevertheless an important first step in the assessment.

A good understanding of the purpose and design and the decisions made at the inception of the structure will help you identify the activities that significantly affect the return of the securitisation structure (relevant activities).

Under FRS 110, if you have the power to direct the relevant activities and could use your power to significantly affect your returns e.g. tax benefits, fees, ability to use assets to achieve economies of scale, and other synergies derived from your involvement with these structures, you will need to consolidate the structure.

5. Are you an asset or property manager?

You might be managing the business of an investee as an agent on behalf of other parties, for example as an asset manager holding a 20% interest in the managed fund.

FRS 110 includes the explicit concept of delegated power. This means that you now have specific literature to refer to when assessing your relationship with the investee under your management, and determining if the investee should be consolidated.

Under FRS 110, you will need to make an assessment as to whether you are using the delegated power primarily

- *to benefit yourself*, in which case, you are the principal and will consolidate the investee; or
- *to benefit the others*, in which case, under FRS 110, you are an agent and will not consolidate the investee.

Having a fiduciary duty to act in the best interests for other parties and receiving a market-based remuneration will not be sufficient to support an agent conclusion.

Instead, you will need to look at your level of economic interest in the investee in aggregate and the ease with which you could be removed as an agent.

The stronger the rights held by other parties to remove you as an agent, the higher the economic interest you can hold while still being an agent. Conversely, the weaker the rights held by other parties to remove you as an agent, the lower the economic interest you can hold while still being considered an agent.

The aggregation of economic interest and the determination of the appropriate threshold below which consolidation is not required have proven to be the most difficult and judgemental in practice.

Developing an acceptable approach to aggregate the economic interest and achieving a consensus on the consolidation threshold are likely to be time consuming. Hence, you should start your assessment earlier rather than later.

3. Integrated Reporting – The Time Has Come for a New Reporting Model

This article is contributed by:

Reinhard Klemmer
Partner, Professional Practice

Malgosia Aitchison
Director, Accounting Advisory Services

The Pollutant Standards Index (PSI) hit 401 on Friday 21 June 2013 - the highest in Singapore's history[1]. How could agricultural businesses communicate that their land-clearing practices comply with environmental standards?

Financial statements currently do not include much information beyond mere numbers. Integrated Reporting aims to broaden the aspects companies would report on in their annual reports.

What is integrated reporting?

Integrated Reporting is a new corporate reporting model, designed to support a more resilient business environment and better decision making by providers of financial capital. It integrates strategy, governance, performance and prospects over the short, medium and long term. Integrated Reporting offers the opportunity to centre business reporting on strategy and value creation, to demonstrate how the business uses capital and the extent to which it should continue to be invested in the business. Integrated reporting is about better communication between companies and the capital markets.

Why is it important to bring it to your attention now?

There is a general consensus that current corporate reports provide a good assessment of the financial condition of a company at a specific point in time, but do not present a forward looking picture. Ticking the compliance box with boiler plate disclosures is something that financial reports do extremely well. The current financial reporting framework is also criticised for not conveying information in a clear and concise way. There is a divergence between IFRS numbers and the non-IFRS numbers, such as 'normalised earnings' based on the data used internally to manage the business, which is also of interest to investors.

Further, there is limited information about social responsibility. Consider the recent haze in Singapore, which impacted our health and overall the economy. One would applaud a framework where companies are required to report on whether they use fires to clear land for plantations and report on their interaction with the communities and how they use natural resources. This would then form a part of the basis for a reader to decide whether or not to do business with or invest in such a company. And changing investor and stakeholder behaviour would in turn incentivise the company to change their behaviour, even if it is not directly reflected in their reported numbers.

[1] Source: BBC news article *Singapore haze hits record high from Indonesia fires* dated 21 June 2013

The current reporting model needs to change – stakeholders as well as regulators are demanding greater transparency, investors want forward looking information about strategy, business models and the ability of the company to create a sustainable long-term value and standard setters are equally critical. A matter of debate is how and how far the current reporting model should change.

The International Integrated Reporting Council (IIRC), a global market-lead coalition of regulators, investors, companies, standard setters, the accounting profession and non-government organisations is catalysing the developments in shaping corporate reporting for the 21st century.

On 16 April 2013, the IIRC has released a Consultation Draft of its International Integrated Reporting (IR) Framework, which marks an important milestone in the progress to a new global reporting model.

A number of events were held in Singapore at the time to launch the Consultation Draft and raise awareness for Integrated Reporting. Participants included the IIRC represented by its CEO, Paul Druckman, Singapore Exchange, the Institute of Certified Public Accounts of Singapore (ICPAS), Association of Certified Public Accountants (ACCA), Singapore Institute of Directors (SID), Securities Investors Association, major corporates and many others taking active interest in the subject.

The business case for IR is compelling. Over 50 institutional investors were helping to ensure that the proposed Framework addresses the needs of providers of financial capital. More than 80 businesses from more than 20 countries, including DBS Bank from Singapore, have been testing the prototype of the Framework by applying its principles to their own reporting.

They have reported that IR provides substantial benefits to their organisation, including:

- establishing the basis for more meaningful engagement with investors
- placing the company's strategy and business model at the centre of attention with providers of financial capital
- breaking internal silos; and
- providing greater transparency.

What are the key features of the proposed International IR Framework?

1. Overview

The IIRC defines IR as "a process that results in communication by an organisation, most visibly a periodic integrated report, about value creation over time". An integrated report is "a concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term."

2. Fundamental concepts

The fundamental concepts of the Framework centre on:

- the six capitals (financial , manufactured, intellectual, human, social and relationship and natural) that an organisation uses and affects;
- the organisation's business model; and
- the creation of value over time.

An organisation's business model is the vehicle through which it creates value. That value is embodied in the capital it uses and affects. The assessment of an organisation's ability to create value in the short, medium and long term depends on an understanding of the connectivity between its business model and a wide range of internal and external factors.

3. Principles based framework

The IIRC has suggested a principles-based framework that would allow businesses to tell their own story, rather than through a checklist of disclosures and values.

It will be a cultural shift for the preparers, who would need to explain what drives the underlying value of the business and how management has acted to develop and protect this value. They would need to ask themselves what the reader needs to know, rather than what they are required to tell the reader.

The Framework sets out six guiding principles:

- Strategic focus and future orientation
- Connectivity and information
- Stakeholder responsiveness
- Materiality and conciseness
- Reliability and completeness
- Consistency and comparability

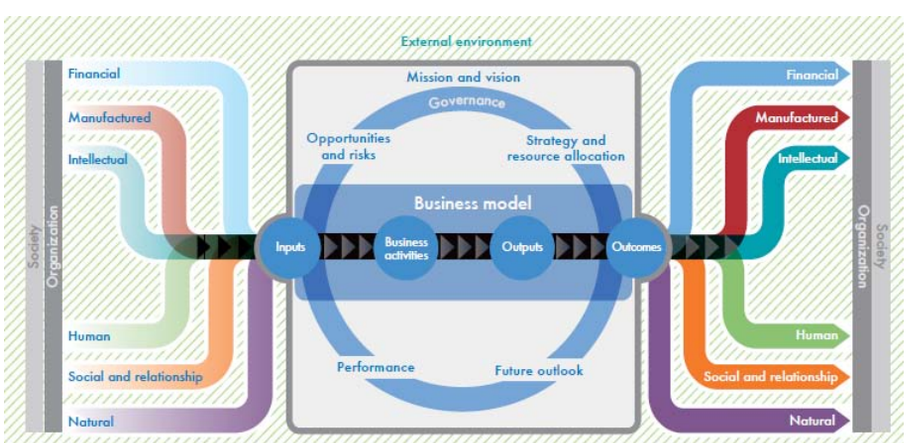
4. Content elements

IR is built around seven components of content, which are not considered discrete sections of the report, but rather a high-level check to ensure coverage of all relevant aspects when telling the business story:

- Organisational overview and external environment
- Governance
- Opportunities and risks
- Strategy and resource allocation
- Business model
- Performance
- Future outlook

By linking content across the above components, the result should be a report focused on the key drivers of the business value. The issues covered should be the same that management is focused on in the day-to-day operation of the business, and the same issues that should be driving investors' decision making.

The figure below presents a complete picture of an organisation value creation process, showing the interaction of the content elements and the capitals in the context of the organisation's external environment:



Source: Consultation Draft of the International <IR> Framework, 2013

5. Preparation and presentation

The IIRC provides guidance on the preparation and presentation of an integrated report. The topics include: materiality, disclosure of material matters, involvement of those charged with governance, frequency of reporting, reporting boundary and the use of technology.

6. Expected outcomes

It is expected that IR would result in reporting the information most relevant to each business with the following outcomes:

- More operationally focused measures of performance, with the aim to assist the readers in understanding progress in implementing strategy, developing business assets and creating new income streams;
- Greater focus on explaining key business assets, for example, customer base, intellectual property and reputation with the aim of explaining how these assets have been managed and enhanced in line with the business strategy and changes to the external operating environment;
- More emphasis in explaining factors driving future performance, including risks and opportunities; and
- IR will not replace other reporting frameworks. Instead, it will incorporate relevant information produced under other frameworks, such as IFRS, as building blocks for an integrated report.

How does it affect you?

Businesses and investors are coming together to help develop a new corporate reporting model for the future. The IIRC has requested comments from all stakeholders by 15 July 2013. This is your invitation to shape the future of better business reporting and your involvement is vital to encourage and embed a more integrated business culture.

You can participate in the consultation process by:

- discussing internally the Consultation Draft of the International IR Framework;
- conducting an assessment of its impact on your organisation;
- engaging in external discussions with your capital providers; or
- submitting a formal response to the IIRC.

You can find a step-by-step guide on how to respond on www.theiirc.org.

The approach described in the International IR Framework is also relevant to those who simply want to improve the focus of their corporate reporting.

> "We applaud the work of the IIRC and urge regulators, investors and governments to actively drive for change for better business reporting, which can help ensure future financial stability"
>
> Wolfgang Laubach, KPMG's global IFRS Leases leader

How KPMG can assist

It is anticipated that the initial version of the International IR Framework will be published in December 2013. KPMG will be holding a briefing event in Singapore to share the insights.

For further information, please visit www.kpmg.com/integratedreporting.
You can also contact Malgosia Aitchison (maitchison@kpmg.com.sg) or speak to your regular KPMG contact.

You can also download the following publications:

The Future of Corporate Reporting: Towards a Common Vision tests the premise that fundamental reforms are needed by interviewing ten international leaders in the field.

Integrated Reporting: Addressing the Reporting Gap provides a brief introduction to Integrated Reporting.

4. XBRL – The New Language for Business and Regulatory Reporting

This article is contributed by:

Geraldine Lau
Senior Manager, Professional Practice

Lamiya Bhatri
Manager, Accounting Advisory Services

Starting October 2013, all Singapore-incorporated companies are required to file their financial statements with the ACRA in XBRL. It's never too soon to get ready.

What is XBRL?

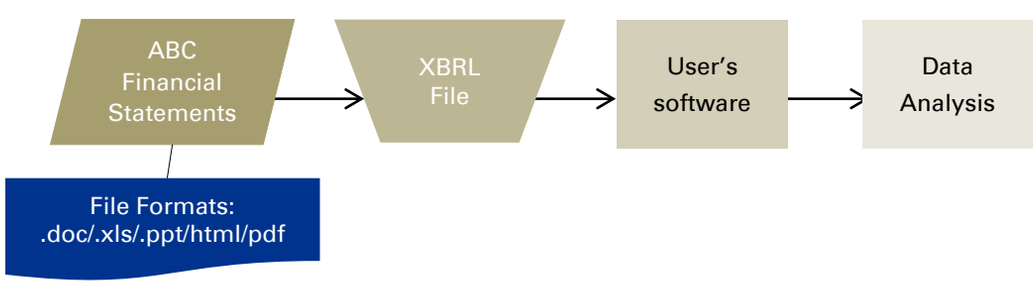
XBRL (eXtensible Business Reporting Language) is a computer language that, through a process of tagging, makes documents machine-readable.

Way forward to assist more effective and efficient decision making

Currently, financial statements or other information prepared in Word, Excel or HTML formats can be read but not analysed or processed according to the user's needs. For example, the word "Revenue" appears in many places in the financial statements, but a reader may want to have all "Revenue" references and related information collated in one place. Currently, they would need to do so manually because information is not machine-readable and needs to be copy/pasted or keyed-in before it is used for analysis/ decision-making purposes.

XBRL enables source data to be tagged electronically, making the data machine-readable. Thus, the user's system can automatically extract the information without the need for copy-pasting or keying-in. XBRL enables tagging of numbers, quantitative data and textual information. The benefits of XBRL go beyond compliance since any data collation process can be streamlined using electronic tags.

The following diagram depicts the process:



ACRA announces revised XBRL filing requirements

ACRA announced on 27June 2013 that the revised XBRL filing requirements will be implemented from October 2013. Replacing the online FS Manager will be a new offline tool, BizFin^{x}, for preparing XBRL financial statements and the BizFin^{x} Portal, for submitting the Annual Returns together with these financial statements.

Who is affected?

From October 2013, all Singapore incorporated companies (unless exempted below) which are either unlimited or limited by shares required to file their financial statements with ACRA will be required to file a full set of financial statements in XBRL format, according to a Minimum Requirement List within the new ACRA Taxonomy 2013 (i.e. Full XBRL). Filing of Option B (Partial XBRL), using FS Manager, will no longer be available.

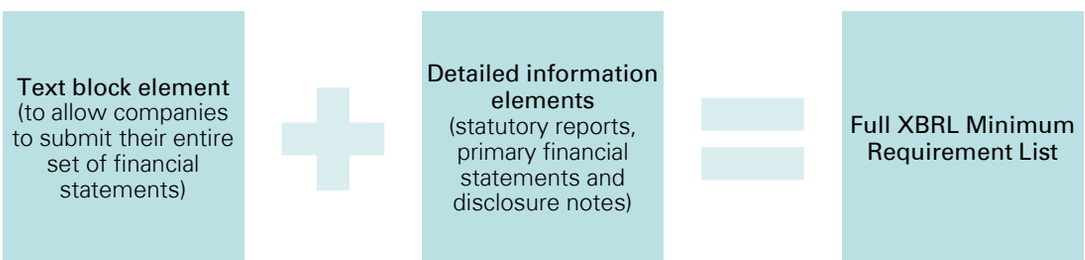
Who is exempted?

There are two main categories of companies exempted from Full XBRL:

Exempted companies	Filing requirements from October 2013
(1) Companies which are Commercial Banks; Merchant Banks; Registered Insurers; and Finance Companies, that are regulated by the MAS (2) Companies allowed by law to prepare accounts in accordance with accounting standards other than SFRS, SFRS for Small Entities and IFRS	Continue to file a PDF set of financial statements but to also submit a XBRL set of Financial Statement Highlights prepared using BizFin^{x}
(1) Companies limited by guarantee (2) Foreign companies and their local branches	Continue to file a PDF set of financial statements only

What is the Minimum Requirement List?

The Minimum Requirement list comprises a set of elements within ACRA Taxonomy 2013.



Detailed information element	Minimum Requirement List	
Statutory reports	1. Statement by directors	2. Independent auditors' report
Primary financial statements	1. Statement of financial position 2. Income statement	3. Statement of cash flows
Disclosure notes	1. Corporate and general information 2. Trade and other receivables 3. Trade and other payables 4. Provisions 5. Share capital 6. Revenue	7. Government grants 8. Employee benefits expense 9. Operating segments 10. Property, plant and equipment 11. Selected income and expense

Transition support available for preparers and companies

To assist companies in meeting the revised XBRL filing requirements, ACRA is offering support in various ways, including:

1. Release of a beta version of BizFin^{x} for companies to explore its functionalities in the preparation of XBRL financial statements.

   This version will be replaced by a final version in August 2013, which will be the official version for use in the preparation of XBRL financial statements for final submission to ACRA in October 2013. A functionality will also be available to transfer information from this beta version to the final version.

2. 30-day extension for companies other than public listed ones to hold AGMs and file Annual Returns, with fee waiver available from 19 August 2013.
3. Road shows to create awareness for business community.
4. Subsidised half-day training seminars to provide more detailed information to companies on the revised XBRL requirements and a demonstration of BizFin^{x}.
5. One-day intensive training courses for preparer to explore the tool in-depth.
6. Various useful guides are also being provided by ACRA to understand the requirements and how to use BizFin^{x}.

What you should start considering now?

As the effective date is October 2013, it is not too soon to get started. In fact, companies should not underestimate the steep learning curve that comes with any new technology and would be well advised to start their process planning now.

Here are some pointers for your consideration:

1. Understand what the revised XBRL filing requirements entail and how they will impact your company's financial reporting processes
2. Identify key individuals within the company who will be responsible for managing the XBRL preparation process
3. Plan for the magnitude of the initial efforts involved in tagging and resolving errors identified as well as for the appropriate level of review throughout the process to help ensure completeness and accuracy
4. Consider if you wish to outsource the preparation of XBRL financial statements, if resources are constrained and not yet fully trained.
5. Provide adequate time for training, process development and quality assurance checks
6. Explore using the beta version of BizFin^{x} to prepare draft financial statements based on prior period's audited set of financial statements.
7. For companies other than public listed companies, consider if the company would like to apply for extension and fee waiver from ACRA from 19 August 2013 onwards.
8. For companies expecting to submit their XBRL financial statements around October 2013, plan to ensure that you are using the appropriate tool (FS Manager or BizFin^{x}) to prepare your financial statements. If delays are likely, we would encourage companies to start off with BizFin^{x} to avoid any reworks required.

How can we help?

KPMG has been active in the development and adoption of XBRL across the world. KPMG member firms are leading the way, helping clients across the globe, understand and clarify their business needs.

KPMG in Singapore, can assist in training for internal resources on XBRL, review and comment on XBRL financial statements prepared by the company, provide resource support, project management and overall implementation of XBRL in a manner that makes XBRL 'business as usual'.

Speak to your usual KPMG contact or Lamiya Bhatri (lamiyabhatri@kpmg.com.sg)

5. International developments

A new world for insurance

The IASB has issued its targeted re-exposure draft on insurance contracts, marking a major step forward towards implementing a common insurance reporting framework across much of the world.

The proposals apply to all insurance contracts, including certain financial guarantees, rather than insurance entities, and to investment contracts with a discretionary participation feature (DPF) issued by insurance companies.

The re-exposure draft introduces a revised current value measurement model, which would go some of the way towards addressing concerns over increased volatility in profit or loss. It also introduces a new presentation approach, which would significantly change the way insurers – especially life insurers – report performance.

The proposals are likely to have a profound impact across an organisation, affecting asset-liability management and decisions over product design, features and pricing. Capital management and regulatory requirements may also be affected in some jurisdictions. And the new data collection and retention requirements could necessitate systems upgrades, increased demand for resources and additional training.

Comments are due to the IASB by 25 October 2013, and comments to the Singapore ASC closes on 12 September 2013. The FASB is expected to publish its own exposure draft shortly.

> "The IASB has made great efforts to improve the proposals by addressing the key concerns of constituents while retaining the objective of a current value basis for measuring insurance liabilities – bringing a final IFRS standard for insurance a great deal closer."
>
> Frank Ellenbürger, KPMG's global Head of Insurance

For details, refer to:

In the Headlines – June 2013: Insurance contracts

Proposal for simpler accounting

In response to constituent feedback that the fair value model is not appropriate for measuring bearer plants – e.g. grapevines or palm trees bearing fruit – the IASB has issued an exposure draft *Agriculture: Bearer Plants*.

For details, refer to:

Under the proposal, an entity could elect to measure bearer plants at cost. However, the produce growing on bearer plants would continue to be measured at fair value less costs to sell under the standard on agriculture (IAS 41).

The proposal would simplify the measurement of bearer plants and will be welcomed by many companies and investors – particularly in Asia – who consider the current fair value accounting for bearer plants as being subject to too much uncertainty.

In the Headlines – June 2013: Cost accounting for bearer plants

Comments are due to the IASB by 28 October 2013, and comments to the Singapore ASC closes on 12 September 2013.

> "Many companies and investors in Asia will welcome the proposal, because they see the current fair value accounting for bearer plants as being subject to too much uncertainty ."
>
> Reinhard Klemmer, Partner, KPMG in Singapore

Limited exception provides relief

Laws and regulations on over-the-counter (OTC) derivatives are changing in several jurisdictions, requiring or providing incentives for entities to novate many OTC derivatives to a clearing counterparty.

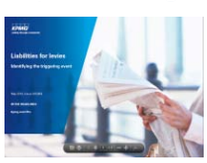
In response to this, the IASB has published *Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)*, providing relief from discontinuing an existing hedging relationship when a novation that was not contemplated in the original hedging documentation meets specific criteria.

For details, refer to: In the Headlines – June 2013: Continuing hedge accounting after derivative novations

If you anticipate novating derivatives from the original counterparty to a clearing counterparty, then you should pay careful attention to the amendments, to see whether you would be eligible for relief from discontinuing hedge accounting.

> "The amendments provide some welcome relief on a widespread issue."
>
> Andrew Vials, KPMG's global IFRS financial instruments leader

Greater clarity on levy accounting



Levies have become more common in recent years, with governments in a number of jurisdictions introducing levies to raise additional income. A new interpretation has provided more clarity as to when a liability for a levy should be recognised.

The IFRS Interpretations Committee has defined the term 'levy' and confirmed that the trigger for recognising a liability is the obligating event specified in the legislation.

The interpretation will achieve greater comparability between entities that operate in the same market within the same jurisdiction.

For details, refer to: In the Headlines – May 2013: Liabilities for levies

> "The interpretation clarifies that the wording of the relevant legislation drives the timing of the recognition. This will achieve greater comparability between entities operating in the same market."
>
> Phil Dowad, KPMG's global IFRS revenue recognition and provisions leader

Leases: On-balance sheet – but at what cost?

For details, refer to: Our article on page 2: Leases: A Controversial Proposal

In the Headlines – May 2013: Leases

New on the Horizon: Leases

In a major shake-up of lease accounting, the IASB and FASB have published proposals to bring most leases on-balance sheet for lessees. A dual model would apply, based on a new lease classification test, which would impact the profile of lease income or expense recognised over the lease term.

Implementing the proposals would be a real challenge for many companies. The impacts – including significant effort to identify leases and extract lease data, changes in financial metrics, and balance sheet volatility – would be felt across sectors.

Companies that lease high-value assets would see large increases in reported liabilities, while companies with large volumes of lower-value leases could face high implementation costs.

Comments to the IASB are due by 13 September 2013, and the comment period to the Singapore ASC closes on 19 July 2013.

> "Bringing leases on-balance sheet is a cherished goal of the standard setters. These proposals would achieve that goal – but we question whether they will satisfy financial statement users, or justify the considerable cost and complexity of implementation."
>
> Wolfgang Laubach, KPMG's global IFRS Leases leader

Integrated Reporting – The journey to better business reporting

For details, refer to: Our article on page 13: Integrated Reporting – The Time Has Come for a New Reporting Model

In the Headlines – April 2013: Integrated Reporting

The Integrated Reporting (IR) Framework is an ambitious attempt to reshape the direction and focus of corporate reporting, aiming to provide investors with a more complete picture of the business story that looks beyond short-term earnings metrics.

The International Integrated Reporting Council (IIRC) has issued a consultation draft, representing the final stage of development for an IR Framework.

IR is a market-led initiative that will be of most interest to those looking to improve their narrative reporting to explain how the business has developed and protected long-term value. Broadly speaking, an IR approach to narrative reporting should lead to each business presenting the information most relevant to its operations, resulting in:

- more operationally focused measures of performance;
- greater focus on explaining key business assets; and
- more emphasis on explaining factors driving future performance.

Comments are due to the IIRC by 15 July 2013.

> "Integrated Reporting provides an opportunity to re-align corporate reporting with investor decision-making. It is an opportunity to shift reporting focus from short-term financial performance to long-term value creation."
>
> David Matthews, Leader, KPMG's Integrated Reporting team

The new proposed impairment model and regulatory focus on forbearance

For details, refer to IFRS Newsletter – Banking Issue 9

The *IFRS Newsletter – Banking* is a quarterly publication that provides updates on IFRS developments directly impacting banks, considers accounting issues affecting the sector, and discusses potential accounting implications of regulatory developments.

Highlights of this issue include:

- The IASB's long-awaited revised proposals on the impairment of financial assets have been re-exposed for public comment, whereas the issuance of the final general hedging standard will be delayed until the IASB has completed further outreach.
- Regulators are focusing on forbearance arrangements. We explore the related accounting and disclosure requirements.
- Amendments to IFRS 9 on classification and measurement can impact banks' regulatory ratios. We consider some areas of potential interaction between these amendments and certain elements of the Basel III regulatory framework.

> "Although a useful credit management tool, forbearance can potentially obscure the credit quality of a bank's portfolio because it can improve the arrears statistics even though the underlying credit risk may remain constant. Hence, forbearance has increasingly become a focus of attention of regulators, analysts and other stakeholders"
>
> Abhimanyu Verma, Financial Services, KPMG in Canada

Transaction declined – no new guidance for credit card issuers

For details, refer to IFRS Newsletter – Revenue Issue 9

Despite the IASB and FASB completing substantive redeliberations on the revenue project in February, the Boards continued discussions on sweep issues in their May meeting.

Responding to queries from the financial services industry, the Boards decided not to provide specific guidance on applying the revenue model to credit card reward programmes. Without this guidance, credit card issuers would need to use judgement in accounting for their reward programmes.

Meanwhile, first-time adopters of IFRS could elect not to apply the new revenue standard to contracts that were closed under local GAAP before the date of transition. This would reduce the cost of applying the new standard, but might further compromise comparability.

> "The Boards' decision that there is no need for the standard to include a specific example on reward programmes provided by credit card issuers is further evidence of their desire to minimise sector-specific guidance in the final standard."
>
> Phil Dowad, KPMG's global IFRS revenue recognition and provisions leader

Relief planned for derivative novations

For details, refer to IFRS Newsletter – Financial Instruments Issue 12

Responding to constituent feedback on its proposals for continuing hedge accounting after a derivative novation, the IASB decided in its May meeting to extend its proposed relief to indirect clearing arrangements and certain voluntary novations.

Following the Board's decision, voluntary novations in response to regulatory changes would not result in a discontinuation of hedge accounting, provided that a central counterparty is involved either directly or indirectly. The finalised amendments are still expected by the end of June.

The Board also discussed macro hedging – focusing on the scope and presentation of the proposed revaluation approach – and the feedback received on the proposed limited amendments to the classification and measurement requirements of IFRS 9 *Financial Instruments*. No decisions were made on these topics.

> "The IASB's decision to extend relief from discontinuing hedging relationships to indirect clearing arrangements and some voluntary novations is a welcome response to constituent feedback."
>
> Andrew Vials, KPMG's global IFRS financial instruments leader

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
XBRL	eXtensible Business Reporting Language

Contact us

Reinhard Klemmer
Partner, Professional Practice
T: +65 6213 2333
E: rklemmer2@kpmg.com.sg

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

kpmg.com.sg