

# Corporate Watch

December 2004 Issue

## CCDG issues FRS 102, FRS 104, FRS 105 and Amendments to FRS 39

On 6 September 2004, the Council on Corporate Disclosure and Governance issued three Financial Reporting Standards (FRS), these being FRS 102 *Share Based Payment*, FRS 104 *Insurance Contracts*, FRS 105 *Non-current Assets Held for Sale and Discontinued Operations* and Amendments to FRS 39 relating to macro hedging.

FRS 102 *Share Based Payment* requires an entity to recognise share-based payment transactions in its financial statements, including transactions with employees or other parties that are settled in cash, other assets, or equity instruments of the entity. This standard also sets out measurement principles and specific requirements for three types of share-based payment transactions.

FRS 104 *Insurance Contracts* is the first FRS to deal with insurance contracts and has been issued to make limited improvements to accounting for insurance contracts. It requires any entity issuing insurance contracts (an insurer) to disclose information about such contracts.

FRS 105 *Non-current Assets Held for Sale and Discontinued Operations* sets out requirements for the classification, measurement and presentation of non-current assets held for sale and replaces FRS 35 *Discontinuing Operations*.

Amendments to FRS 39 relating to macro hedging provide additional guidance on certain aspects of hedging.

*To read the full Financial Reporting Standard, please visit the CCDG website.*

## Are you ready for FRS 39?

The effective date of the revised FRS 39 *Financial Instruments: Recognition and Measurement* is the annual period beginning on or after 1 January 2005. FRS 39 is viewed as the most complicated standard ever issued to date. The implementation issues have been dealt with in various publications including the earlier issues of Corporate Watch. The perception of FRS 39 being an industry specific issue has been corrected for it has an impact on all entities. The following briefly outlines the FRS 39 implementation issues that should be considered by entities when implementing FRS 39, relating to:

- 1) Definition of financial instruments
- 2) Identification of financial instruments
- 3) Classification & measurement of financial assets & liabilities
- 4) Identification & accounting for embedded derivatives
- 5) Hedge accounting
- 6) Derecognition and recognition of financial assets and liabilities

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**Definition of financial instruments (FRS 32.11)**

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

A financial asset is any asset that is:

- (a) cash;
- (b) an equity instrument of another entity;
- (c) a contractual right:
  - (i) to receive cash or another financial asset from another entity; or
  - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
- (d) a contract that will or may be settled in the entity's own equity instruments and is:
  - (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
  - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

A financial liability is any liability that is:

- (a) a contractual obligation:
  - (i) to deliver cash or another financial asset to another entity; or
  - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
- (b) a contract that will or may be settled in the entity's own equity instruments and is:
  - (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
  - (ii) a derivative that will or may be settled other than by the exchange of a fixed

amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

**Identification of financial instruments (refer to Table 1)**

FRS 39 is applicable to financial assets, financial liabilities and derivatives. The first step in the implementation process is to identify the respective financial assets, financial liabilities and derivatives.

**Classification & measurement of financial assets & liabilities (refer to Table 2a & 2b)**

Once identified, the financial assets and liabilities should be categorised into:

- fair value through profit or loss;
- held-to-maturity investments (financial assets only);
- loans & receivables (financial assets only); and
- available-for-sale (financial assets only)

The classification process is critical as the measurement method is dependent upon the categorisation. Fair valuation is applied to:

- 1) financial assets at fair value through profit or loss;
- 2) available-for-sale financial assets; and
- 3) held-for-trading financial liabilities

Amortised cost is applied to all other categories.

**Identification & accounting for embedded derivatives (refer to Table 3a & 3b)**

Examples of embedded derivatives are listed in Table 1. Embedded derivatives are now required to be separately accounted for if they are not closely related to the host contract at fair value measurement. Changes in fair value are included in the income statement. The identification of the embedded derivative follows the assessment of the relation between the host and derivative before the fair value is determined.

**Hedge Accounting**

The strict rules for hedge accounting require:

- identification of hedge item and hedge instrument;
- assessment of hedge effectiveness;
- documentation of hedge relationships; and
- profit and loss impact resulting from the ineffective portion of the hedge

**Derecognition of financial asset and liability**

The derecognition of financial asset requires the consideration of transfer of risks and rewards. The transfer of ownership risks and rewards precedes the evaluation of the transfer of control.

The derecognition of financial liability occurs when the obligation specified in the contract is discharged, cancelled or expires.

*The above outlines the identification, classification, recognition/derecognition and measurement requirements specified in FRS 39. Fair value measurement prevails in FRS 39. This measurement process is a complex exercise and issues relating to effective interest rate and impairment should be taken into consideration. For the continuous implementation of FRS 39, systems and personnel requirements should also be taken into the equation.*



**Table 1: Examples of financial assets, financial liabilities, derivatives and embedded derivatives**

<p><b>Examples of financial assets</b></p> <ul style="list-style-type: none"> <li>• Bank deposits</li> <li>• Trade debtors</li> <li>• Inter-company loans</li> <li>• Staff loans</li> <li>• Other receivables &amp; advances</li> <li>• Investments</li> </ul> <p><b>Examples of financial liabilities</b></p> <ul style="list-style-type: none"> <li>• Trade creditors and other payables</li> <li>• Bank borrowings</li> <li>• Bonds</li> <li>• Certain Preference shares</li> </ul> <p><b>Examples of derivatives</b></p> <ul style="list-style-type: none"> <li>• FX forwards, swaps</li> <li>• Interest rate swaps</li> <li>• Cross currency swaps</li> <li>• FX options</li> <li>• Interest rate options</li> <li>• Equity options</li> <li>• Interest rate futures</li> <li>• Commodity derivatives</li> </ul> <p><b>Examples of embedded derivatives</b></p> <ul style="list-style-type: none"> <li>• Lease with contingent rental payment</li> <li>• Non-financial contract denominated in foreign currency</li> <li>• Non-financial contract with net settlement</li> <li>• Loan with extension option</li> <li>• Loan with prepayment option</li> </ul>
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**Table 2a: Classification & Measurement of Financial Assets**

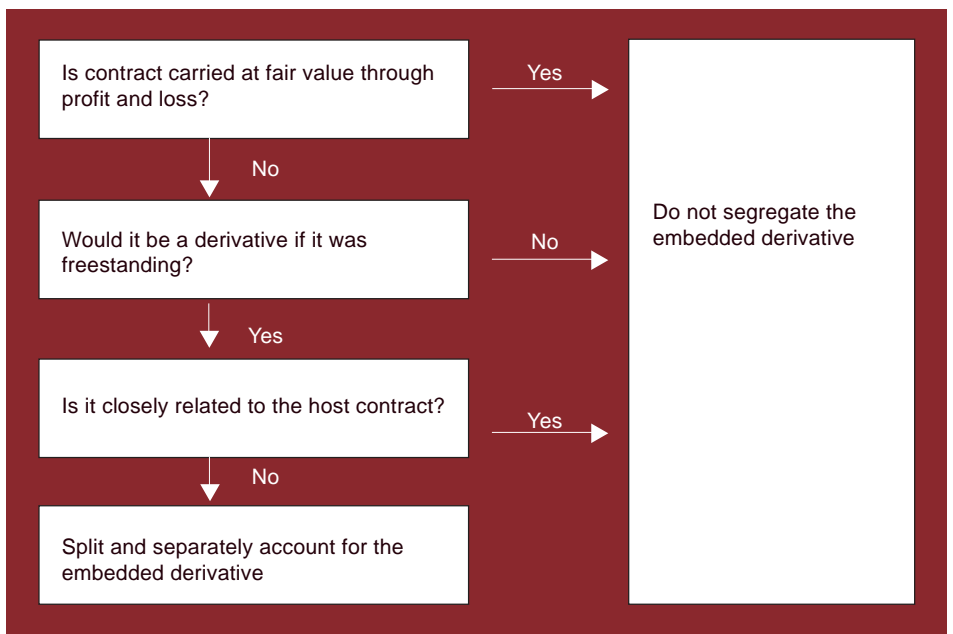
Category	Held-to-maturity	Loan & receivable	FV – PL <sup>1</sup>	Available-for-sale
Measurement	Amortised Cost		Fair Value	

<sup>1</sup> FV-PL: A financial asset or financial liability at fair value through profit or loss

**Table 2b: Classification & Measurement of Financial Liabilities**

Category	Held-to-trading	Others
Measurement	Fair Value	Amortised Cost

**Table 3a: Accounting for embedded derivatives**



**Table 3b: Type of embedded derivatives**

Not Closely Related	Closely Related
x Equity conversion or 'put' option in debt instrument	✓ Interest-rate swap embedded in a debt instrument
x Fixed-rate debt extension option	✓ Inflation-indexed lease contracts
x Debt security with interest or principal linked to commodity or equity prices	✓ Cap and floor in a sale and purchase contract
x Credit derivatives embedded in a host debt instrument	✓ Prepayment option in a mortgage where the option's exercise price is approximately equal to the mortgage's amortised cost on each exercise date
x Sales or purchases not in: <ol style="list-style-type: none"> <li>1) measurement currency of either party;</li> <li>2) currency in which products are routinely denominated in international commerce; or</li> <li>3) currency commonly used in the economic environment in which the transaction takes place</li> </ol>	✓ A forward foreign exchange contract that results in payments in either party's reporting currency
	✓ Dual currency bonds
	✓ Foreign currency denominated debt



# Changes in your FY 2004 & FY 2005 Annual Reports

2004 has seen a significant number of changes in accounting standards. Since December 2003, the Council on Corporate Disclosure and Governance (CCDG) has revised or issued 20 Financial Reporting Standards (FRSs) and made consequential amendments to 17 FRSs. Six exposure drafts on new or proposed revisions to the FRSs and interpretation to FRS are outstanding as of November 2004. The majority of these standards take effect on 1 January 2005 and thus affect the FY 2005 annual report.

This article outlines the changes expected in the FY 2004 annual report emanating from:

- 1) Operating and Financial Review (OFR) Guide
- 2) Companies (Amendment) Act 2004 (CA 2004)
- 3) SGX Listing Manual

In view of the numerous FRSs that have been issued and effective from FY 2005, entities should consider their implications on the FY 2005 annual report and the required actions. Impending legislations such as the Companies (Amendment No. 2) Bill 2004 and Proposed Revision to the Code of Corporate Governance should also be taken into consideration and is discussed in the second section of this article, under the section on FY 2005 Annual Report.

## FY 2004 Annual Report

### Operating and Financial Review (OFR) Guide

Under Rule 1207(4)(a) of the SGX Listing Manual, listed companies are required to conduct an Operating and Financial Review (OFR). In February 2004, the Ministry of Finance accepted the CCDG's recommendations to issue an Operating and Financial Review (OFR) Guide. Adherence to the OFR Guide by listed companies is voluntary. Listed companies are urged to consider the principles and guidelines in the OFR Guide in preparing their annual reports for financial years starting from 1 January 2004. The 8 principles included in the OFR Guide are:

- 1) Focus on investor matters
- 2) Describe nature of company, its objectives and broad strategies
- 3) Discuss key financial and non-financial performance indicators
- 4) Discuss performance for the period
- 5) Discuss the dynamics and risks factors of the business
- 6) Comment on maintaining and enhancing company's position and profitability

- 7) Discuss capital structure and capital management policies
- 8) Discuss overall return attributable to shareholders

### Company Registration Number

Following the Companies (Amendment) Act 2004 (CA 2004), the amended section 144 requires the company registration number to be included (after the name of the company) in official documents issued by a company on or after 1 October 2004.

This affects business letters, statements of account, invoices, official notices and publications of or purporting to be issued or signed by or on behalf of the company. Therefore, all financial statements issued after 1 October 2004 must include the company registration number.

ACRA has clarified that bills of exchange, promissory notes, indorsements, cheques, orders, receipts and letters of credit issued by or purporting to be issued or signed by or on behalf of the company only need to have the company's registered name appearing on them.

### Exemption from Preparation of Consolidated Accounts

Prior to CA 2004, the Companies Act specifically exempted only wholly owned

subsidiaries of Singapore incorporated companies from preparing consolidated accounts. Following CA 2004, and in line with FRS 27 *Consolidated and Separate Financial Statements*, wholly owned subsidiaries of foreign companies and virtually owned subsidiaries are also exempted from preparing consolidated accounts.

### Auditors' Report

Due to the deletion of Companies Act section 207(2)(c), auditors of a holding company are no longer required to:

- disclose the names of subsidiaries not audited by the auditors of the holding company;
- state whether they have considered the accounts and the auditors' report of all subsidiaries of which they have not acted as auditors;
- state whether they are satisfied that the accounts of the subsidiaries are properly consolidated and whether they received satisfactory information and explanation; nor
- state whether any auditors' report on the subsidiaries' accounts was subject to material qualification

Auditors of the holding companies are expected to have considered all these matters before issuing the audit opinions.

## Listing Rules

One of the January 2004 changes in the SGX Listing Rules relate to the audit report. Previously, any qualification or emphasis of matter in the audit report of the listed company or its subsidiaries must be announced immediately and this rule was extended to the audit report of associates. Now, only a qualification or emphasis of matter that has a material impact on the group financial statements needs to be announced.

## FRS 101 First-Time Adoption of Financial Reporting Standards

FRS 101 was issued in November 2003 and effective for the annual period beginning on or after 1 January 2004. In the first instance, entities should note that FRS 101 does not apply to companies that had been complying with the Statements of Accounting Standards (SAS). However, FRS 101 would apply to other companies preparing financial statements in compliance with FRSs for the first time.

FRS 101 requires an entity to apply retrospectively each FRS effective at the reporting date in preparing its first FRS financial statements. FRS 101 grants limited exemptions from this requirement in specified areas. Retrospective application of FRSs is also prohibited in areas such as:

- derecognition of financial assets and liabilities;
- hedge accounting; and
- estimates

Disclosures include explanation(s) of how the transition from previous GAAP to FRSs affected the entity's reported financial position, financial performance and cash flow.

## FY 2005 Annual Report

In addition to the FRSs that have been issued since December 2003 (i.e. Improvement Project, FRS 101, FRS 102, FRS 103, FRS 104 and FRS 105<sup>1</sup>), the Ministry of Finance has also issued the Proposed Revisions to the Code of Corporate Governance and issued the Companies (Amendment No. 2) Bill.

Although these pronouncements are not effective for FY 2004, entities should consider their implications and especially whether any decisions are required before the commencement of FY 2005.

## Improvements Project

On 12 April 2004, the CCDG issued 12 improved standards<sup>2</sup> (5 of which had some further refinements compared to the IASs) and withdrew FRS 15, *Information Reflecting the Effects of Changing Prices*. The improved FRSs are effective for financial periods beginning on or after 1 January 2005 and comprise:

- FRS 1 *Presentation of Financial Statements*
- FRS 2 *Inventories*
- FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- FRS 10 *Events after the Balance Sheet Date*
- FRS 16 *Property, Plant and Equipment*
- FRS 17 *Leases*
- FRS 21 *The Effects of Changes in Foreign Exchange Rates*
- FRS 24 *Related Party Disclosures*
- FRS 27 *Consolidated and Separate Financial Statements*
- FRS 28 *Investments in Associates*
- FRS 31 *Interests in Joint Ventures*
- FRS 33 *Earnings Per Share*

Some changes, relating to the removal of accounting choice or new guidance/disclosures, are highlighted in Table 4. Before considering the implications of these revised standards, it is important to note the revised requirements in FRS 8 in relation to:

- retrospective application of accounting policy upon initial application of a Standard or an Interpretation that does not include specific transitional provisions;
- retrospective application of voluntary changes in accounting policies; and
- retrospective restatement to correct prior period errors

In particular, the retrospective application of accounting policy requires the new accounting policy to be applied to the comparatives as far back as practicable.

This retrospective application requirement affects the revisions arising from the Improvements Project, especially those relating to new requirements and disclosures. Therefore, it would be efficient to consider the implications on the FY 2005 comparatives now.

Furthermore, current events and/or transactions being negotiated and expected to be finalised in 2005 could be affected by the revised standards. Such transactions should be identified as soon as possible. Examples include the identification of idle assets for the depreciation of assets from the day it is available for use till it is idle or held-for-sale, and accounting for restoration cost of property, plant and equipment.

Revised requirements such as annual review of residual values may affect resource requirements, which should be identified and planned for accordingly.

Additional information may need to be collated due to changes such as the usage of uniform accounting policies and no greater than three month difference in the accounting period specified in FRS 28.

## FRS 102 Share-Based Payments

FRS 102 was issued in September 2004 and effective for the annual period beginning on or after 1 January 2005. It is applicable for:

- grants on or after 22 November 2002 not yet vested by 1 January 2005;
- modifications of grants on or after 1 January 2005; and
- liabilities as at 1 January 2005

It should be highlighted that FRS 102 is applicable even when the parent company is issuing shares or share options to employees of the subsidiary. In such circumstances, both the parent and subsidiary are required to recognise the transaction in their respective books. Generally, entities are required to recognise an expense and to measure all share-based payment transactions for goods and services received by the entity at fair value.

<sup>1</sup> FRS 104 *Insurance Contract* is an industry specific standard and thus, will not be included in the current discussion.

<sup>2</sup> FRS 32 and FRS 39 were also revised as part of the Improvements Project and issued in December 2003. This has been dealt with in an earlier article *Are you ready for FRS 39?* (Refer to Page 1)

In order to implement fair value accounting for share-based payments, it would be necessary to identify transactions that are within the scope of FRS and obtain information for the computation of fair value, i.e. fair value of instrument and behavioural considerations affecting number of instruments expected to vest. Given the requirement to restate comparatives, it is imperative to commence the information collation exercise prior to FY 2005.

#### FRS 103 Business Combinations

FRS 103 was issued in July 2004 and effective for the annual period beginning on or after 1 July 2004. Requirements in FRS 103 include:

- prohibition of pooling-of-interest method;
- application of the acquisition method;
- identification and measurement of intangible assets at fair value;
- exclusion of restructuring cost from purchase price allocation;
- measurement of contingent liabilities of acquiree at fair value;
- allocation of goodwill to cash-generating units at acquisition and no later than the end of first annual period beginning after acquisition;
- replacement of goodwill amortisation with annual impairment test; and
- no reversal of impairment loss on goodwill

For existing business combinations, goodwill impairment should be reviewed and consideration should be taken for the reversal of goodwill impairment loss in FY 2004 as it is strictly prohibited under FRS 103.

For new acquisitions, which require the implementation of the acquisition method, specialist help may be required in the identification and valuation of identifiable asset/liabilities and contingent liabilities of the acquiree.

#### FRS 105 Non-Current Assets Held-for-Sale and Discontinued Operations

FRS 105 was issued in September 2004 and effective for the annual period beginning on or after 1 January 2005. It requires, amongst many:

- assets held-for-sale to be stated at the lower of carrying value and fair value less cost to sell, with no requirement for depreciation or amortisation;
- classification of discontinued operations at the earlier of the date the operation meets the criteria to be classified as held-for-sale or when the entity has disposed of the operation; and
- separate presentation of discontinued and continuing operations

The classification of assets held-for-sale is subject to strict criteria and entities should review the criteria to determine assets that may fall within this classification. Presentation formats of the annual reports should be reviewed to ensure compliance with FRS 105.

#### Code of Corporate Governance

On 1 December 2004, the CCDG issued a consultation paper on the Proposed Revisions to the Code of Corporate Governance which was first issued in March 2001. Comments close on 15 February 2005.

#### Companies (Amendment No. 2) Bill

The Ministry of Finance sought public comments on the proposed draft Companies (Amendment No. 2) Bill 2004. The following items covered in the Bill are relevant to financial reporting:

- abolishing the concept of par value and authorised share capital;
- introducing an alternative capital reduction process which does not require court sanction;
- redemption of preference shares using capital;
- share buy-backs out of profits or capital, provided the company is solvent; and
- introduction of treasury shares instead of cancelling re-acquired shares

#### Conclusion

With less mandatory changes in the FY 2004 annual report to contend with, effort should be expended to prepare for the numerous changes affecting the FY 2005 annual report. Evidently, the FRSs outlined above

are effective for financial period from 1 January 2005 (1 July 2004 for FRS 103) but there are implications and action required to be taken now in order to be prepared to meet reporting requirements in FY 2005. The developments of the Code of Corporate Governance and Companies (Amendment No. 2) Bill, both of which are expected to be finalised in 2005, should also be closely monitored.



**Table 4 – Selective Changes Arising from Improvements Project<sup>3</sup>**

New Guidance	New Disclosures
<p><b>FRS 2</b></p> <ul style="list-style-type: none"> <li>Circumstances that would trigger a reversal of a write-down of inventories recognised in a prior period</li> </ul>	<p><b>FRS 1</b></p> <ul style="list-style-type: none"> <li>Judgements made in applying accounting policies</li> <li>Key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date</li> <li>Profit or loss for period disclosed on the face of income statement and statement of changes in equity</li> <li>To present the allocation of profit or loss for period between 'profit or loss attributable to minority interest' and 'profit or loss attributable to equity holders of the parent' on the face of the income statement and statement of changes in equity</li> </ul>
<p><b>FRS 10</b></p> <ul style="list-style-type: none"> <li>If an entity declares dividends after the balance sheet date, the entity shall not recognise those dividends as a liability at the balance sheet date</li> </ul>	<p><b>FRS 2</b></p> <ul style="list-style-type: none"> <li>Carrying amount of inventories carried at fair value less costs to sell</li> <li>Write-downs of inventories recognised as an expense in the period</li> </ul>
<p><b>FRS 16</b></p> <ul style="list-style-type: none"> <li>An entity is required to measure the residual value of an item of property, plant and equipment as the estimated amount it would receive currently for the asset if the asset were already of the age and in the condition expected at the end of its useful life</li> <li>The residual value and useful life should be reviewed at least at each financial year end</li> <li>An entity is required to begin depreciating an item of property, plant and equipment when it is available for use and to continue depreciating it until it is derecognised, even if the item is idle during that period of time</li> </ul>	<p><b>FRS 8</b></p> <ul style="list-style-type: none"> <li>Impending change in accounting policy when an entity has yet to implement a new Standard or Interpretation that has been issued but not yet come into effect</li> </ul>
<p><b>FRS 17</b></p> <ul style="list-style-type: none"> <li>Initial direct costs of lessors cannot be charged as expenses as incurred</li> </ul>	<p><b>FRS 21</b></p> <ul style="list-style-type: none"> <li>Change in functional currency and the reasons for the changes</li> </ul>
<p><b>FRS 21</b></p> <ul style="list-style-type: none"> <li>Replaced 'reporting currency' with 'functional currency' and/or 'presentation currency'</li> <li>An entity does not have a free choice of functional currency</li> <li>An entity is required to translate its results and financial position from its functional currency into presentation currency using the closing rate for the assets and liabilities, and the transaction or average rate for income and expenses</li> </ul>	<p><b>FRS 24</b></p> <ul style="list-style-type: none"> <li>Compensation of key management personnel</li> <li>Amounts, in place of proportions, of transactions and outstanding balances</li> <li>Expense recognised during the period in respect of bad or doubtful debts due from related parties</li> <li>Classification of amounts payable to, and receivable from, related parties into different categories of related parties</li> </ul>
<p><b>FRS 24</b></p> <ul style="list-style-type: none"> <li>Expansion of related party to include parties with joint control over the entity, joint ventures in which the entity is a venturer and post-employment benefit plans for the benefit of employees</li> <li>Clarified that non-executive directors are key management personnel</li> </ul>	<p><b>FRS 28</b></p> <ul style="list-style-type: none"> <li>Prepare investor's separate financial statements</li> </ul>
<p><b>FRS 27</b></p> <ul style="list-style-type: none"> <li>Modified exemption from preparing consolidated financial statements</li> <li>Requirement to use uniform accounting policies for reporting like transactions and other events in similar circumstances</li> <li>Present minority interests in the consolidated balance sheet within equity</li> <li>Investment in subsidiaries, jointly controlled entities and associates accounted for at cost or in accordance with FRS 39 if an entity elects or is required to present separate financial statements</li> </ul>	<p><b>FRS 31</b></p> <ul style="list-style-type: none"> <li>Prepare investor's separate financial statements</li> <li>Method used to recognise interests in jointly controlled entities (proportionate consolidation or equity method)</li> </ul>
<p><b>FRS 28</b></p> <ul style="list-style-type: none"> <li>Investments in associates over which the investor has significant influence must be accounted for using the equity method whether or not the investor also has investments in subsidiaries and prepares consolidated financial statements</li> <li>When financial statements of an associate used in applying the equity method are prepared with a reporting date that is different from that of the investor, the difference must be no greater than three months</li> <li>Requirement to use uniform accounting policies for reporting like transactions and other events under similar circumstances</li> </ul>	<p><b>Removal of Accounting Choice</b></p> <p><b>FRS 8</b></p> <ul style="list-style-type: none"> <li>Removed allowed alternative to retrospective application of voluntary changes in accounting policies and retrospective restatement of restatement to correct prior period errors<sup>4</sup></li> <li>Eliminated the concept of fundamental error</li> </ul>
<p><b>FRS 33</b></p> <ul style="list-style-type: none"> <li>Illustrative examples of complex matters</li> <li>Need to take into account dilution effects on earnings of investment in subsidiaries</li> </ul>	<p><b>Withdrawn Disclosures</b></p> <p><b>FRS 1</b></p> <ul style="list-style-type: none"> <li>Results of operating activities</li> <li>Extraordinary items</li> <li>Number of employees</li> </ul> <p><b>FRS 2</b></p> <ul style="list-style-type: none"> <li>Inventories carried at net realisable value</li> </ul> <p><b>FRS 24</b></p> <ul style="list-style-type: none"> <li>Pricing of transactions and related disclosures between related parties</li> </ul>

<sup>3</sup> These changes are extracted from the 'Introduction' section of the respective FRSs.

<sup>4</sup> Comparative information for prior periods is presented as if new accounting policies had always been applied and prior period errors had never occurred.

# Changes in existing decommissioning and other similar liabilities – How does it affect you?

## Background

The International Accounting Standard Board's International Financial Reporting Interpretations Committee (IFRIC) released the IFRIC Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* on 27 May 2004. Locally, the Council on Corporate Disclosure and Governance (CCDG) issued the Singapore equivalent interpretation, namely Interpretation of Financial Reporting Standards (INT FRS) 101 *Changes in Existing Decommissioning, Restoration and other Similar Liabilities* on 31 August 2004. This Interpretation contains guidance on accounting for changes in existing decommissioning, restoration and similar liabilities that are recognised both as part of the cost of an item of property, plant and equipment in accordance with FRS 16 *Property, Plant and Equipment* and as a liability in accordance with FRS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

How is the change in the estimated liability of decommissioning or restoration accounted for?

Currently, neither FRS 16 nor FRS 37 specifically addresses the accounting for the effect of changes in such liability although FRS 37 requires companies to assess the measurement of the provision at every balance sheet date.

Generally, companies would account for changes in the estimated decommissioning liabilities in the income statement in the period where the estimate is adjusted.

Required treatments under INT FRS 101 *Changes in Existing Decommissioning, Restoration and other Similar Liabilities*

In general, the Interpretation requires changes in the liability resulting from changes in cash flows or discount rates to be capitalised in full and depreciated prospectively over the life of the item to which they relate. It also requires the unwinding of the discount to be recognised in profit or loss as a finance cost as it occurs and provisions to be measured using a current market-based discount rate.

The Interpretation also addresses the accounting for changes in existing decommissioning, restoration and similar liabilities that fall within the scope of FRS 16 and FRS 37.

Under FRS 37, the amount recognised as a provision should be the best estimate of the expenditure required to settle the obligation at the balance sheet date. This is measured at its present value, which the Interpretation confirms should be arrived at using a current market-based discount rate.

The Interpretation deals with three scenarios where changes in an existing liability for such costs can occur.

The two main kinds of changes are those that arise from a revision of:

- a) estimated outflow of resources required to settle the obligation; or
- b) current market-assessed discount rate

Most entities account for their property, plant and equipment using the cost model. In such cases, the aforementioned changes should be capitalised as part of the cost of the item and depreciated prospectively over the remaining life of the item to which the costs relate. This is consistent with the treatment under FRS 16 of other changes in estimate relating to property, plant and equipment.

Where entities account for their property, plant and equipment using the fair value model, a change in the liability would not affect the valuation of the item for accounting purposes, but rather the revaluation surplus or deficit (that is, the difference between its valuation and its

## PwC Illustrative Annual Report 2004 : A guide to drafting your 2004 annual report

This publication provides a sample annual report of a fictitious group. It illustrates the financial statements disclosures required by the following regulations that are applicable for financial year commencing on or after 1 January 2004:

- Singapore Companies Act
- Singapore Exchange Securities Trading Listing Manual; and
- Singapore Financial Reporting Standards and Interpretations

It also includes selected global best practice disclosures.

This publication also includes an Illustrative Directors Report, a sample corporate governance report, a listing of Financial Reporting Standards (FRS) and Interpretations, and a comparison between FRS and International Financial Reporting Standards as of August 2004, as well as a summary of the key changes that are effective from 1 January 2005.

A copy of this publication can be downloaded from our PwC Singapore website.



carrying amount under the cost model). Any change is thus treated consistently with other revaluation surpluses or deficits, where any cumulative deficit is taken to profit or loss, and cumulative surplus credited to equity.

The adjusted depreciable amount of the asset is depreciated over its useful life. Once the related asset has reached the end of its useful life, all subsequent changes in liability should be recognised in the profit or loss account as they occur. This applies under both the cost and revaluation models.

The third kind of change dealt with by the Interpretation is an increase in the liability that reflects the passage of time – also referred to as the unwinding of the discount. This is recognised in profit or loss as a finance cost as it occurs. The unwinding of the discount is not regarded as a borrowing cost under FRS 23 *Borrowing Costs*, because FRS 23 addresses funds borrowed specifically for the purpose of obtaining a particular asset. Therefore, the allowed alternative treatment of capitalisation under FRS 23 is not permitted.

**Difference between the issued INT FRS 101 and the original exposure draft (ED INT FRS 2)**

Previously, the draft interpretation required retrospective adjustments. That is, adjustments relating to the depreciated portion of the asset would be adjusted to opening retained earnings and the portion to be depreciated in the future would be capitalised at the date of the adoption of the draft Interpretation.

During the comment period, the respondents observed that anomalies could result from such a retrospective treatment – if other changes in estimate were to be dealt with prospectively as set out in FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* – and that a prospective treatment would be consistent and easier to apply.

Thus, in the issued Interpretation, such changes in accounting policies are accounted for prospectively, according to the requirements of FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

*For a copy of the entire Interpretation, please visit the CCDG website.*

**Standards covered in previous issues of Corporate Watch**

The following standards were covered in the previous issues of Corporate Watch:

**January 2004**

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

**February 2004**

- IAS 1 Presentation of Financial Statements
- IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

**March/April 2004**

- IAS 27 Consolidated and Separate Financial Statements
- IAS 28 Investments in Associates
- IAS 31 Interests in Joint Ventures

**May/June 2004**

- IAS 21 The Effects of Changes in Foreign Exchange Rate
- IAS 24 Related Party Disclosures

**July/August 2004**

- IFRS 3 / Business Combinations
- FRS 103
- FRS 105 Non-current Assets Held-for-sale and Discontinued Operations



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