

Corporate Watch

January 2004 Issue

What's new in your FY 2003 Annual Reports?

It's that time of the year again when companies are busy closing their financial books for the year-end, drafting their full year financial results announcements and preparing their annual reports.

Companies face significant challenges as 2003 was an eventful year where there were major changes in Singapore legislation relating to corporate reporting, accounting standards and a shorter reporting time-frame.

To assist directors and management understand the changes that have been or will be made to their companies' annual reports for the financial year ended 31 December 2003, this article highlights the legislative and accounting standard changes and their implications.

One of the most critical changes affecting corporate reporting is the legislation of the accounting standards under the Companies Act (Act).

All Singapore companies are required by law to present their statutory accounts in accordance with the Financial Reporting Standards (FRS) with effect from financial years commencing on or after 1 January 2003. There are limited exceptions to this, one of which is that the company obtains specific approval from the Registrar of Business and Companies for not applying the provisions of the Act and/or the FRS.

Offence by Directors if statutory accounts do not comply with FRS

Legislation has not changed with respect to the directors' obligation to comply with the provisions under *Part VI - Accounts and Audit* of the Act. However, with the new requirement to present statutory accounts that comply with the FRS, directors would be considered committing an offence under the Act if the statutory accounts do not comply with

the FRS. This is a significant change from the past where there is no regulatory consequence if the statutory accounts did not comply with the Statement of Accounting Standards (SAS).

Are directors thus expected to be more savvy about accounting standards? If yes, how have they prepared themselves?

To assist directors and senior management to review/prepare their FY 2003 Annual Reports, we discuss the expected changes in their FY 2003 statutory accounts in the following order:

- Directors' report and Statement by Directors
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A point to note is that a significant amount of the changes in accounting treatments and disclosures have arisen from the alignment of Singapore accounting standards with the International Financial Reporting Standards (IFRS) upon which the FRS are principally based on. Nevertheless, there are still a number of significant differences between FRS and IFRS at this moment such that a company may only convert their FRS-compliant financial statements into IFRS-compliant financial statements by going through certain restatement of numbers.

DIRECTORS REPORT AND STATEMENT BY DIRECTORS

Streamlined Directors Report

The Directors Report now sets out the following information only:

- directors in office as at the date of report;
- arrangements to enable directors to acquire shares and debentures;
- directors interests in shares or debentures (including options);
- directors contractual benefits;
- details on share options; and
- details on the Audit Committee.

All other disclosures previously required in the directors' report have been removed, primarily because these disclosures relate to the financial position of the company/group which are already disclosed and available in the financial statements.

There are no changes to the Statement by Directors.

5th Annual Corporate Governance Conference — 11 February 2004

This annual conference organised by Enterprise Promotion Centre will focus on the recent developments of corporate governance, the evolving roles of independent and non-executive directors and the ways and circumstances in which they can make an effective contribution to their Boards.

The conference will be chaired by **Mr JY Pillay, Chairman of SGX and CCDG**. Among Its distinguished speakers are Mr Derek Higgs, Chairman of Partnerships UK plc and Member of the Financial Reporting Council, Department of Trade & Industry, UK; Mr Ronald E. Berenbeim, Principal Researcher and Director of the Working Group on Global Business Ethics Principles, The Conference Board, USA; **Keith Stephenson, Partner and Head of Global Risk Management Solutions, PricewaterhouseCoopers Singapore**; and Jackson Tai, Vice Chairman and Chief Executive Officer, DBS Group Holdings.

For more details and registration information, please visit the EPC website at <http://www.epc.com.sg>.

CONTENTS OF FINANCIAL STATEMENTS

Holding company need not present company level income statement and statement of changes in equity

If consolidated accounts are presented, the only required financial information of the holding company is its balance sheet (and the explanatory notes). Hence, a holding company need not present its company level profit and loss account and statement of changes in shareholders equity, although it is not precluded to do so.

Foreign wholly-owned or virtually wholly-owned intermediary holding companies need not prepare consolidation accounts

FRS 27 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* exempts a foreign-owned holding company from preparing consolidated accounts if its parent publishes consolidated accounts and it is either (i) a wholly-owned subsidiary; or (ii) a virtually wholly-owned subsidiary (90% or more of the voting power) that has obtained the approval of the owners of the minority interest.

Although the Act requires statutory accounts to be prepared in accordance with the FRS, the exemption for preparation of consolidated accounts under the Act is currently only expressly extended to wholly-owned subsidiaries of Singapore- incorporated companies. Hence, foreign wholly-owned or virtually wholly-owned intermediary holding companies may need to present consolidated accounts, despite the exemptions in FRS 27.

These conflicting requirements in the Act and the FRS are addressed in the Companies (Amendment) Bill published on 6 January 2004. Once the amendments become effective, this conflict will be removed, i.e. companies that are exempted from preparing consolidated accounts under FRS 27 would not be required to do so under the Act as well.

All companies must prepare cash flow statements

Previously, SAS 7 *Cash Flow Statements* exempted the following companies from preparing cash flow statements:

- exempt private companies;

- wholly-owned subsidiaries of Singapore-incorporated companies; and
- companies with gross assets of less than S\$5m or gross sales and other operating revenue of less than S\$5m.

In line with IFRS, FRS 7 *Cash Flow Statements* does not set out any exemptions regarding the presentation of cash flow statements.

Statutory accounts need not be presented in S\$

Previously, the Ninth Schedule of the Act required statutory accounts to be presented in S\$. As this has been repealed, companies may present their statutory accounts in any currency as long as they are prepared in accordance with the provision of the FRS. It is most common for an reporting entity to present its financial statements in its measurement currency (see page 3 of this article under the paragraph *Accounting Treatments - Foreign Currencies*).

ACCOUNTING TREATMENTS

An important issue to address is whether the switch from SAS to FRS triggers the application of FRS 101 *First-time adoption of FRS*. Other amendments in accounting treatments in the following areas arise because of alignments with the requirements under IFRS:

- Foreign currencies
- Property, plant and equipment
- Construction contracts
- Goodwill

First FRS financial statements

Switch from SAS to FRS does not constitute change in accounting standards

The Council on Corporate Disclosure and Governance (CCDG) clarified that the switch from SAS to FRS does not constitute a change in accounting standards and that FRS 101 *First-time Adoption of FRS* would not apply.

Having said that, where there are differences between FRS and SAS, such resultant adjustments to the prior years statutory accounts would not be reflected as prior year adjustments as both FY

2003 and its comparatives are prepared under the FRS. Such material adjustments made to prior year's statutory accounts should nevertheless be disclosed in the FY 2003 financial statements.

Foreign currencies

An appropriate measurement currency must be selected

Under Interpretation to FRS (INT FRS) 19 *Reporting Currency*, with effect from financial years commencing 1 January 2003, an enterprise is required to select a measurement currency that provides information about a company that is useful and reflects the economic substance of the underlying events and circumstances relevant to that company. The choice of the measurement currency is thus one of judgement. Transactions in currencies other than the measurement currency would be accounted for as foreign currency transactions in accordance with FRS 21 *The Effect of Changes in FX Rates*.

Where the measurement currency is different from that of the country where the enterprise is domiciled, the basis for selection should also be disclosed.

If the measurement currency previously used is deemed inappropriate, the company is required to restate its prior periods financial statements which may require an involved process in restating the non-monetary assets/liabilities.

Whatever the measurement currency is, companies can still present its financial statements in a currency that is different its measurement currency, with appropriate accompanying disclosures. If so, the translation methodology prescribed in INT FRS 30 should be applied.

Deferred recognition of exchange differences on long-term foreign currency monetary item disallowed

With effect from financial periods commencing 1 April 2002, all exchange differences arising on reporting an enterprise's long-term foreign currency monetary items should be recognised immediately in income statement. Previously, deferral was allowed over the remaining life of the monetary item.

Property, plant and equipment

Revaluation surplus and deficit can only be offset for the same asset

The previous interpretation under SAS that revaluation surplus and deficit can be offset for the same class of assets has been removed with effect from financial periods commencing 1 April 2002. Companies may thus have to reverse the revaluation deficits previously charged against revaluation surplus on certain assets to the opening retained earnings as revaluation deficits are required to be included in the profit and loss account in the year where the revaluation deficits arise.

Revaluation of PPE to be kept up-to-date if more than one revaluation was performed between 1 January 1984 and 31 December 1996

With effect from FY commencing 1 January 2003, companies are required to perform regular subsequent revaluations unless the initial revaluations were performed before 1984 or only one-off revaluations were performed between 1 January 1984 and 31 December 1996 (both dates inclusive). In the event that an item of property, plant and equipment has been revalued more than once between 1 January 1984 and 31 December 1996, the company should explain why the item should be exempted from subsequent revaluations and obtain its auditor's concurrence on this.

Previously, companies in practice do not perform regular subsequent revaluations if the initial revaluations were performed before 1997.

IAS 16 does not give such exemption when the PPE are revalued subsequent to 1983.

Construction contracts

Completed contract method for recognising contract revenue and cost disallowed

The completed contract method for recognising contract revenue and cost has been prohibited with effect from financial periods commencing on or after 1 April 2002.

Goodwill on acquisition

Requirement to re-cycle goodwill to income statement removed

SAS 22 *Business Combinations* required goodwill or negative goodwill on acquisition previously adjusted against shareholders' interest to be included in the computation of profit or loss on disposal or discontinuance of subsidiaries. FRS 22 *Business Combinations*, consistent with IAS 22 is silent on this matter and this can be interpreted that such goodwill or negative goodwill may be left in the shareholders interest. As with all accounting policies, companies are required to apply their choice consistently.

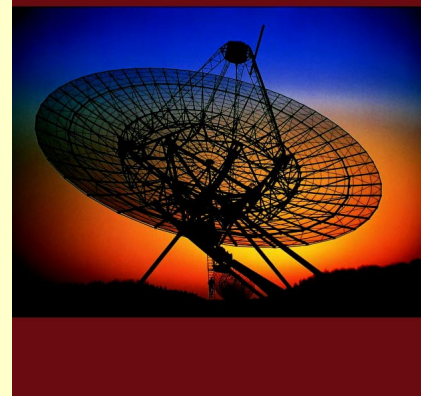
For a company that chooses to retain the goodwill or negative goodwill in shareholders equity upon disposal or discontinuance, such treatment should be applied retrospectively. This may result in the restatement of prior year's comparatives.

Need help in drafting your Annual Report?

PwC Singapore has published the *Illustrative Annual Report 2003* to assist our clients in drafting their latest financial statements.

PRICEWATERHOUSECOOPERS

Illustrative Annual Report
2003 edition



This publication is available for download at our PwC Singapore website (<http://www.pwc.com/sg>). For hardcopies, kindly contact us at corporatewatch@sg.pwc.com.

DISCLOSURES IN FINANCIAL STATEMENTS

The following are areas where disclosure requirements have changed:

- Disclosures previously required under Ninth Schedule of the Act
- Leases
- Property, plant and equipment

Ninth Schedule Disclosure Requirements

Ninth Schedule disclosure items not required unless required by FRS

The Ninth schedule previously prescribed the disclosure items that should be included in the statutory accounts. With effect from FY commencing on or after 1 January 2003, if not required by FRS, such disclosure items are removed.

The following are key items that are no longer required to be disclosed in the statutory accounts:

- **Income/Expense items**
 - Analysis of dividend income from quoted / unquoted investments
 - Analysis of interest income from government bonds, corporate debentures, fixed deposits
 - Audit fees (however, we recommend this to be disclosed for listed companies)

- Allowance for doubtful trade debts, inventory write-down, gain/loss on disposal of property, plant and equipment/ long-term investments, unless these items are of such size, incidence / nature to warrant disclosure

- **Balance Sheet items**

- Analysis between quoted / unquoted investments
- Analysis of investments in public debentures/ stocks/ bonds and those of other corporations
- Asset allowance type movement of provision (eg doubtful debts, inventory)
- Amount of secured liabilities (however, still need to disclose assets that are restricted as required by the relevant FRS)
- Amount of investment in each and every subsidiaries and associates (however, details of significant subsidiaries and associates are still required under FRS 27)

Leases

Lessors must disclose minimum lease payments of operating leases

SAS 15 *Leases* exempted lessors from disclosing the future revenue (minimum lease payments) on non-cancellable operating leases.

Such exemption has been removed under FRS 17, in line with IFRS.

Property, plant and equipment

Disclosure of valuers names and their qualifications no longer required

SAS 14 *Property, Plant and Equipment* required the disclosure of valuers names and the particulars of their qualifications. FRS 16 does not have the same requirement.

CHANGES IN DEADLINES

Earlier deadline for AGM

The Annual General Meeting of listed companies are now required to be held within 4 months (previously 5 months) of its financial year end.

The annual reports are required to be distributed to the shareholders at least 14 days before the AGM (no change).

WHAT S THE OUTLOOK FOR FY 2004?

FY 2004 will continue to be a challenging year for corporate reporting. In addition to the legislative changes, accounting standards are also expected to go through a revolution. Almost all existing standards will change with key areas of focus on Financial Instruments, Business Combinations, Goodwill, Impairment and Share-based payments. Interim reporting deadlines will also be shortened to 45 days from the period end, although the form of quarterly reports has been relaxed. The pressure for more transparency in corporate reporting is ever increasing and corporates should brace themselves for these changes and plan early.



Coming Soon!

Watch out for details about the following PwC Public Seminars to be held in **March 2004** in our next issue of Corporate Watch:

- Fraud —On Guard!
- Revised IAS 32 and IAS 39 on *Financial Instruments*

Business Trusts in Singapore

The Ministry of Finance (MOF) and the Monetary Authority of Singapore (MAS) intend to introduce Business Trusts (BT) in Singapore, which are already available in countries such as the United States, Canada and Australia.

On 10 December 2003, the MAS issued a consultation paper which included a draft Business Trusts Bill (Bill), setting out key proposals for the governance and offers of units in BTs and the regulatory treatment of Real Estate Investment Trusts (REITs). A second consultation paper for proposed changes to the Securities and Futures Act (SFA) was also issued in December 2003 to govern BTs that intend to raise capital from the public. Comment periods of the papers ended on 12 and 19 January 2004.



What are BTs?

BTs are essentially businesses structured in the form of trusts with no separate legal existence. Like existing unitholders of unit trusts under the Collective Investment Scheme (CIS), unitholders of BTs do not have legal ownership of the assets of the BTs but have beneficial interest and the right to distribution from the BT. However, unlike the unit trusts, BTs are expected to actively undertake business operations.

In addition, unlike a unit trust where both a trustee and a manager are appointed for the unit trust, a single-responsibility model is proposed for BT where the manager would also be the trustee of the assets of the BT (Trust-manager or TM). This proposal is on the rationale that the trustee may not be in a position to have the intimate knowledge of running the operations of BT nor the operations of the manager to fulfil its oversight role. This model is practised in Australia and Canada.

BT can solicit funds from the public and be listed on the Singapore Exchange.

BTs can distribute cash profits

The chief advantage of the BT structure is its ability to pay dividends to unitholders out of its **cash profits**, as opposed to companies where dividends can only be paid out of accounting profits.

Distributions can be declared out of cash profits when (i) the value of trust property of the registered BT would exceed the liabilities of the BT and (ii) the TM will be able to pay such liabilities in the ordinary course of business as they come due.

A BT structure would hence be suitable for businesses with stable growth and high cash flow, and can render companies in real estate or utilities sector more attractive to investors. Unitholders of BTs are also accorded limited liability for the obligations of the trusts as is the case for shareholders of companies.

Statutory duty of TM to act in best interests of unitholders

The TM should be a public company incorporated in Singapore. A statutory duty is imposed on the TM to act in the best interests of the unitholders at all times. To do so, the legislation proposed that the majority of the TM's BOD must be independent of the management of, and business dealings with, the TM and substantial shareholders of the TM. In addition, the TM must form its own audit committee with a majority of independent directors, even when the BT is not listed on the stock exchange. The TM is also limited to running only one BT so as to prevent TM from undertaking fiduciary duties to multiple and different groups of unitholders whose interests may conflict.

Voting rights of unitholders

Unitholders have the power to appoint or remove the TM and make amendments to the trust deed subject to a special resolution (75% of votes of unitholders present and voting). Additional threshold where those present and voting would be required to hold at least 50% of total outstanding units of the BT can be imposed. This requirement for BT is more stringent than that for companies where a director may be removed or the articles of the company may be amended by ordinary resolution of shareholders.

Creditors to be granted right of subrogation to the TM's right of indemnity on trust assets only

Creditors can only claim from the assets of the BT via the rights of indemnity of the TM. Creditors may therefore be reluctant to do business with BTs under the current level of protection accorded to them under the Bill.

When does a trust have to be registered under the proposed Bill?

Any trust may register under the proposed Bill. However, it is proposed that registration be compulsory for trusts which offers units to the public in Singapore unless it is authorised or recognised as a CIS. A foreign BT could either register under the proposed Bill or, subject to approval by MAS, apply under a recognised regime to offer units in Singapore.

REITs can choose to be BT or regulated under CIS

Existing REITs or new trusts investing in real estate are proposed to be given the flexibility to make a choice to be regulated under either the CIS or the BT regime.

Other proposals

Other proposals include disclosures of TM's governance practices in the annual report of the BT that must be certified by the Board and CEO of the TM, provisions for winding up and take-over of units in the BT and the requirement for BT financial statements to be audited.

To read the complete consultation paper, please visit the MAS website (<http://www.mas.gov.sg>).

IASB Improvements Project Series

- IAS 16 *Property, Plant and Equipment*, IAS 17 *Leases* and IAS 40 *Investment Property*

The International Accounting Standards Board (IASB) embarked on a project (generally referred to as *Improvements Project*) in 2001 to reduce or eliminate alternatives, redundancies and conflicts within the International Accounting Standards (IAS), to deal with some convergence issues and to make other improvements. Exposure drafts to amend the IAS were issued by IASB in May 2002. Locally, similar exposure drafts were issued in July 2002. To facilitate preparation, the IASB made available the provisional final drafts of certain standards since October 2003. The IASB eventually issued all 13 revised standards and gave notice on the withdrawal of one standard on 18 December 2003.

This article is part of a series that started in December 2003 where we highlight the key changes between the revised standards/ provisional final drafts and their exposure drafts. IAS 2 *Inventories*, IAS 10 *Events After the Balance Sheet Date*, and IAS 33 *Earnings Per Share* were discussed last month. This month, we will address IAS 16 *Property, Plant and Equipment*, IAS 17 *Leases*, and IAS 40 *Investment Property*.

IAS 16 Property, Plant and Equipment

The IASB's main objective for revising IAS 16 is to provide additional guidance and clarification on selected property, plant and equipment (PPE) matters such as recognition of subsequent costs, component approach for depreciation, review of asset's residual value and criteria on derecognition. In addition, the following have been incorporated:

Subsequent costs of dismantlement, removal and site restoration

The cost of dismantlement, removal and site restoration could be incurred when the asset was initially acquired or in subsequent periods. Under the exposure draft (ED) to IAS 16, provided such cost does not arise from producing inventories, it shall be capitalised at initial recognition. It is however silent on the treatment subsequent to initial recognition.

The revised IAS 16 clarifies that the *estimated amount* of such cost shall be capitalised at initial recognition. It also specifies that subsequent changes in the estimated amount shall only be recognised as provision if:

- the entity has a present obligation (legal or constructive) as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

The effect of changes in liabilities is dealt with in Draft Interpretation 2, *Changes in*

Decommissioning, Restoration and other similar Liabilities. This draft interpretation was illustrated in our November 2003 issue of Corporate Watch.

Exchange of assets

The ED to IAS 16 proposed that all exchanges of items of PPE and intangible assets should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably. The revised IAS 16 includes an additional exception to this rule, that is when the exchange transaction lacks commercial substance.

Commercial substance is determined by considering the extent to which its future cash flows are expected to change as a result of the transaction. Specifically, an exchange transaction has commercial substance if:

- (a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or
- (b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and
- (c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

When the exchange transaction lacks commercial substance, the acquired asset shall be measured at the carrying amount of the asset given up. Otherwise, an acquired asset shall be measured at fair value even if an entity cannot immediately derecognise the

asset given up. That said, retrospective adjustment is not allowed on previous asset exchanges that lacked commercial substance.

Depreciation for asset with residual value equal to or greater than its carrying amount

The ED to IAS 16 required that the residual value of an asset be reviewed at least at each financial year-end and, when expectations differ from previous estimates. As a result, the residual value of an asset might increase to an amount equal to or greater than its carrying amount.

When such situation arises, the revised IAS 16 provides that the asset's depreciation charge should be zero unless and until the residual value subsequently decreases to an amount below the asset's carrying amount. The change in residual value shall not be recognised as credits to depreciation as well. The ED to IAS 16 was silent on this matter.

IAS 17 Leases

The IASB's main objective for revising IAS 17 is to clarify the classification of a lease of land and buildings and to eliminate accounting alternatives for initial direct costs in the financial statements of lessors. The proposed amendments to IAS 17 were limited because the IASB would be undertaking a project on lease accounting jointly with the United Kingdom Accounting Standards Board.

Inception of the lease and commencement of the lease term

Filing of non-S\$ tax computations and financial statements

On 31 December 2003, the IRAS has issued a circular for businesses filing their income tax computations and financial statements in non-S\$ functional currencies (or measurement currencies). The circular gives an irrevocable choice of 2 options to translating unabsorbed tax items, tax written down value of existing assets brought forward, cost of existing assets and prior year income/expense items. Translation rules are also prescribed for other items in the profit and loss account.

For the complete IRAS circular, please visit the IRAS website (<http://www.iras.gov.sg>).

Some respondents to the ED highlighted that the inception date of the lease (when the agreement is entered into) and the commencement date of the lease term (when the lease begins) might differ and the ED to IAS 17 did not provide adequate guidance on such situation.

Consequently, the revised IAS 17 now defines commencement date. It also specifies that the initial recognition of a lease (i.e. the recognition of asset, liabilities, income or expenses resulting from the lease, as appropriate) should take place at commencement of lease term based on values measured at the inception of the lease.

Initial direct costs incurred for finance leases by lessors other than manufacturers and dealers

The ED to IAS 17 proposed that lessors include in the initial measurement of the finance lease receivable the initial direct costs incurred. Such initial direct costs include commissions, legal fees and internal costs that were incremental and directly attributable to negotiating and arranging for a lease.

The revised IAS 17 adopts the above proposal. In addition, it specifies that initial direct costs should not include general overheads.

Costs incurred in negotiating and arranging finance leases by manufacturer or dealer lessors

Under the ED to IAS 17, initial direct costs shall exclude incremental costs

that are directly attributable to negotiating and arranging a lease incurred by manufacturer or dealer lessors. Therefore, such costs are excluded from net investment in leases.

The revised IAS 17 requires such costs to be recognised as an expense when the selling profit is recognised. This is in contrast with the ED proposal to recognise such costs as expense at the inception of the lease.

IAS 40 Investment Property

The IASB's main objective for revising IAS 40 is to permit a property interest held under an operating lease to be classified as investment property under specified conditions.

Interaction between IAS 17 and IAS 40 - Classification of a lease of land and buildings

The ED to IAS 17 proposed that for a lease of both land and buildings, the land and buildings elements should be considered separately for the purposes of lease classification, unless title to both elements is expected to pass to the lessee by the end of the lease term.

The revised IAS 17 retains this proposal. It also provides that the minimum lease payments at the inception of such lease shall be allocated between the land and buildings elements in proportion to the fair values of the leasehold interests in the land and buildings of the lease, and not the fair values of the underlying land and buildings.

The revised IAS 17 also clarifies that if the lease payments cannot be allocated reliably between these two elements (e.g. because similar land and buildings are not sold or leased separately), the entire lease shall be classified as a finance lease, unless it is clear that both elements are operating leases, in which case the entire lease shall be classified as an operating lease.

Valuation of leasehold property interests

The revised IAS 40 confirms that leasehold property interests should be valued by reference to expected cash flows — both inflows and outflows. But, the expected cash flows should exclude those that have been separately recognised in the balance sheet as a

liability. Accordingly, if the valuation obtained for the property is net of all payments expected to be made, it will be necessary to add back any recognised liability. The reconciliation between the valuer's net valuation and the valuation should also be disclosed in the financial statements.

Classification of property interest held under an operating lease

The ED to IAS 40 allows a property interest held under an operating lease to be classified and accounted for as investment property provided that:

- the property interest meet the definition of an investment property;
- the lease is accounted for as if it is a finance lease; and
- the resulting leased asset is measured using the fair value model.

Besides retaining the above, the revised IAS 40 clarifies that the lessee shall continue to account for such lease as a finance lease, even when a subsequent event changes the nature of the property interest to the extent that it should no longer be classified as an investment property.

The revised IAS 40 also states that the classification alternative is available on a property-by-property basis. But, once this classification alternative is selected for one such property interest held under an operating lease, all property classified as investment property shall be consistently accounted for using the fair value model.

Disclosures such as (1) whether the fair value or cost model has been applied, and (2) if the fair value model is applied, whether and in what circumstances are the property interests held under operating leases classified and accounted for as investment property, shall be included as well.

These revised standards are available for download at the IASB website (<http://www.iasb.org.uk>).



IFRS Adoption — *Time to take action.*

Outright adoption of International Financial Reporting Standards (IFRS) or convergence with the standards is now a global phenomenon that is rapidly gathering pace. Australia, Russia, New Zealand, the entire European Union (EU), several countries in the Middle East and Africa and others have decided on a wholesale, mandatory change to IFRS. The US, South Africa, Singapore and Malaysia, to name but a few, are committed to the convergence of local standards with the international benchmark.

In this article, we focus on the key questions a Singapore company must address as reporting under IFRS becomes prevalent world-wide.

Is my company required to comply with IFRS?

At present, Singapore companies only have to comply with Singapore Financial Reporting Standards (FRS). Although Singapore is committed towards the convergence of FRS with IFRS, we have not moved towards mandatory adoption of IFRS in Singapore.

However, with increasing world-wide acceptance of IFRS, Singapore-based multinationals should expect increasing demands for IFRS based financial reporting. In addition, all EU listed companies and Australian companies are required to comply with IFRS in 2005 for their group financial statements. This will have a direct impact on the Singapore operations of EU-based and Australian-based multinationals that will need to report under IFRS for group-reporting purposes. IFRS compliant financial statements may not be identical to the FRS-compliant financial statements and hence, reconciliation / adjustments would be required for reporting to the holding companies.

From which financial year will financial statements first have to comply with IFRS?

EU listed companies must issue IFRS compliant financial statements for financial years starting on or after 1 January 2005. (For those with 12 month accounting periods ending on 31 December, 31 March or 30 June, IFRS will first apply to annual periods ending on 31 December 2005, 31 March 2006 and 30 June 2006 respectively.) For companies with a 31 December year end that report more frequently, they will publish IFRS financial information as at 31 March 2005 (if they report quarterly)

or as at 30 June 2005 (if they report half yearly).

The Singapore operations of EU-based multinationals will have to submit IFRS compliant financials for group-reporting purposes during these periods.

When will IFRS data need to be collected?

Companies will need to apply the standards to the most recent comparative prior year presented in their financial statements. Companies with a 31 December year end will therefore have to obtain IFRS-compliant data going back to 1 January 2004, and companies with a 30 June year end will have to obtain IFRS-compliant data going back to 1 July 2004.

Those companies that show two prior years of comparative information, but do not restate the earliest comparative year, will still need to collect some IFRS data earlier, in order to disclose the nature of the main adjustments that would have been necessary to make the data comply with IFRS.

However, those companies that are also foreign registrants in the US which prepare their financial statements on the basis of IFRS and lodge them with the SEC, must continue to restate comparative information for all prior years presented, unless relief is granted by the SEC.

What are the requirements for first time adoption of IFRS?

On 19 June 2003, the IASB issued IFRS 1 *First-time Adoption of International Financial Reporting Standards* which is

effective for financial periods commencing on or after 1 January 2004.

IFRS 1 applies when an entity adopts IFRSs for the first time as its basis of accounting. The key principle is full retrospective application of all IFRSs in force at the closing balance sheet date for the first IFRS financial statements.

In particular, the IFRS requires an entity to do the following in the opening IFRS balance sheet that it prepares as a starting point for its accounting under IFRSs:

- (a) recognise all assets and liabilities whose recognition is required by IFRSs;
- (b) not recognise items as assets or

Revised standards on Financial Instruments

The IASB has issued the **revised IAS 32 and IAS 39** on 17 December 2003. IAS 32 deals with the disclosure of financial instruments and their classification as debt or equity. IAS 39 deals with recognition, derecognition, measurement and hedge accounting.

These revised standards clarify certain requirements and make the standards significantly easier to apply. The changes are expected to have a significant impact on both existing IFRS reporters and first-time adopters - this impact is explained in our *Financial instruments under IFRS* publication which would soon be available for download at our PwC Global website.

[\(http://www.pwc.com/corporatereporting/\)](http://www.pwc.com/corporatereporting/)

liabilities if IFRSs do not permit such recognition;

- (c) reclassify items that it recognised under previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under IFRSs; and
- (d) apply IFRSs in measuring all recognised assets and liabilities.

IFRS 1 grants limited optional exemptions from the above requirements that are designed to relieve the burden of retrospective application:

- Business combinations
- Fair value as deemed cost for property, plant and equipment and investment property
- Employee benefits
- Cumulative translation differences on foreign operations
- Split-accounting for compound financial instruments
- Assets and liabilities of subsidiaries

For instance, a first time adopter may elect not to apply IAS 22 *Business Combinations* retrospectively to business combinations that occurred before the date of transition to IFRS. However, if the entity elects to restate a particular business combination, all subsequent

combinations occurring after it must also be restated.

IFRS 1 prohibits retrospective application of IFRSs in some areas, particularly to avoid retrospective application that requires management judgement on past events that would be influenced by use of hindsight since the outcome of a particular transaction is already known. Retrospective application is prohibited in accounting for:

- Derecognition of financial assets and financial liabilities
- Hedge accounting
- Estimates

How different are IFRS from Singapore Financial Reporting Standards (FRS)?

The FRS prescribed by the Council of Corporate Disclosure and Governance are based closely on the IFRS issued by the IASB. However, differences continue to exist between IFRS and FRS, a key example being the accounting treatment of leasehold lands as prepaid lease payments under IFRS as opposed to capitalisation of leased assets as fixed assets or investment property under FRS as these are held to be finance leases.

IAS 40 Investment property that includes a fair value model for accounting for investment property has not been adopted in Singapore's standards. *FRS 39 Financial instruments: recognition and measurement of financial instruments* is based on IAS 39 of the same name. However, FRS 39 is effective only from 1 January 2005 while IAS 39 was effective from 1 January 2001. The gap in the adoption dates of FRS 39 from IAS 39 will introduce significant impact for Singapore companies if they have to submit IFRS compliant financials prior to 1 January 2005.

In addition, IASB continues to work on new standards that will be relevant to the IFRS adopter. Accounting topics that are expected to be the subject of new standards include insurance contracts and share-based payments (including employee share options).

Time to take action

It is tempting for companies contemplating the adoption of IFRS to view the change simply as an accounting exercise, something chief financial

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officers and their staff can do in their spare time. But this assumption is dangerous.

IFRS conversion is a change in primary GAAP and for many companies, this will mean fundamental changes — changes that can ripple right across their business operations from investor relations to everyday procedures, changes that can affect the viability of some products and even the reported profitability of the business itself. It is likely to take considerable time to plan and make the necessary changes and to integrate them fully across your company while continuing your business operations as effectively as usual.

The key to successful IFRS implementation is to start early and involve management at the highest level in the exercise.

IFRS News — January 2004 is now available

This issue features the second article of the IAS 39 series that looks at the definition of an **embedded derivative** and how to fair value it, taking into consideration the requirements in revised IAS 39 published last month.

It includes interviews with national standard setters and PwC partners on what their expectations are for 2004. It also outlines the 14 revised standards from the IASB's Improvements project published last month.

IFRS News is a monthly newsletter produced by PwC Global Corporate Reporting Group and is available for download at the PwC Global website. (<http://www.pwc.com/corporatereporting/>)