Principal Member of HLB International

Q1 2018 Financial Reporting Updates

This is your quarterly update on all things relating to International Financial Reporting Standards or Singapore Financial Reporting Standards. We will bring you up to speed on topical issues, provide our comments and view points on any significant developments.

January 2018

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Prepayment features with negative compensation

What's the issue?

On 12 October 2017 and 29 December 2017, the International Accounting Standards Board ("IASB") issued the amendment to IFRS 9 / FRS 109 *Financial Instruments* (the Amendment).

This allows financial assets with prepayment features that pay or receive reasonable compensation for the early termination of the contract (so that, from the perspective of the holder of the asset permit or require a party to a contract either to there may be 'negative compensation'), to be measured at amortised cost or at fair value through other comprehensive income.

What you need to know?

- The IASB has amended IFRS 9 / FRS 109 to allow debt instruments with negative compensation prepayment features to be measured at amortised cost or fair value through other comprehensive income.
- The amendment is effective for annual reporting periods beginning on or after 1 January 2019, but earlier application is permitted.

Under IFRS 9 / FRS 109, a debt instrument can be measured at amortised cost or at fair value through other comprehensive income, provided that the contractual cash flows are 'solely payments of principal and interest on the principal amount outstanding' (the SPPI criterion) and the instrument is held within the appropriate business model for that classification. A prepayment option in a financial asset meets the SPPI criterion if the prepayment amount substantially represents unpaid amounts of principal and interest, which may include reasonable additional compensation for early termination of the contract.

An instrument with a contractual term that permits or requires *either* the borrower or the lender to prepay a loan before maturity at an amount which includes compensation for changes in the relevant benchmark interest rate would, therefore, have failed the SPPI criterion. This is because the lender could end up compensating the borrower (i.e. 'negative compensation'). For instance, if the current market interest rate is higher than the effective interest rate of the debt instrument, then a prepayment by the borrower would be less than the unpaid amount of principal and interest. 'Reasonable additional compensation' implies that the party choosing to exercise its option to terminate the contract compensates the other party. But some prepayment options could result in that other party being forced to accept negative compensation – e.g. the lender receives an amount less than the unpaid amounts of principal and interest if the borrower chooses to prepay.

Applying current IFRS 9 / FRS 109 would result in these instruments being measured at FVTPL. The IASB believes this result would not be appropriate if amortised cost provides useful information.

Amendments to measure at amortised cost or FVOCI

The Amendment to IFRS 9 / FRS 109 clarifies that a financial asset passes the SPPI criterion regardless of the event or circumstance that cause the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract.

The Basis for Conclusions to the Amendment clarifies that the early termination can result from a contractual term or from an event outside the control of the parties to the contract, such as a change in law or regulation leading to the early termination of the contract.

To be eligible for the exception, the fair value of the prepayment feature would have to be insignificant on initial recognition of the asset. If this is impracticable to assess based on the facts and circumstances that existed on initial recognition of the asset, then the exception would not be available.

Financial assets pre-payable at current fair value would be measured at FVTPL. The same would apply if the prepayment amount includes the fair value cost to terminate a hedging instrument if the amount is inconsistent with the current IFRS 9 prepayment rules.

Effective date and transition requirements

Amendments would be effective for annual periods beginning on or after 1 January 2019. The amendments are required to be applied retrospectively.

The Amendments provide specific transition provisions if it is only applied in 2019 rather than in 2018 with the remainder of IFRS 9 / FRS 109:

- The entity must revoke its application of the fair value option if, as a result of the amendments, an accounting mismatch no longer exists, and may newly designate a financial asset or liability to be measured at fair value though profit or loss if a new accounting mismatch is created.
- Restatement of prior periods is not required and is only permitted if such restatement is possible without the use of hindsight.
- Additional disclosures must be made to describe the effect of applying the amendments and any changes to the use of the fair value option.

Long-term interests in associates and joint ventures (Amendments to IAS 28 and FRS 28)

On 12 October 2017 and 29 December 2017, the amendments to IAS 28 / FRS 28 *Investments in Associates and Joint Ventures* clarify that companies account for long-term interests in an associate or joint venture—to which the equity method is not applied—using IFRS 9 / FRS 109.

IFRS 9 / FRS 109 *Financial Instruments* does not apply to interests in associates and joint ventures that are accounted for using the equity method. The issue is whether it applies to long-term interest in an associate or joint venture that forms part of the net investment in that venture but to which the equity method is not applied. The IASB clarify that these long-term interests are included within the scope of IFRS 9 / FRS 109, meaning they will be included within its impairment requirements.

Clarification

IASB thus clarified that:

a) an entity accounts for long-term interests applying IFRS 9 / FRS 109, including the impairment requirements in IFRS 9 / FRS 109;

b) in allocating any losses of the investment applying the requirements in paragraph 38 of IAS 28 / FRS 28 *Investments in Associates and Joint Ventures*, the entity includes the carrying amount of those long-term interests (determined applying IFRS 9 / FRS 109) as part of the net investment to which the losses are allocated;

c) the entity then assesses the impairment the net investment by applying the requirements of paragraphs 40 and 41A-43 of IAS 28 / FRS 28; and

d) in applying IFRS 9, the entity does not take account of any adjustments to the carrying amount of long-term interests that result from the application of IAS 28 / FRS 28:

Illustrative Example

You may refer to the Illustrative Example—*Long-term Interests in Associates and Joint Ventures.*

Effective date and transition requirements

The amendments are effective from 1 January 2019, with early application permitted, with earlier application permitted, which require retrospective application of the amendments applying IAS 8 / FRS 8 Accounting Policies, Changes in Accounting Estimates and Errors, subject to the transition requirements similar to those in IFRS 9 / FRS 109 regarding the classification and measurement of financial assets for entities that apply the amendments after they first apply IFRS 9 / FRS 109.

Annual Improvements to IFRS Standards 2015 –2017 Cycle

On 12 December 2017, the IASB issued the following amendments in December 2017 as part of *Annual Improvements to IFRS Standards 2015–2017 Cycle*:

Amendments	**Our Insight**
IFRS 3 *Business Combinations* and IFRS 11 *Joint Arrangements*	

These amendments clarify whether the previously held interest in a joint operation (that is a business as defined in IFRS 3) should be measured to fair value, when:

- A party to a joint operation obtains control over the joint operation (IFRS 3)
- A party that participates in (but does not have joint control over) a joint operation obtains joint control over the joint operation (IFRS 11)

IFRS 3

When a party to a joint operation obtains control of a joint operation that is a business, it must re-measure to fair value the interest it previously held in that operation. This is because the board views a transaction where control is gained as a significant change in the nature of and the economic circumstances surrounding the interest in the joint operation. Paragraph 42A is therefore added to IFRS 3, to clarify that such a transaction must be accounted for as a business combination achieved in stages.

IFRS 11

When a party that participates in (but does not have joint control over) a joint operation, obtains joint control over that joint operation that is a business (as defined in IFRS 3), it must not measure the interest it previously held in that joint operation. Although such a transaction changes the nature of an entity's interest in a joint operation, in the Board's view, it does not result in a change to the group boundaries. Paragraph B33CA is therefore added to IFRS 11 to clarify this point.

Below summarises whether a company should re-measure its previously held interest after increasing its interest?

<table>
<tr><td rowspan="7">The IASB has issued the above amendments. They aim to clarify the accounting treatment when a company increases its interest in a joint operation that meets the definition of a business.</td><td colspan="3">Should a company re-measure its previously held interest after increasing its interest?</td></tr>
<tr><td colspan="3">Company's interest in joint operation</td></tr>
<tr><td>Before transaction</td><td>After transaction</td><td>Re-measure at fair value?</td></tr>
<tr><td>Party to JO</td><td>Joint Control</td><td>X</td></tr>
<tr><td>Joint Control</td><td>Joint Control</td><td>X[1]</td></tr>
<tr><td>Party to JO</td><td>Control</td><td>√</td></tr>
<tr><td>Joint Control</td><td>Control</td><td>√</td></tr>
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1 Existing requirement under IFRS 11

Our Insight: Challenges are likely to remain whether an entity obtains control or joint control that is a joint operation.

IAS 12 *Income Taxes*	
The Board was asked to clarify whether income tax consequences of payments on financial instruments classified as equity should be recognised in profit or loss or in equity, The Board added paragraph 57A to IAS 12 to clarify that an entity must recognise all income tax consequences of dividends in profit or loss, other comprehensive income or equity, depending on where the entity recognised the originating transaction or event that generated the distributable profits giving rise to the dividend, Paragraph 52B relating to the income tax consequences of dividends are recognised when a liability to pay the dividend is recognised was deleted.	Although the amendments provide some clarifications, they don't attempt to address the underlying question – i.e. how to determine if a payment represents a distribution of profits. Therefore, challenges are likely to remain when determining whether to recognise the income tax on some instruments in profit or loss or in equity.
IAS 23 *Borrowing costs*	
Paragraph 14 of IAS 23 requires an entity to exclude borrowings made specifically for the purpose of obtaining a qualifying asset, when determining the funds that an entity borrows generally and uses for the purpose of obtain a qualifying asset. The Board amended paragraph 14 to clarify that, when a qualifying asset is ready for its intended use or sale, and some of the specific borrowing related to that qualifying asset remains outstanding at that point, that borrowing is to be included in the funds that an entity borrows generally.	Depending on an entity's current policy, the proposed amendments may result in more borrowings being included in the general borrowings pool. Whether it will result in more or less borrowings being capitalised during a period will depend on: • whether the weighted-average interest cost of any additional borrowings included in the pool as a result of the amendments is higher or lower than that of those that would be included under the entity's current approach; and • the relative amounts of qualifying assets under development and general borrowings outstanding during the period.

What should entities do?

Entities should analyse these amendments to determine whether the clarifications affect their accounting policies or reporting requirements.

IFRS 9 and IFRS 15 are now effective

IFRS 9 Financial Instruments

IFRS 9 was issued in 2014 and replaces IAS 39 Financial Instruments: Recognition and Measurement. It consists of three different parts: classification and measurement, impairment and hedge accounting.

IFRS 9 represents a fundamental shift in accounting for financial instruments and will have an enormous impact on all financial institutions.

New impairment rules for calculating the allowance for credit losses on loans or investments are by far the most significant change brought by IFRS 9. The incurred loss model is being replaced by an expected loss model (i.e., instead of only setting loan provisions for losses actually incurred, companies will have to provide against losses they can reasonably expect to incur). Essentially, companies no longer wait until something goes wrong to recognize a loss. Rather, by following credit deterioration on every loan that goes on the books, companies can classify them as either having the same risk today as they did at origination (classified as stage 1) or having significantly greater risk than at origination (stage 2) and make loan provisions according to that risk.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 was also issued in 2014. It replaces two Standards, IAS 18 Revenue and IAS 11 Construction Contracts.

IFRS 15 specifies when and how much revenue a company should recognise, and the information about revenue that the company should disclose in its financial statements. IFRS 15 is a major change from the old standard and will affect almost all companies and industries that have revenue.

Effective year

IFRS 9 and IFRS 15 are effective for reporting periods starting on or after 1 January 2018.

Are entities ready for IFRS 9 and IFRS 15?

These two standards will require some companies to change the way they not only gather data, but the way they group, cut and analyse it, which has wide-ranging system implications.

Experience shows that many companies will underestimate the work required, especially given that multiple IFRS adoptions will be required in a short period of time.

A First Year Review of the Enhanced Auditors' Report in Singapore

For periods ending on or after 15 December 2016, **t**he most significant enhancement to the auditor's report is the **new requirement for auditors of financial statements of listed entities to communicate "Key Audit Matters (KAM)"** – those matters that the auditors judge to be of most significance in the current period audit, with an explanation of how they were addressed in the audit.

There are also enhancements to the auditor's attention and communication on matters related to going concern in the auditor's report, applicable to audits of financial statements of all entities. These additional disclosures help investors focus on the critical areas in the financial statements which in turn, lead to more meaningful engagements with auditors, directors and management.

Findings from a study that examined the impact of the first-year implementation of enhanced auditor reporting (EAR) standards in Singapore were also released at SAAC 2017. It was revealed that more insightful auditor's reports were leading to greater corporate disclosures. Investors were also using these enhanced reports to identify significant accounting and audit issues before reading through the financial statements.

This study also gathers the views of audit committees and investors through online surveys and focus group discussion study is conducted by several parties, namely Accounting and Corporate Regulatory Authority (ACRA), Association of Chartered Certified Accountants (ACCA), Institute of Singapore Chartered Accountants (ISCA) and Nanyang Technological University (NTU).

ASC has issued Singapore Financial Reporting Standards (International)(SFRS (I)s)

The Accounting Standards Council announced on 29 May 2014 that Singapore-incorporated companies listed on the SGX-ST will apply a new financial reporting framework identical to the International Financial Reporting Standards ("IFRS") for financial year ending 31 December 2018 onwards. The Accounting Standards Council announced on 29 December 2017 that it has issued Singapore Financial Reporting Standards (International) (SFRS(I)s), Singapore's equivalent of the International Financial Reporting Standards (IFRSs).

Which entities should adopt SFRS(I)(s)?

SFRS(I)s is the applicable framework for Singapore-incorporated companies that have issued, or are in the process of issuing, equity or debt instruments for trading in a public market in Singapore. It is also available to other Singapore-incorporated companies[1] as an alternative framework to the Singapore Financial Reporting Standards (SFRSs) as well as the Singapore Financial Reporting Standard for Small Entities (SFRS for Small Entities).

Entities applying SFRS(I)s[2] can elect to state simultaneous compliance with IFRSs issued by the International Accounting Standards Board (IASB) in its SFRS(I) financial statements.

Are the SFRS (I) s equivalent to International Financial Reporting Standards (IFRSs)?

SFRS (I)(s) comprise Standards and Interpretations that are equivalent to IFRSs issued by the International Accounting Standards Board (IASB).

Table of SFRS(I)s and IFRSs

How should an entity disclose?

The ASC's policy intent is that an entity complying with SFRS(I)s can elect to simultaneously include an explicit and unreserved statement of compliance with IFRSs in its first SFRS (I) financial statements, and thereafter, in its subsequent SFRS (I) financial statements.

When are the effective dates of the SFRS (I)s?

SFRS (I)s are available for entities to apply for annual reporting periods beginning on or after 1 January 2018.

1 Excludes Singapore-incorporated companies that are registered as a charity or approved as an institution of a public character under the Charities Act (Cap. 37).

2 Nonetheless, a non-listed entity applying paragraphs in SFRS(I)s indicated with an asterisk (*) shall determine its eligibility for making such an election. The term 'non-listed entity' is defined in the Statement on Applicability.

ACRA has issued the FRSP – Review Procedures Guide and ACRA's Practical Guidance No. 1 of 2018

On 2 January 2018, ACRA has issued the following:

- FRSP - Review Procedures Guide
- ACRA's Practical Guidance No. 1 of 2018

FRSP Review Procedures Guide

From 1 April 2017, all reviews of the financial statements under the FRSP will be completed with the following outcomes:

a. Closed with no points for enquiry;
b. Enquired and closed with no findings or minor findings;
c. Enquired and closed with material findings requiring restatements in future year's financial statements; *and*
d. Enquired and closed with findings of significance requiring restatements in the prior year(s) and/or future year's financial statements.

For the past two review cycles under FRSP, most reviews were completed with outcomes (a) to (c).

The Guide seeks to share ACRA's review procedures under the FRSP with directors and management. Such information will be useful, particularly when their companies' financial statements are selected for review under the FRSP.

ACRA focuses the FRSP on the review of financial statements of listed companies incorporated in Singapore.

These financial statements are selected using a risk-based approach, which includes the following considerations:

1. Risk to the public interest based on criteria such as market capitalisation, revenue and asset size, as well as multiple stakeholders;
2. Significant transactions that require complex accounting considerations and have a material financial impact;
3. Significant impact from the adoption of new accounting standards;
4. Changes in listing or trading status;
5. Changes in key stakeholders, including directors, management and auditors;
6. Modified audit reports indicating potential material misstatements; *and*
7. Referrals or complaints.

From 1 April 2017, ACRA works with companies to correct material findings and findings of significance by restating the financial statements.

Depending on the nature and extent of these findings, the type of restatements required could include:

1. Restating comparatives or adding/improving disclosures in the next year's financial statements;
2. Restating comparatives in the next results announcement; and/or
3. Restating, re-auditing and re-filing past year(s)'s financial statements. The "restatement first" policy is aligned with ACRA's objective to provide investors and other stakeholders with clear and reliable financial statements on a timely basis for their decision-making.

To facilitate timely restatements, ACRA would not check the proposed restatements before they are take effect. After the restated financial statements have been issued, companies and its directors will submit the relevant extracts of the financial statements reflecting those restatements, together with supporting explanations and documents, to ACRA. ACRA then checks to ensure that remediation is carried out satisfactorily and in accordance with the prescribed timeline.

In situations where a company refuses to remediate within the prescribed timeline or in egregious cases, ACRA will consider enforcing directors' duties under the Companies Act and where necessary, issue notices to inform the public as well.

ACRA's Practical Guidance No. 1 of 2018

To guide directors in reviewing their company's upcoming financial statements, ACRA is publishing the FRSP areas of review focus for FY2017 FS. This will remind directors of some potential risks of misstatement in the financial statements and provide the questions they may ask management to improve the quality of financial reporting. Directors are urged to pay more attention to the following financial reporting areas:

1. Upcoming changes in accounting standards – Is financial effect adequately disclosed?

Changes effective for financial years starting on or after	1 January 2018	1 January 2019
SFRS(I) 15 / SFRS 115 Revenue from Contracts with Customers	✓	
SFRS(I) 9 / SFRS 109 Financial Instruments	✓	
Convergence with IFRS (ie SFRS(I))	✓	
SFRS (I) 16 / SFRS 116 Leases		✓

2. Going concern – Can the entity continue to operate in the near term (at least 12 months)?
3. Value of long-lived assets – Any indication of impairment? If yes, has an impairment test been conducted? If a previous impairment loss is reversed, is this supported by real improvement in performance or economic conditions?
4. Significant one-off gains or losses – Does it make business sense?
5. Consolidation or Equity Accounting – Looking beyond legal forms, has the rights to participate in decision-making held by various parties been considered?
6. Business acquisitions – Have other intangible assets been carved out from goodwill and separately recognised? What is the date of acquisition for accounting purposes? Are there terms that may affect purchase consideration?
7. Statement of cash flows – Are cash flows appropriately classified within operating, investing or financing cash flows?
8. Significant judgements and estimates – Are disclosures tailored to the circumstances?

Contact us

If you need assistance or advice on the above, we are here to assist you.

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