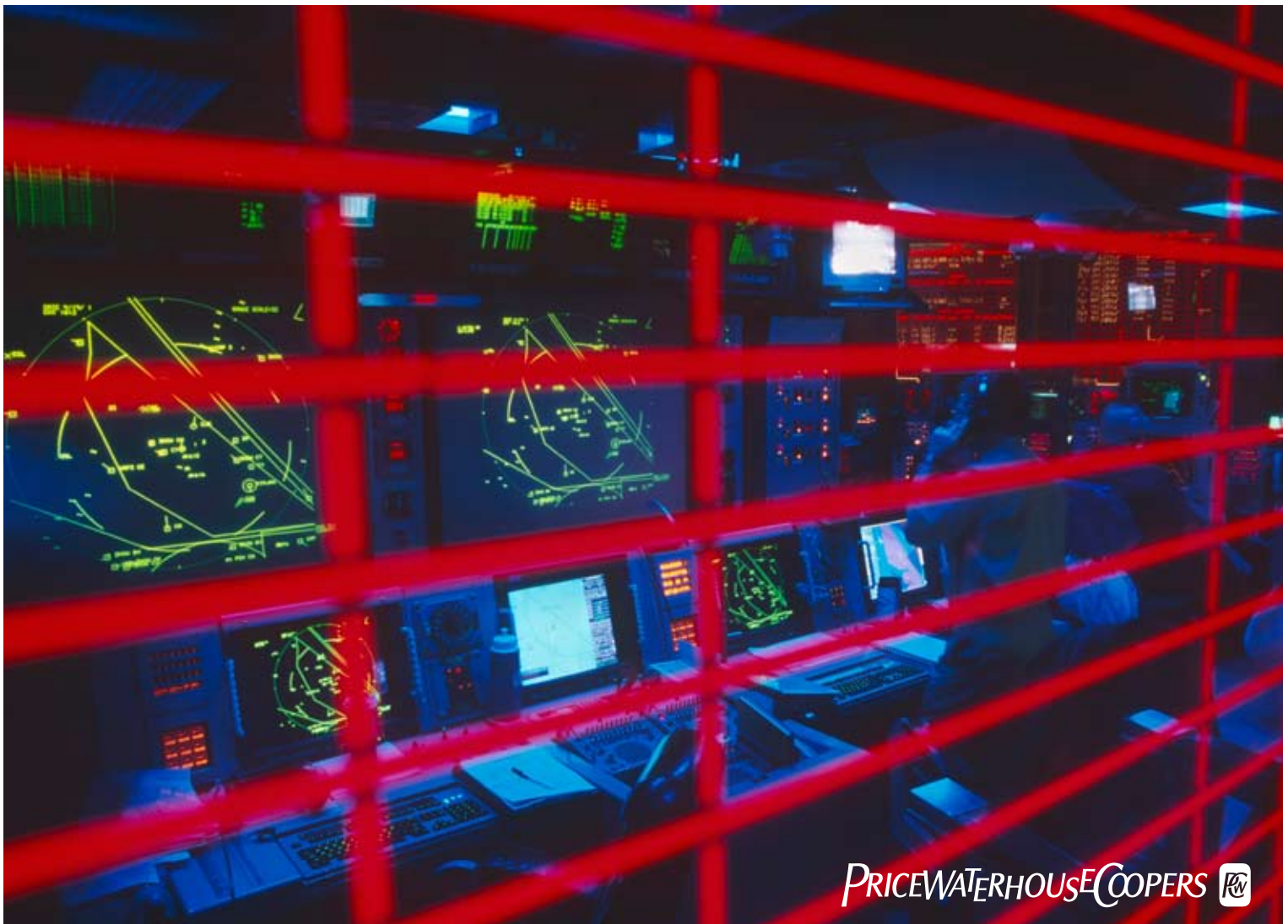


Corporate Watch

Developments on Corporate Reporting and Governance
May 2009



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Acronyms

ASC	Accounting Standards Council
FRS	Financial Reporting Standards
IAS	International Accounting Standards
ICAPS	Institute of Certified Public Accountants of Singapore
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards
INT FRS	Interpretations of FRS
RAP	Recommended Accounting Practice
SOCI	Statement of Comprehensive Income
SOCE	Statement of Changes in Equity

Bracing into 2009 amidst the financial crisis

“...quality and transparent information of listed companies held the key to (re) building trust amongst market participants.”

Companies have rounded up the last reporting season for 2008 with the issuance of their annual reports and holding of annual general meetings. Yet, they seem to have no time to take a breather and to start fortifying themselves for the next 2009 financial reporting cycle.

For listed companies, the SGX is expecting heightened vigilance from audit committees and independent directors to ensure that listed companies provide timely and complete information to market participants. It leaves no doubt that quality and transparent information of listed companies held the key to (re) building trust amongst market participants.

Areas of focus for 2009 financial reporting

So, what should companies look out for in the preparation of their 2009 financial results announcement?

Issues addressed in the 2008 financial reporting such as those relating to going concern, impairment of financial and non-financial assets, provisions for contract close out costs and onerous contracts will continue to be on the agenda - as unfortunately, we have yet to sail through the global financial crisis to calmer waters. In addition, companies must also consider other issues that are brought about by new financial reporting standards that are applicable from 2009.

The new or revised standards are shown in the table on page 3.

What's new in 2009?

Some of these new or revised standards will draw the presentation of financial statements under FRS closer to U.S. GAAP.

For example, under the revised FRS 1 – ‘Presentation of financial statements’, a new statement of comprehensive income (which has been used in U.S. GAAP) has now been introduced under FRS. This statement presents all the items of recognised income and expenses, with separately presented items for the income statement and those recognised directly either in equity or recycled from equity into the income statement. Total comprehensive income will be presented and this may soon be a new total that attracts more attention.

Requirements dealing with the disclosure of segmental information have been overhauled to bring them in line with U.S. GAAP. The segments reported by many groups of companies will change, under FRS 108 – ‘Operating segments’, as the standard adopts a ‘through the eyes of management’ approach. This requires the disclosure and presentation of segment information that management uses to run the business. There is also an expectation that such management information included in the financial statements will relate to the “management discussion and analysis” more, thus enhancing transparency and relevance of the financial statements.

Bracing into 2009 amidst the financial storm *(continued)*

Significant changes for some entities

Other amendments and new requirements will impact some entities more significantly.

- The revised FRS 23 – ‘Borrowing costs’ now requires capitalisation of borrowing costs that finance the construction of qualifying assets, whereas previously, there was a choice to capitalise or to include it in the income statement.
- The amendment to FRS 27 – ‘Consolidated and Separate Financial Statements’ concerning the recognition of dividends from associates, joint ventures and subsidiaries in the separate financial statements of the investor may affect the bottomline of the investor significantly.
- There are a number of technical changes relating to financial instruments, which need to be considered carefully, as some relax requirements and others restrict accounting treatments that have previously been acceptable.
- The change to FRS 102 – ‘Share-based payment’, narrows the definition of vesting conditions and will require restatement of many schemes when the standard is first adopted. Companies should evaluate the terms of the scheme on adoption of the revised standard.

2008 Annual Improvements to FRS

The 2008 improvements project has indeed impacted many of the standards. Some of these changes deal with terminology inconsistencies between the standards. Others will impact certain entities, thus necessitating careful, due consideration. One of the amendments worth a special mention is FRS 40 ‘Investment Property’.

Under the revised FRS 40, companies applying the fair value model on completed investment properties will be required to account for investment properties under construction at fair value, except in the event that the fair value is not reliably determinable. Previously, such properties were accounted for at cost under FRS 16 – ‘Property, Plant and Equipment’ (at cost) until completion. For property under construction at 1 January 2009, the previously unrecognised fair value gains or losses (if not already impaired) should be recognised in the income statement in the first period of preparation of financial information (i.e. for the first quarter/half of 2009 or in the annual 2009 financial statements) as fair value gains/losses. This is because the change in FRS 40 is required to be accounted for prospectively under the revised standard. Appropriate disclosures should then be made in the financial statements and quarterly financial announcement.

Bracing into 2009 amidst the financial storm *(continued)*

The new or revised financial reporting standards applicable for financial years commencing on or after 1 January 2009	Effective date (annual periods commencing on or after)
<ul style="list-style-type: none"> • INT FRS 116 – ‘Hedges of a net investment in a foreign operations’ 	1 October 2008
<ul style="list-style-type: none"> • FRS 1 Revised – ‘Presentation of financial statements’ • FRS 23 Revised – ‘Borrowing costs’ • FRS 32 and FRS 1 Amendment – ‘Puttable financial instruments and obligations arising on liquidation’ • FRS 101 and FRS 27 Amendment – ‘Cost of an investment on first-time adoption’ • FRS 102 Amendment – ‘Vesting conditions and cancellations’ • FRS 107 Amendment – ‘Improving disclosures about financial instruments’ • FRS 108 – ‘Operating segments’ 	1 January 2009
<p>Amendments from May 2008 Annual Improvements project</p> <ul style="list-style-type: none"> • FRS 1 – ‘Presentation of financial statements’ • FRS 16 – ‘Property, plant and equipment’ • FRS 19 – ‘Employee benefits’ • FRS 20 – ‘Government grants and disclosure of government assistance’ • FRS 23 – ‘Borrowing costs’ • FRS 27 – ‘Consolidated and separate financial statements’ • FRS 28 – ‘Investments in associates’ • FRS 29 – ‘Financial reporting in hyperinflationary economies’ • FRS 31 – ‘Interests in joint ventures’ • FRS 36 – ‘Impairment of assets’ • FRS 38 – ‘Intangible assets’ • FRS 39 – ‘Financial instruments: Recognition and measurement’ • FRS 40 – ‘Investment property’ • FRS 41 – ‘Agriculture’ 	1 January 2009

For a more comprehensive discussion on the amendments, please refer to the PwC publication “A practical Guide to new IFRS for 2009” available for download under Publications in www.pwc.com/ifrs.

Implications of IFRIC Interpretation 15 (IFRIC 15) 'Agreements for the Construction of Real Estate'

IFRIC 15 was issued on 3 July 2008 and has yet to be adopted in Singapore. If adopted, it will prohibit the use of the percentage of completion revenue recognition method for certain real estate development contracts.

The percentage of completion method allows developers to recognise revenue on sold properties while they are under construction. This method produces less “lumpy” results as compared to the alternative method, which is to recognise the entire revenue when construction has been completed, typically at the receipt of the Temporary Occupancy Permit (TOP). This second method results in no revenue or profit during the construction period, and the entire profit on the project in the year when TOP is received. Both methods are currently allowed in Singapore under Recommended Accounting Practice 11 Pre-Completion Contracts for the Sale of Development Property (RAP 11). When IFRIC 15 is adopted in Singapore, RAP 11 is likely to be withdrawn.

Under IFRIC 15, the appropriate revenue recognition method depends on the following considerations:

1. Buyer's ability to specify design of the real estate

If the buyer can specify major structural elements of the design, the sales agreement is likely to qualify as a construction contract that is under the purview of FRS 11 'Construction Contracts'. Construction contracts are accounted for under the percentage of completion method.

If the buyer has limited ability to influence the design of the real estate, the agreement does not qualify as a construction contract and is accounted for using FRS 18 'Revenue'. The accounting method depends on whether the agreement is a provision of service or a sale of goods.

2. Developer's obligation to acquire and supply construction materials

Where the developer is not required to acquire and supply construction materials, the developer's obligation would be limited to the provision of construction services. The percentage of completion method is again appropriate, because service revenue is recognised over the period of service provision under FRS 18.

Where the developer must provide both materials and services to complete the construction, the developer has essentially signed an agreement to sell completed properties (i.e. sale of goods). The appropriate revenue recognition method depends on how the contract transfers control and risks and rewards of ownership of the property.

Implications of IFRIC Interpretation 15 (IFRIC 15) 'Agreements for the Construction of Real Estate' *(continued)*

3. Manner of transfer of control and risks and rewards of ownership

Where the agreement continuously transfers to the buyer the control, as well as the significant risks and rewards of ownership of the work in progress in its existing state as construction progresses, revenue shall be recognised using the percentage of completion method.

However, where control, risks and rewards are transferred in entirety upon completion, the entire revenue can be recorded only upon completion.

The following table summarises the various scenarios and the accounting treatment:

Scenario	Revenue recognition method
<ul style="list-style-type: none"> Buyer can specify design. 	Percentage of completion under FRS 11
<ul style="list-style-type: none"> Developer is not obligated to acquire and supply construction materials. 	Percentage of completion under FRS 18
<ul style="list-style-type: none"> Sales agreement continuous transfers control, risks and rewards to buyer. 	Percentage of completion under IFRIC 15
<ul style="list-style-type: none"> Buyer cannot specify design. Developer is obligated to acquire and supply materials. Sales agreement transfers control, risks and rewards upon completion. 	Revenue is recognised in entirety when FRS 18 criteria for sale of goods are met.

In order for Singapore developers to continue to adopt the percentage of completion method to recognise revenue on sale of the uncompleted properties, significant judgement has to be made to assess whether the arrangements with buyers and the supporting legislation on the development and agreements would indicate a continuous transfer of control and risks and rewards.

IFRIC 15 contains two interesting examples to illustrate whether control and risks and rewards have been transferred. In the first example, the fact that buyers are required to make unrefundable deposits and progress payments during construction (unless developer fails to complete the property) and the buyer has the right to on-sale the uncompleted property to another party do not by themselves demonstrate that control and risks and rewards have been transferred to the buyer.

Implications of IFRIC Interpretation 15 (IFRIC 15) 'Agreements for the Construction of Real Estate' *(continued)*

However if, in the event that the agreement has been terminated before the construction is completed, the buyer is able to (through legislation or agreement) retain the work-in-progress and the developer has the right to be paid for its work done to-date, this might indicate that control and risks and rewards is being transferred as construction progresses. Careful and detailed analysis of the terms in the arrangement and the legislation is required. It is conceivable that differentiation of recognition of revenue may be needed as arrangement and legislation differ in different jurisdiction.

Currently, developers in many parts of the world, including Australia, China, Hong Kong and the UK, recognise revenue on sale of properties upon completion and delivery to customers. IFRIC 15 is not expected to change the accounting in these jurisdictions.

IFRIC 15 is applicable for annual periods commencing on or after 1 January 2009 with retrospective effect, meaning that comparative numbers must be adjusted to show the effect of applying the interpretation. In Singapore, RAP 11 already requires developers to compute and disclose the effect of using the percentage of completion method as compared to recognising revenue and profit on completion. As such, most developers would already have the necessary information to implement IFRIC 15 if a change in the accounting becomes necessary.



A new paradigm shift taking its form

"In the span of six months to 31 March 2009, the IASB issued three discussion papers and three exposure drafts covering topics fundamental to financial reporting. Preparers and other stakeholders should follow these developments... on these matters."

Since the International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB) took their vow to embark on a roadmap to converge IFRS with U.S. GAAP in 2006, many of the converged standards issued were quick fixes. The momentum of convergence moved to a high gear in 2008, partly due to SEC's proposal to allow U.S. domestic issuers to adopt IFRS and partly as a response to the economic crisis.

In the span of six months to 31 March 2009, the IASB issued three discussion papers and three exposure drafts covering topics fundamental to financial reporting. Preparers and other stakeholders should carefully follow these developments and provide their viewpoints on these matters. The discussion papers and exposure drafts issued in the last six months include:

- Discussion Paper – Preliminary view on presentation of financial statements (October 2008)
- Discussion Paper - Discussion paper - Preliminary views on revenue recognition in contracts with customers (December 2008)
- Discussion Paper – Leases (March 2009)
- Exposure Draft – Consolidated Financial Statements (December 2009)
- Exposure Draft – Income Tax (March 2009)
- Exposure Draft – Derecognition (March 2009)

It is worthy to note that the exposure drafts on consolidation and derecognition were noticeably fast-tracked. The planned discussion papers were scrapped and the IASB went straight into issuance of exposure drafts.

In April 2009, the IASB also published a detailed six-month timetable for publishing a proposal to replace the existing financial instrument standard, IAS 39 'Financial Instruments: Recognition and Measurement'. This means that we can expect the exposure draft by the fourth quarter of 2009.

This article is the first in the series of a synopsis of key changes proposed. Many of the changes involve fundamental changes in accounting principles, representing a paradigm shift in our current thinking on financial reporting. Companies need to understand the proposals and provide inputs at an early stage because comments by preparers and users of financial statements at the discussion stage are more likely going to result in modifications rather than comments closer to final publication.

A new paradigm shift taking its form *(continued)*

New format of presenting financial statements

The Discussion Paper – “Preliminary view on presentation of financial statements” (DP) discusses how a profit-oriented entity should present its assets, liabilities, income, expenses, cash flows and other related information in its financial statements so as to best meet the financial information requirement of readers. Recognition and measurement issues are excluded from the scope of the DP.

Under the DP, financial statements will look fundamentally different from current practices. For example:

The balance sheet (or statement of financial position), statement of comprehensive income and statement of cash flows, will include segregated categories of business activities (sub-categorised into operating and investing), financing activities, income taxes, and discontinued operations.

The DP also proposes a “cohesive” manner of presentation across the primary statements. When an entity classifies an asset or liability in the business-operating category in the balance sheet, the changes in that asset/liability in the statement of comprehensive income and cash flows will also be presented in the same business-operating category.

In addition to the segregation of income and expenses into the categories as mentioned above, it is now proposed that expenses within each category be presented by function and then further disaggregated into their nature. In other words, more detailed information and subtotals are expected on the statement of comprehensive income. Currently, companies can choose to only present expenses by nature.

All statement of cash flows will be prepared using the direct method. In addition, reconciliation between the statement of cash flows and the statement of comprehensive income is also required. This reconciliation will allow a reader to analyse those amounts that are recognised as income and expenses into cash items, accruals other than re-measurement and re-measurement (e.g. fair value changes) items. These information aims to enhance the use of statement of cash flow for prediction of future cash flows.

Changing the way financial information is presented is clearly driven by the need to enhance the usefulness of that information or to address weaknesses in the existing model. The proposals included in the DP will require many companies to change the way in which financial data is collected, aggregated and presented. They will also require users and investors to adapt the models and processes they use to analyse and interpret the information in financial statements. All these will incur associated cost.

A new paradigm shift taking its form *(continued)*

“This concept of a dominant shareholder having “de facto” control is a rather unchartered area in Singapore.... Careful evaluation of whether the investment managers are the dominant shareholders having the power to control the REITS under the proposal will be required.”

New model of consolidation

The exposure draft on consolidation proposes a single control-based model as the basis for consolidation and expands significantly the disclosure requirements.

The proposal introduces two significant areas whereby more entities may be included for consolidation:

- **Consolidation by an investor who is a dominant shareholder of its investee.**

The concept of a reporting entity that holds less than half of the voting rights in another entity can control the other entity is not new. For example, a reporting entity that holds 30 per cent voting power as a shareholder and has the power to cast the majority votes at meetings of board of directors of another entity will consolidate the other entity under the current standard.

The exposure draft introduces the notion that a “dominant shareholder” can control another entity if it is the largest shareholder (and all other shareholders with voting rights are widely dispersed) and its voting rights are sufficient for it to dominate and therefore determine the other entity’s strategic operating and financial policies. For example, at shareholder meetings, the dominant shareholder may be able to cast the majority of the votes as the other shareholders are widely dispersed and may not be present to vote.

This concept of a dominant shareholder having “de facto” control is a rather unchartered area in Singapore. Other than companies with largest significant “dominant” shareholders impacted by this change, the investment property industry may also be impacted as investment property managers tend to be the largest unit-holder in the REITs that they manage. Careful evaluation of whether the investment managers are the dominant shareholders having the power to control the REITs (and hence required to consolidate the REIT)



A new paradigm shift taking its form *(continued)*

under the proposal is required.

- **Consolidation of “structured entity” by a sponsor of the entity.**

The exposure draft introduces the concept of a “structured entity”. The use of special structures, particularly by banks, to manage securitisations and other more complex financial arrangements as a matter of concern has been highlighted by the Financial Stability Forum (FSF – the international body tasked with co-ordinating the global regulatory response to the credit crisis) and the G20. They are concerned that financial statements do not convey the extent to which reporting entities are exposed to risks from those types of structures. The proposals in the exposure draft form part of the Boards’ comprehensive review of off-balance sheet activities and its response to the recommendations from the FSF.

Extensive disclosures are proposed for unconsolidated structured entities to enable an investor to assess the extent to which a reporting entity has been involved in setting up special structures and the risks to which these special structures expose the entity. Entities that regularly set up such entities, for example, investment fund managers and banks will be impacted significantly by such extensive disclosure requirements. The proposal will require many such agencies to implement processes in which financial data is collected, reviewed for their integrity, even for disclosure purposes.

The exposure draft also provides guidance on agent/principal relationships in the determination of control. An agent might have the ability to direct the activities of an entity and make decisions concerning operating and financing activities. However, that ability is governed by an agreement, law or fiduciary responsibility that requires the agent to act in the best interests of the principal. The inclusion of the concept of agent/principal is particularly useful in the investment management industry for a robust assessment of control. However, the real challenge is usually presented when the manager is both agent and principal (e.g. when holding equity interest in addition to being an agent). Companies acting in such capacity should evaluate whether the guidance included in the proposal is adequate and robust.

Look out for the following in the next issue....

- Discussion Paper: Preliminary views in Revenue recognition in contracts with customers – Will a single revenue recognition model achieve consistency in the myriad revenue contracts?
- Exposure Draft: Income Tax – Would clarity be achieved?

Looking for some better “options”?

“The downward slide in the stock markets in the current global crisis presents challenges to many companies that offer share option based rewards.... The challenge to management is how to modify such ‘underwater’ options for employee motivation and reward...”

Richard Davis of the PricewaterhouseCoopers (PwC) Global Accounting Consulting Services looks at the benefits and accounting implications of share-option repricings (and modifications).

The downward slide in the stock markets in the current global crisis presents challenges to many companies that offer share option based rewards. Management and employees holding options have realised that the current share price has sunk well below exercise price. The challenge to management is how to modify such ‘underwater’ options for employee motivation and reward, while managing the financial reporting consequences and shareholder and market expectations.

A. What can management do?

Cancellations, in broad terms, accelerate the recognition of expense. Increasing the value now for a share-based payment, even if it can restore some of the value that may have been eroded in recent months, will only lead to additional expense. These changes can result in significant impact on the income statement.

• **Cancelling option awards?**

Cancellation requires an immediate recognition of an expense based on the grant date fair value of the original option awards. Management should bear this in mind if a cancellation of awards is being considered – either because employees no longer place any value on the awards or because they are unlikely to vest given that performance conditions will not be met. When non-market performance conditions or service conditions are not met by the end of the vesting period, the cumulative expense of share-based payments will be zero (since no awards will have vested). However, if awards were cancelled before the end of the vesting period, the remaining unrecognised grant date fair value for all of the cancelled options will be recognised immediately in the income statement.

Global Accounting Consulting Services (ACS) is the coordinating function specialising in accounting consulting services related to the consistent application of International Financial Reporting Standards (IFRS) for PwC offices around the world.

• **Repricing options**

– **Lower exercise price to current market price**

There are several strategies that management might consider to revive underwater options. One is to simply reprice the options – that is, to lower the exercise price to the current market share price. This is equivalent to replacing existing underwater options with new options at the current market price.

This is a most straightforward strategy and will increase incentive to the employees. There is however, no benefit to investors who will obviously

Looking for some better “options”? *(continued)*

lose value as they are unable to participate in the repricing. Moreover, the incremental value to the employees resulting from the repricing is recorded as an additional expense over the remaining vesting period.

– **Repricing and reducing number of options**

There are other repricing strategies that involve a more ‘give and take’ approach. One example is to reprice and at the same time reduce the number of options held by the employee. This revives, to some extent, the value of underwater options, and it may counter investor resistance. It may also reduce additional expense, as the entity will have to account for a lower number of options.

– **Repricing and extending service period**

Another strategy is to reprice the options and extend the employee’s service period (with or without extending the expiration term). Management may find this modification advantageous as it requires the employee to work for a longer period to earn the options. The original grant date fair value remains spread over the original vesting period, but any incremental expense will be amortised over a longer vesting period. The fair value of the options is increased, leading to a higher incremental charge, if the expiration period is also extended.

– **Repricing and adding performance/market condition**

Management might also consider having performance or market vesting condition added to repricing options. These modification strategies are more complex, but can help management meet other objectives. For example, investors may find having an added a performance condition – such as a revenue or EBITDA target that must be achieved before the repriced options vest – more desirable. The employees benefit from the options only if the entity has positive results.

The drawback is that employees may feel penalised by a weak market, which has further eroded the value off their stock options. Hence, a way to address this concern is to add a market condition to the award i.e. the shares outperforming an industry or market index prior to the vesting of the repriced options. While complex, these are sound alternatives to a simple repricing. Analysing the underlying valuation implications are beyond the scope of this article and we recommend management consult with valuation experts if they are considering this strategy.

• **Swapping options for shares**

An alternative to repricing options is to swap them for shares that are subject to the same vesting conditions as the options. Management might view this as a better strategy as it can restore the alignment of interests between employees and investors. Employees may also consider this to be of greater security during a prolonged bear market since repriced options can go underwater again.

Looking for some better “options”? *(continued)*

“Management might adopt a combination of strategies to address underwater options...

Any decision in choosing an options strategy should carefully balance the various factors involved including employee expectations, investment interests, market perception and financial reporting impacts.”

The impact on income statement depends on how much ‘incremental’ value will be provided to the employees. Exchanging options for a smaller number of restricted shares may help to reduce or even eliminate any additional expense.

- **Employee cancellations**

There are current examples of senior employees waiving their entitlement to bonuses, some of which may be share-based payments. The treatment of an employee giving up an unvested award is not clear in the current version of IFRS 2. Entities have a choice to treat the waiver as a cancellation, which will accelerate the expense, or ignore the waiver and continue to account for the expense based on grant date fair value. This choice will not be available from 1 January 2009. IFRS 2 has now been amended, making it clear that the treatment would be the same as a cancellation by the employer (i.e. acceleration of expense).

- **Changing an award from equity-settled to cash-settled**

Management could change an award from being equity-settled to cash-settled. Care should be taken unless the cash payment is fixed at the date of the modification because a cash-settled award will introduce income statement volatility, since the liability is marked to fair value. IFRS 2 requires the original grant date fair value to be recognised, in addition to any post-modification changes in fair value, so the cumulative expense will be the original grant date fair value plus any fair value movements in the liability. A fixed cash award will still result in the original grant date expense plus any incremental fair value being recognised.

- **Other alternatives**

Management might adopt a combination of the above and other strategies to address underwater options. Management might also tailor the changes to include or exclude certain options and/or groups of employees. Any decision in choosing an options strategy should carefully balance the various factors involved including employee expectations, investor interests, market perception and financial reporting impacts. It is also important to be aware of any legal and contractual implications – for example, some option agreements may prohibit the employer from modifying the awards without approval of the option holders. Finally, management should consider the tax consequences, if any, of option repricing in the relevant jurisdiction.

B. What are the accounting treatments?

The accounting impact of some of the repricing strategies described above is illustrated, at a high level, by some of the examples below. Remember however that every company’s share-option plan is unique - we recommend that management model and estimate the potential income statement effect of various scenarios to determine which is most effective to achieve their goals and to consult the relevant experts at an early stage.

Looking for some better “options”? *(continued)*

The following examples are for ‘plain vanilla’ share-option with a service condition such that all awards vest after the fourth year, expiry in the tenth year and a zero forfeiture rate. The repricing is assumed to take place at the end of the third year.

- **Simple repricing**

The exercise price is reduced to current market value; all other terms of the original option are the same.

	Fair value at grant date	Fair value before repricing	Fair value after repricing
Market price	C50	C20	C20
Exercise price	C50	C50	C20
Expected term	7	4	4*
Volatility	20%	30%	30%
Risk-free interest rate	3%	3%	3%
Fair value per option	C15	C1	C6
Number of options	100	100	100
Total value of options	C1,500	C100	C600

Total share compensation expense in the remaining vesting period (year 4) will be C875, calculated as the unrecognised compensation expense remaining for the original award (C1, 500 over 4 years), plus the incremental fair value of C500 calculated above (C600 - C100). [IFRS 2 paras 26-27; IG Example 7].

* The modification may impact the expected term, but it remains the same in this example for simplicity.

- **Fair value balanced**

The exercise price is reduced to current market value and the number of options is also reduced so there is no incremental fair value to the employee. The accounting for this can be looked at in two different ways. One view is that for the options that remain, the treatment is the same as in the ‘simple repricing’ above, and the other options are cancelled, so the recognition of the grant date fair value is accelerated. The alternative view, which we believe is a better reflection of the economics involved, is that there is no change in the aggregate fair value and so there is neither an incremental fair value nor a cancellation. The examples set out below are based on this view.

The accounting treatment applied to a reduction in the number of awards and a corresponding, or greater, increase in the fair value of each award is a judgment that will depend on the specific facts of each case and should be applied consistently. Views may vary.

Looking for some better “options”? *(continued)*

This modification will require no additional share compensation expense, but it may result in a decline in the number of share-options that limits the incentive to employees.

	Fair value at grant date	Fair value before repricing	Fair value after repricing
Market price	C50	C20	C20
Exercise price	C50	C50	C20
Expected term	7	4	4*
Volatility	20%	30%	30%
Risk-free interest rate	3%	3%	3%
Fair value per option	C15	C1	C6
Number of options	100	100	17
Total value of options	C1,500	C100	C100

The number of repriced options is determined by dividing the aggregate fair value of C100 by the fair value of one repriced option. The 17 remaining options have the same total fair value as the 100 options before the repricing. There is no incremental compensation expense. Only the C375 of unrecognised share compensation expense from the original award is recorded in the fourth year. [IFRS 2 paras 26-27].

* The modification may impact the expected term, but it remains the same in this example for simplicity.

- **Extended life**

The exercise price is reduced to current market value, and the life of the option (both the vesting period and the expected term) is increased by two years. The company is still required to record the unrecognised share compensation expense of the original awards over the original vesting period*.

	Fair value at grant date	Fair value before repricing	Fair value after repricing
Market price	C50	C20	C20
Exercise price	C50	C50	C20
Expected term	7	4	6
Volatility	20%	30%	30%
Risk-free interest rate	3%	3%	3%
Fair value per option	C15	C1	C7
Number of option	100	100	100
Total value of options	C1,500	C100	C700

Looking for some better “options”? *(continued)*

This modification has resulted in incremental fair value of C600 that will be recognised over the remaining modified vesting period. The company will still be required to record the unrecognised portion of the original award (C375) in the fourth year, as follows:

	Option grant	Expense after repricing	Repricing impact on expense
	C	C	
Year 1	375	375	
Year 2	375	375	
Year 3	375	375	
Year 4	375	575	200
Year 5	0	200	200
Year 6	0	200	200
Total	1,500	2,100	600

[IFRS 2 para 26-27].

* If the employee leaves during year 5 or 6 and thus fails to meet the revised vesting condition, it is only the repricing impact that is reversed; the original grant date fair value expense of C1,500 is unaffected because the employee satisfied the four-year service condition for the original award.

- **Swap option for unvested shares**

The share-option is cancelled and immediately replaced by an unvested share award, providing the employee with 25 shares that will be earned over the remaining one year vesting period of the original award.

	Fair value at grant date	Fair value before repricing	Fair value after repricing
Market price	C50	C20	C20
Exercise price	C50	C50	C0
Expected term	7	4	–
Volatility	20%	30%	–
Risk-free interest rate	3%	3%	–
Fair value per option	C15	C1	C20
Number of awards	100	100	25
Total value of awards	C1,500	C100	C500

Total share compensation expense in year 4 will be C775, calculated as the unrecognised compensation expense remaining for the original award (C1,500 / 4 years), plus the incremental fair value of C400 calculated above (C500 - C100).

Other accounting developments

A) FRS/INT FRS issued (Current as at 30 April 2009)

11 December 2008 – Amendments to FRS 39 Financial Instruments: Recognition and Measurement - Eligible Hedged Items

The Accounting Standards Council (ASC) has issued the above amendment which now has two significant changes: (1) it prohibits designating inflation as a hedgeable component of a fixed rate debt; (2) it prohibits including time-value in the one-sided hedged risk when designating options as hedges. The former supports the view taken by the firm but the latter precludes a treatment that the firm had considered acceptable. It is effective for accounting periods beginning on or after 1 July 2009 and must be applied retrospectively in accordance with FRS 8, Accounting Policies. Accordingly, hedging strategies involving options should be re-assessed immediately to avoid complications as a result of the retrospective application from 1 July 2009.

20 January 2009 – INT FRS 117 Distributions of Non-Cash Assets to Owners

INT FRS 117 clarifies how an entity should measure distributions of assets, other than cash, when it pays dividends to its owners. It states that

- 1) a dividend payable should be recognised when appropriately authorised,
- 2) it should be measured at the fair value of the net assets to be distributed, and
- 3) the difference between the fair value of the dividend paid and the carrying amount of the assets distributed should be recognised in profit or loss.

INT FRS 117 applies to pro rata distributions of non-cash assets except for distributions to a party or parties under common control.

The interpretation is effective for annual periods beginning on or after 1 July 2009. Early application is permitted.

20 January 2009 – Amendments to FRS 39: Financial Instruments: Recognition and Measurement and FRS 107 Financial Instruments: Disclosures – Reclassification of Financial Assets - Effective Date and Transition

ASC updates reclassification amendment for financial instruments. This clarifies the effective date and transition requirements of the recent amendment to FRS 39 and FRS 107 which permits reclassification of certain financial assets from 'held-for-trading' or 'available-for-sale' under limited circumstances issued in October 2008 by the ASC. This confirms that any **reclassifications made on or after 1 November 2008 shall take effect only from the date of the reclassification** and may not be backdated.

Other accounting developments *(continued)*

8 April 2009 – Amendments to FRS 107: Improving Disclosures about Financial Instruments

The amendment increases the disclosure requirements about fair value measurement and reinforces existing principles for disclosure about liquidity risk. It introduces a three-level hierarchy for fair value measurement disclosure and requires some specific quantitative disclosures for financial instruments in the lowest level in the hierarchy.

The amendment is effective for accounting period starting on or after 1 January 2009 with no comparatives for the first year of application.

8 April 2009 – INT FRS 118 Transfer of Assets to Customers

The interpretation applies prospectively to transfers of assets from customers received on or after 1 July 2009, although some limited retrospective application is permitted. The interpretation clarifies the accounting for arrangements where a customer provides an item of property, plant and equipment (or in some cases cash which must be used to acquire or construct an item of property, plant and equipment) which must be used either to connect the customer to a network or to provide an ongoing service. This is particularly relevant to the utility sector with the provision of the service being that of, for example, gas or electricity.

23 April 2009 – Amendments to INT FRS 109 and IAS 39 – Embedded

Derivatives The amendment clarified that companies making use of the October 2008 reclassification amendment (allowing to reclassify particular financial instruments out of the ‘at fair value through profit or loss’ category in specific circumstances) need to assess at the date of reclassification the existence of embedded derivatives and account for them separately, if necessary. The amendment and is required to be applied for annual periods ending on or after 30 June 2009 and is retrospective.

B) Exposure Drafts/Discussion Papers (Current as at 30 April 2009)

30 December 2008 – Proposed amendments to INT FRS 109 Reassessment of Embedded Derivatives and INT FRS 116 Hedges of a Net Investment in a Foreign Operation

The ASC has published an Exposure Draft to amend the above 2 interpretations:

In terms of INT FRS 109, the ASC proposes to exclude from INT FRS 109’s scope, those embedded derivatives in contracts acquired in combinations of entities, business entities under common control and in the formation of joint ventures.

Other accounting developments *(continued)*

In terms of INT FRS 116, the ASC proposes to remove a current restriction on the entity that can hold the hedging instrument. In other words, under the proposal, the foreign operation/entity that is being hedged can hold the hedging instrument.

The amendments would be effective for annual periods beginning on or after 1 July 2009.

31 December 2008 – Exposure Draft of proposed amendments to FRS 24 – Relationships with State

The ASC has published a revised proposal to simplify the disclosure requirements that apply to state-controlled entities. Currently, FRS 24 – Related Party Disclosures requires entities to provide disclosures about transactions with related parties. However, state-controlled entities may find it difficult and costly to provide all the required details for transactions with other state-controlled entities. As a result, the proposal published in 2007 provided an exemption to state-controlled entities from providing disclosures about transactions with other state-controlled entities if specified conditions were met. However, respondents were concerned about the complexity of the proposals.

Unlike the original proposal, the revised exemption would not require state-controlled entities to assess the extent of state influence. It would exempt such entities from providing full details about transactions with other state-controlled entities and the state. Instead, (unlike the 2007 Exposure Draft) it would require general disclosures about the types and extent of significant transactions.

31 December 2008 – Exposure Draft 10 Consolidated Financial Statements

The proposals address those concerns by presenting a new, principle-based, definition of control of an entity that applies to a wide range of situations and would be more difficult to evade through special structuring. The proposals also include enhanced disclosure requirements that would enable an investor to assess the extent to which a reporting entity has been involved in setting up special structures and the risks to which these special structures expose the entity. The proposals would apply not only to the banking sector but to any entity that uses legal entities to manage its activities.

We have included a brief synopsis on Page 9 of this new model of consolidation.

4 February 2009 – Exposure Draft of proposed amendments to INT FRS 109 and FRS 39 – Embedded Derivatives

On 30 December, the ASC published an Exposure Draft of proposed amendments to the above standards to clarify that if an asset is reclassified under the recent amendment to FRS 39 and FRS 107 (that permits reclassification of certain financial assets from ‘held-for-trading’ or ‘available-for-sale’ under limited circumstances issued in October 2008 by the ASC), it must be assessed for embedded derivatives at the date of reclassification.

Other accounting developments *(continued)*

ASC invites comments on the Discussion Paper issued by IASB 31 December 2008 - Preliminary views on Revenue Recognition in Contracts with Customers

The discussion paper which proposes a change to the revenue recognition guidance will lead to a new, converged and comprehensive IFRS that will replace the present standards IAS/FRS 18 (Revenue) and IAS/FRS 11 (Construction contracts). The objective is to improve the existing guidance in both IFRSs and US GAAP by developing a single revenue model that can be applied consistently regardless of industry. Applying the underlying principle, revenue would be recognised on the basis of increases in an entity's net position in a contract with a customer. When an entity becomes a party to a contract with a customer, the combination of the rights and the obligations in that contract gives rise to a net contract position. Whether that net contract position is a contract asset, a contract liability or a net nil position depends on the measurement of the remaining rights and obligations in the contract. In the proposed model, revenue is recognised when a contract asset increases or a contract liability decreases (or some combination of the two). That occurs when an entity performs by satisfying an obligation in the contract.

(Comments due by 3 April 2009)

8 April 2009 – Discussion Paper: Preliminary Views on Leases

In the discussion paper a possible new approach to lease accounting has been proposed. The paper states that lease accounting should be based on the principle that all leases give rise to liabilities for future rental payments and assets (the right to use the leased asset) that should be recognised in an entity's statement of financial position. Specifically, the new accounting model for leases would result in the lessee recognising: (a) an asset representing its right to use the leased item for the lease term (the 'right-of-use' asset) and (b) a liability for its obligation to pay rentals. This approach is aimed at ensuring that leases are accounted for consistently across sectors and industries. The discussion paper includes preliminary views on measurement of the lessee's right-of-use asset and its obligation to pay rentals. However, it is decided to defer consideration of lessor accounting in order to resolve the problems associated with lessee accounting as quickly as possible. Consequently, the discussion paper deals mainly with lessee accounting. Nonetheless, it describes some of the issues that will need to be addressed in a future proposed standard on lessor accounting.

(Comment period ends on 20 May 2009)

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