Corporate Watch

Volume 3 2005

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Acronyms

CA 2005	Companies (Amendment) Act 2005
CCDG	Council on Corporate Disclosure and Governance
CW	Corporate Watch
DTC	Draft Technical Correction
EPS	Earnings Per Share
ED	Exposure Draft
FRS	Financial Reporting Standards
IAS	International Accounting Standards
IASB	International Accounting Standards Board
ICPAS	Institute of Certified Public Accountants of Singapore
IFRS	International Financial Reporting Standards
INT FRS	Interpretations of FRS
RAP	Recommended Accounting Practices
SME	Small and Medium-sized Entities
US GAAP	US Generally Accepted Accounting Principles

Changes in your FY 2005 & FY 2006 Annual Reports

There are significant changes in corporate reporting in both FY 2005 and FY 2006 . These arise from changes in both the Financial Reporting Standards and the Companies Act. Most of these new or revised FRSs have been covered in detail in earlier issues of Corporate Watch (see Table 3). This article highlights the FRSs affecting the FY 2005 annual report, provides a brief summary of standards not covered in Corporate Watch yet and outlines the implications of standards that are not effective on the FY 2005 annual report. The later section discusses the effect of CA 2005 on the FY 2006 annual reports.

FY 2005 Annual Report

Improvements Project

The Council on Corporate Disclosure and Governance issued a number of improved standards that are effective in FY 2005. These 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 32 *Financial Instruments: Disclosure and Presentation*
- FRS 33 *Earnings Per Share*

These revised standards provide new guidance, require new disclosures and/or remove accounting choice.

Other pronouncements effective in FY 2005

Other standards and amendments that are effective in FY 2005 include:

- FRS 39 *Financial Instruments: Recognition and Measurement*
- FRS 102 *Share-based Payments*
- FRS 103 *Business Combinations*, together with revisions to FRS 36 *Impairment of Assets* and FRS 38 *Intangible Assets*
- FRS 104 *Insurance Contracts*
- FRS 105 *Non-current Assets Held for Sale and Discontinued Operations*
- INT FRS 101 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*
- Amendment to INT FRS 12, Consolidation - Special Purpose Entities- *Scope of INT FRS 12*
- Amendment to FRS 39, Financial Instruments: Recognition and Measurement - *Transitional and Initial Recognition of Financial Assets and Financial Liabilities*

Table 1 provides a brief summary of the standards that are effective in FY 2005 and identifies the coverage in earlier issues of Corporate Watch.

Table 1 Summary of Standards that are effective in FY 2005

Standard	Summary
Improvements Project	11 standards revised affecting accounting policies, presentation and disclosure, and effective FY commencing 1 January 2005. *Refer to all CW 2004 issues*
FRS 39	Establishes principles for recognising and measuring financial assets and financial liabilities, effective FY commencing 1 Jan'05. *Refer to CW February 2004 and December 2004*
Amendment to FRS 39, *Financial Instruments: Recognition and Measurement - Transitional and Initial Recognition of Financial Assets and Financial Liabilities*	Clarifies that a gain or loss should be recognised after initial recognition of a financial instrument only to the extent that it arises from a change in a factor (including time) that market participants will consider in setting a price. This means that if, at the point of recognition, a difference arises between the transaction price and a fair value derived in accordance with FRS 39.AG76, the difference should not be treated as a gain or loss, as this difference does not arise from a change in any factor. Applies prospectively to transactions entered into after 25 October 2002 or 1 January 2004.
FRS 102	Requires entities to reflect in the Income Statement and Statement of Financial Position the implications of share-based payments, including transactions relating to share options, depending on whether they are equity settled or cash settled. FRS 102 is effective FY commencing 1 January 2005. *Refer to CW March/April 2004 and Volume 1 2005*
FRS 103	Prescribes the purchase method when an entity undertakes a business combination, effective FY commencing 1 July 2004. *Refer to CW July/August 2004*
FRS 104	Specifies the financial reporting for insurance contracts by any entity that issues such contracts, effective FY commencing 1 January 2005. *Refer to CW December 2004*
FRS 105	Specifies that accounting of assets held for sale and the presentation and disclosure of discontinued operations effective FY commencing 1 January 2005. *Refer to CW July/August 2004*
Amendment to INT FRS 12, *Consolidation - Special Purpose Entities- Scope of INT FRS 12*	Includes equity compensation plans under the scope of INT FRS 12. Previously, such plans were excluded. With this amendment, reporting entities have to consider whether those entities that were set up for the purposes of its share-based payment arrangements qualify as special purpose entities. If so, these entities should be consolidated. In addition, the amendment excludes from the scope of INT FRS 12 those post-employment benefit plans and other long-term employee benefit plans to which FRS 19 applies. This is done to achieve consistency with FRS 19 which has already prescribed an accounting treatment for such plans. Effective FY commencing 1 January 2005.
INT FRS 101	Addresses the accounting effect of events that change the measurement of an existing decommissioning, restoration or similar liability. Effective FY commencing 1 September 2004. *Refer to CW December 2004*

Changes effective after FY 2005

5 standards that are effective after FY 2005 have been issued. They are:

- Amendment to FRS 39 *Financial Instruments: Recognition and Measurement - Cash Flow Hedge Accounting of Forecast Intragroup Transactions*
- FRS 40 *Investment Property*
- FRS 106 *Exploration for and Evaluation of Mineral Resources*
- INT FRS 104 *Determining whether an Arrangement contains a lease*
- INT FRS 105 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*

FRS 8 (revised 2004) requires companies to disclose the expected financial effect of standards and amendments that have been issued but not effective. Companies are therefore required to disclose the effect of applying these standards. Table 2 provides a brief summary of the above standards that are effective after FY 2005 and identifies the coverage in earlier issues of Corporate Watch.

Table 2 Summary of Standards that are effective in FY 2005

Standard	Summary
Amendment to FRS 39, *Financial Instruments: Recognition and Measurement - Cash Flow Hedge Accounting of Forecast Intragroup Transactions*	Effective FY commencing 1 January 2006. This amendment deals with a hedge of the foreign currency risk of a highly probable forecast intragroup transaction. Under the amendment, companies are allowed to designate such currency risks as a hedged item provided that: • the transaction is not denominated in the functional currency of the transacting entity; and • the foreign currency risk will affect consolidated profit or loss. This amendment acknowledges that certain intragroup transactions may affect consolidated profit or loss, e.g. a forecast intragroup sale of inventory where there is an onward sale of the inventory to an external party. When an entity chooses to hedge the profit/loss impact, it will be appropriate to designate the associated risks as hedged items.
FRS 40	Effective FY commencing 1 Jan'07. Prescribes accounting treatment for investment property and related disclosure requirements. *Refer to CW Volume 1 2005*
FRS 106	Unlikely to be applicable to Singapore entities
INT FRS 104	Effective FY commencing 1 January 2006. This interpretation deals with arrangements that convey rights to use assets in return for payments. It noted that such arrangements share many characteristics of leases, even when the legal form of a lease is not adopted. The issues addressed are: a) how to determine if an arrangement contains a lease;An arrangement contains a lease if, in substance, • fulfillment of the arrangement is dependent on the use of a specific asset or assets; and • the arrangement conveys a right to use the asset. b) when should such an assessment/reassessment be made; and • The initial assessment should be made at the inception of the arrangement, which is either the date of the arrangement itself or the date that all parties commit to the principal terms of the arrangement, whichever is earlier. c) how lease payments should be separated from payments for other elements in the arrangement. This should be done on the basis of the relative fair values of the lease and the other elements.
INT FRS 105	Unlikely to be applicable to Singapore entities

FY 2006 Annual Report

Other than the standards described in the previous section, the FY 2006 Annual Report will also be affected by the implementation of the Companies (Amendment) Act 2005. This Act has been passed by the Parliament on 16 May 2005 but has not been published in the Gazette and hence, is not in effect. The expected implementation date is 30 January 2006.

When the Act comes into effect, the key effects on financial statements are as follows:

- Share premium and capital redemption reserve accounts will be combined with share capital when the Act comes into effect. These accounts will no longer be applicable in the future.
- Disclosures on authorised share capital will be removed.
- Treasury shares will be shown as a reduction against share capital in accordance with FRS 32.

For a detailed discussion on the requirements and implications of this Act, please refer to Table 3.

Conclusion

Evidently, there are numerous changes in the FY 2005 annual report. The changes involved are widespread and often involve extensive judgment, as well as the application of subjective assumptions and estimates. In line with international standards, FRS have taken a further step towards fair value-based accounting, as opposed to a historical cost-based model, with the introduction of fair value accounting rules in areas such as financial instruments, share-based compensation and business acquisitions. FRS have also introduced extensive disclosure requirements to improve transparency. Reference can be made to the 2005 Illustrative Annual Report produced by PwC.

Table 3 Summary of financial reporting requirements covered in the previous issues of Corporate Watch

Topics	CW issues							
	Jan 2004	Feb 2004	Mar/Apr 2004	May/Jun 2004	Jul/Aug 2004	Dec 2004	Vol 1 2005	Vol 2 2005
Improvements Project						√		
- FRS/IAS 1		√						
- FRS/IAS 2								
- FRS/IAS 8		√						
- FRS/IAS 10								
- FRS/IAS 16	√							
- FRS/IAS 17	√							
- FRS/IAS 21				√				
- FRS/IAS 24				√				
- FRS/IAS 27			√					
- FRS/IAS 28			√					
- FRS/IAS 31			√					
- FRS/IAS 33								
FRS/IAS 36					√			
FRS/IAS 38					√			
FRS/IAS 39		√				√		
FRS/IAS 40	√						√	
FRS 102/IFRS 2			√				√	
FRS 103/IFRS 3					√			
FRS 105/IFRS 5					√			
INT FRS 101/ IFRIC 1						√		
INT FRS 104/ IFRIC 4								√
Amendment to INT FRS 12 - Scope of INT FRS 12								√
Amendment to FRS 39 - Cash Flow Hedge Accounting of Forecast Intragroup Transactions								√
Companies (Amendment) Act 2005							√	
Code of Corporate Governance 2005							√	

IASB publishes Draft Technical Correction 1 *Proposed Amendments to IAS 21 - Net Investment in a Foreign Operation*

On 30 September 2005, IASB published for public comment DTC 1 *Proposed Amendments to IAS 21 The Effects of Changes in Foreign Exchange Rates - Net Investment in a Foreign Operation.* The comment period for DTC 1 ended on 31 October 2005. If the correction is issued, it will apply retrospectively with immediate effect.

DTC 1 deals with monetary items that form part of a reporting entity's net investment in a foreign operation. Currently IAS 21 requires exchange differences on such monetary items to be taken to a separate component of equity if certain conditions are met. Two of these conditions are:

1. The monetary item must be denominated in the functional currency of either the reporting entity or the foreign operation. Otherwise, the exchange difference should be taken to the income statement.
2. The monetary item must result from a transaction by the entity with the foreign operation. However IAS 21 does not specify whether "entity" refers to the parent only, or whether it includes the subsidiaries. If it refers only to the parent, then exchange differences on a monetary item between a subsidiary and a foreign operation must be taken to the income statement.

DTC 1 amends both of the above conditions. When DTC 1 comes into effect, exchange differences on such monetary items should be taken to a separate component of equity regardless of:

- the currency in which that monetary item is denominated; and
- whether the monetary item results from a transaction between the foreign operation and the parent or any of its subsidiaries.

PwC Illustrative Annual Report 2005: A guide to drafting your 2005 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 2005:

- 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 and Interpretations, a comparison between FRS and IFRS as of September 2005, 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 website (www.pwc.com/sg).

Financial reporting for SMEs – A case for simplification?

Businesses communicate their financial results to stakeholders using a set of recognised financial reporting framework and standards. This is to ensure that the reported financial information is credible, universally understood and comparable to other businesses within and across industries. As businesses become increasingly complex and stakeholders more sophisticated, financial reporting standards have responded accordingly with extensive changes in measurement and disclosure rules. These changes (or improvements as some might say) in the last five years, are direct responses to the needs of the market for greater transparency, clarity and consistency. Accounting for financial instruments, share-based compensation and business acquisitions that involve extensive use of fair values, are just a few examples of the more complex accounting issues that have evolved.

The benefits of comprehensive, transparent and comparable financial reporting cannot be ignored. Businesses that do not communicate their performance may lose their competitive advantage in raising funds at lower interest rates; securing new suppliers or customers; or arriving at an acquisition or cooperative agreement. On the other hand, applying comprehensive financial reporting standards comes with a cost. Businesses need to employ more qualified personnel, implement new processes and controls, and train personnel right from the accounts receivable clerk, to financial controller, CEO and audit committee members. Whilst the benefits may outweigh the costs for many businesses, is this always true for smaller businesses?

In Singapore, although audit exemption has been granted to companies with annual revenues of less than $5 million, the Singapore Companies Act still requires all Singapore businesses to prepare financial statements that are in accordance with the Financial Reporting Standards. Such a broad-brush requirement is not seen in the US and Europe, where only listed entities are required to apply the US Generally Accepted Accounting Principles or the International Financial Reporting Standards respectively. Is there a case for a modified (or simplified) financial reporting framework for small and medium-sized businesses in Singapore?

The International Accounting Standards Board has recognised that for some businesses, especially those not seeking to raise funds via the capital markets, the potential benefit of adopting full IFRS can be outweighed by the difficulties or costs of implementing them. IASB has started a project to draft special financial reporting standards for such businesses that will generally be based on the IFRS framework, but yet tailored to meet the differing needs of less complex businesses. As Singapore's accounting framework and financial reporting standards are largely aligned to the IFRS, it is likely that the developments in IASB will be mirrored locally in the future.

Controlling shareholders generally have direct access to the companies and their needs may be satisfied through internal reporting. In contrast, other stakeholders who do not have direct access to the company will have to rely on external reporting by the company. Stakeholders such as banks and tax authorities will probably require full FRS financial statements for private companies that have significant external borrowings, and those that have significant level of business operations (in fact, some private companies have revenues and/or asset size that are larger than listed companies).

What modifications can SMEs look forward to in the SME-FRS? The IASB plans to issue an exposure draft on SME version of IFRS (expected in 2006) that will give clarity on the proposed modifications. We expect limited modifications will be made to the recognition and measurement principles whilst there will be more scope for simplification of disclosure and presentation requirements. Modifications to the recognition and measurement principles under the new and complex standards such as FRS 39 Financial Instruments, FRS 102 Share-based Payment and FRS 103 Business Combinations, may be justified on the basis that they impose very high compliance costs for many private SMEs.

Bearing in mind that all Singapore companies are already in compliance with FRS, further modifications to the recognition and measurement principles in some FRS for SMEs may be construed as taking reverse steps against our present high degree of compliance with FRS. In contrast, for countries where SMEs currently do not need to comply with any accounting framework, the justification for modifications from recognition and measurement principles may be higher, as they will need to incur higher "start-up" costs of compliance with the full IFRS accounting framework.

Having said these, it is not always beneficial for SMEs to adopt SME-FRS. First, financial statements of SMEs prepared under SME-FRS may not be comparable with other companies in Singapore (including SMEs) that are on the full FRS framework. For a SME that is rapidly expanding its operations and/or pursuing access to the capital markets (e.g. in an IPO or other fund raising activities), it will necessarily incur higher costs of transition into the full FRS framework. Hence, each SME should carefully evaluate the costs and benefits of switching from full FRS reporting to SME-FRS reporting. This should be done when the exposure drafts for SME-IFRS are issued (expected in 2006).

Based on the developments at IASB, entities that can apply the SME version of IFRS are likely to be restricted to those that do not have public accountability. Hence, listed companies (and their subsidiaries), entities that have essential public service responsibilities (e.g. public utilities providers), banks, insurance companies and other financial institutions, will be excluded accordingly.

How about privately-held companies? This will depend on the information needs of stakeholders and the simplifications that are allowed under the SME-FRS.

Changes in financial reporting standards for SMEs expected

- The International Accounting Standards Board has started a project to draft special financial reporting standards for SMEs that will generally be based on the IFRS framework, but yet tailored to meet the differing needs of less complex businesses.
- IASB is likely to restrict the application of these modified financial reporting standards to those businesses that **do not** have public accountability. Hence, listed companies (and their subsidiaries), entities that have essential public service responsibilities (e.g. public utilities providers), banks, insurance companies and other financial institutions, will be excluded accordingly.
- Limited modification is expected to be made to the recognition and measurement principles whilst there may be more scope for simplification of disclosure and presentation requirements.
- Exposure draft for SME version of IFRS from IASB is expected in 2006.

This article was first published in Business Times, 25 October 2005

Latest development:

17 November 2005 - The Ministry of Finance has requested for the CCDG (the 'Council') to review the quarterly reporting requirement and make recommendations to the Government. The subcommittee will solicit views from the business community and the public before submitting a report to the Council. The Council aims to complete its review and submit its recommendations to the Ministry of Finance in the first half of 2006.

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