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FOO KON TAN

Financial Reporting Updates – 4Q 2023

This is your quarterly update on all things related to international financial reporting standards or Singapore Financial Reporting Standards. We will bring you up to speed on topical issues, provide our comments and viewpoints on any significant developments.

Sep – Dec 2023

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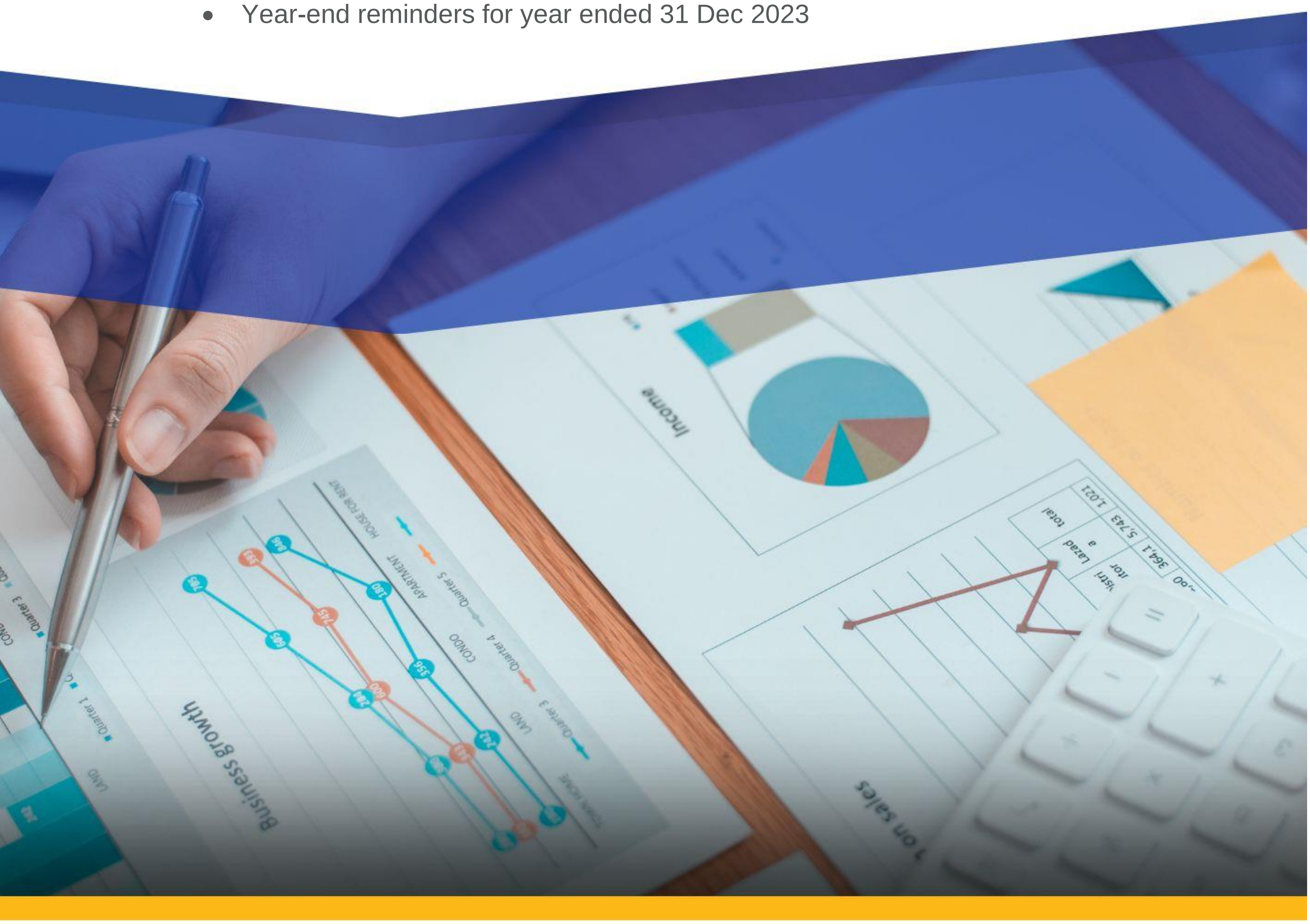
- Our new FKT Holdings Limited and its subsidiaries - 2023 Illustrative FRS Financial Statements
- ACRA has issued Financial Reporting Practice Guidance No. 1 of 2023
- Year-end reminders for year ended 31 Dec 2023



Our new FKT Holdings Limited and its subsidiaries - 2023 Illustrative FRS Financial Statements

We will be issuing our new FKT Holdings Limited and its subsidiaries – 2023 Illustrative FRS financial statements for listed entities incorporated in Singapore soon. Please keep a lookout for it!

This 2023 edition includes the additional disclosures that are required on adoption of the new and revised accounting standards effective for the current financial year, as well as the new and revised accounting standards that have been issued but are not yet effective. For more details on these new and revised accounting standards, please refer to the below section "Areas of Changes in SFRS(I)s". Macroeconomic and geopolitical uncertainties continue to have significant impact on financial reporting in FY2023 and the effects of climate change are more prominent than ever. As such, more attention will also be placed on the related disclosures.

ACRA has issued Financial Reporting Practice Guidance No. 1 of 2023

On 6 November 2023, ACRA has issued the following:

ACRA's Financial Reporting Practical Guidance No. 1 of 2023

To guide directors in the review and approval of their company's financial statements amid macroeconomic and geopolitical uncertainties, as well as climate changes, ACRA has published the proposed areas of review focus for the financial statements that are affected by such uncertainties and climate-related risks. This publication highlights the areas of review focus for FY2023 FS, paying close attention to these emerging risks and trends.

Macroeconomic and geopolitical uncertainties continue to have significant impact on financial reporting in FY2023 and the effects of climate change are more prominent than ever. ACRA's review on FY2023 FS will focus on the following areas:
(1) Accounting Impact From Macroeconomic Uncertainties
(2) Accounting Impact From Climate Change Movements
(3) Accounting Impact From Geopolitical Uncertainties
(4) New accounting standards

1. Accounting Impact From Macroeconomic Uncertainties

Macroeconomic uncertainties will have significant impact on a company's performance and financial position. Directors are reminded to pay close attention to the following accounting considerations in their preparation of the FS:

Impairment

- Inflation continues to **put pressure** on the **top line** and **cost line**
  - may result in recession risks
  - **impact cash flow forecasts** for impairment assessments
- Higher interest rates
  - put **upward pressure** on the **discount rate** used in the discounted cash flow model
  - **lower** the **net recoverable amount**
- When assessing recoverable amounts of cash-generating units (CGUs) containing goodwill or intangible assets with indefinite useful lives, **sensitivity disclosure** should be made if a **reasonable possible change in key assumption(s) would cause the carrying amount to exceed recoverable amount**.

Debt covenants

- Rising interest rates leading to higher discount rates
  - would **reduce asset values**
  - could lead to a **breach of debt-to-equity or asset-to-liability ratios**
- Borrowers should monitor the **terms of existing debt/loan arrangements for possible breaches** and **obtain waivers before year-end** if they do not satisfy debt covenants and wish to continue classifying the debt as non-current.

Going concern

- For highly leveraged companies, **robust assessment** should be performed
  - including **detailed scenario analysis** of the impact of higher interest rates together with other factors, to assess if there are any **material uncertainties on the company's ability to continue as a going concern**.
  - should consider for borrowings approaching maturity and whether there are realistic expectations of repayment or committed refinancing due to the high interest environment
- Cash flow projections should be **updated** with **current interest and discount rates**, **market conditions and business expectations up to the date of authorising the FS**.
  - to consider the fact and circumstances of the individual company and all available information about the future **for at least, but not limited to, the twelve months** from the end of the reporting period.
- If there are **material uncertainties** about going concern or if the going concern assessment involves **significant judgement**, should disclose:
  - such material uncertainties and significant judgement
  - **management's plans to mitigate the conditions that cast significant doubt on going concern**

ACRA's Tips for Directors:

- ❑ When reviewing appropriateness of impairment and going concern assumptions,
  - ✓ obtain an understanding from management about **discerning events** (if any) **existing on and after the reporting date**, up to the date of authorising the FS.
  - ✓ **Do not just rely on historical trend information**.
  - ✓ **Re-assess** if the **basis for inputs and assumptions** used in cash flow projections are **valid** and **supportable**.

- ❑ **Engage external auditor early** to ensure that management's going concern assessment is adequate and/or appropriate.

2. Accounting Impact from Climate Change Movements

ACRA reminds directors to start considering how climate-related risks might have a material impact on a company's operations, and accordingly, its financial performance, position and cash flows.

Expected Credit Loss (ECL)

- Changes in credit risk due to climate change **often impact periods beyond 12-months**.
  - Companies should assess if a 12-month probability of default remains supportable or if there has been a significant increase in credit risk requiring lifetime ECL to be estimated.
- Homogeneous groupings used previously such as customer ratings might need to be **disaggregated into sub-groups**, where
  - climate-related risks might impact loss patterns and probability of default for each sub-group differently

Impairment

- The impact of climate change may result in changes to:
  - **revenues expected to be generated** from an asset
  - **length** of **forecast period**
  - **discount rates**
  - **growth rate assumptions**
  - ➔ These factors will impact the asset's **value-in-use** and **recoverable amount**.

- A company's **cost base may increase** as it adopts greener initiatives to sustain its business and adhere to regulations.
  - Examples include:
    - suppliers passing down increasing cost from carbon tax
    - purchasing cleaner-energy or more energy efficient machinery and equipment
  - Such **costs should be factored into cash flow forecasts for impairment assessments**.
- If there are plans to purchase greener fixed assets, companies should **re-evaluate** the **useful lives** and **residual value** of the **existing fixed assets**.
  - In some cases, certain assets may **become obsolete** and **need to be written down**.

Green Financing

- **Sustainability bonds (or green bonds)** have specific requirements that the proceeds will only be used on specified climate-related projects. Issuers of the bonds should consider:
  - the implications if the **proceeds are not used** for designated green purposes
  - whether this constitutes a **breach** that makes the debt **repayable on demand** or a **default** that will **accelerate** the **bond repayment**
- Complexities may arise in the accounting for **sustainability-linked bonds**
  - due to the **variability in the amount of interest payable**
  - which is dependent on whether the ESG targets are met
    - If the ESG targets are not met, issuers should consider the **changes in expected cash flows**.

Provisions

- Due to changing preference towards sustainable products or sourcing, companies should consider the need to **recognise** a **provision for onerous contract** if there are:
  - **expected potential loss of revenue**
  - **increased costs** (e.g. from carbon tax)
  - **plans to terminate contracts or agreements**
- A **provision for restructuring** should also be recognised if a company:
  - has drawn up a **detailed formal plan** to make significant changes to its operations to achieve climate-related targets and
  - has raised **valid expectations** that the **plan will be implemented** i.e., either by starting to implement the plan or announcing its main features to those affected by it.

ACRA's Tips for Directors:

- ❑ Directors should understand **how climate-related risks can impact the FS**.
  - ✓ Educational materials available for further reading include those published by the
    - Institute of Singapore Chartered Accountants (ISCA) and
    - International Financial Reporting Standards (IFRS) Foundation
- ❑ Directors should remain vigilant for **greenwashing attempts** especially when
  - ✓ commitments have been made towards ambitious goals such as carbon neutral or carbon zero emissions within a short period of time
- ❑ With increasing requirements for climate reporting, Directors should ensure **consistency between financial and non-financial reporting** on **key climate-related assumptions**, **risks** and **opportunities**.

3. Accounting Impact from Geopolitical Uncertainties

Geopolitical uncertainties include:

- Russian-Ukraine war
- Israel-Hamas war
- International sanctions

Entities affected by these developments should carefully consider the resulting accounting implications which will impact FS preparation.

Provisions

- If **losses** are **expected to outweigh** the **economic benefits** from a revenue contract,
    - companies should consider the need to **recognise a provision for onerous contract**
- When applicable, a **provision should be recognised**
    - to record any obligation from **delayed/cancelled deliveries** to customers or **breaches** in contractual terms

Expected Credit Loss (ECL)

- Companies should consider if **trade restrictions imposed** by various governments, as well as the exclusion of major Russian banks from the SWIFT payment system, will **affect previous assessments of ECL**.
- ECL assessments should consider recoverability of amounts owed by debtors who **not only have operations but also significant customers or inventory** in affected areas.

Going Concern

In the assessment of going concern, companies should consider:

- the likelihood of **possible disruptions to production**
    - Examples include:
        - business failure of key suppliers
        - temporary closures of own operations
        - disruptions to workforce availability, etc.
- any **significant deterioration in the company's net working capital position** due to
    - suppliers demanding earlier repayment
    - customers delaying payment beyond agreed credit terms

Impairment

- Companies should assess the **recoverability** of the **carrying amount** of an **asset or CGU**, taking into account:
    - increased costs
    - possible supply chain disruptions
    - changes in cash flow expectations for the asset or group of assets. For example,
        - intangible assets such as software being developed by companies in affected region(s) might face disruptions in the development phase and might require impairment assessment.
- Physical assets that have been **damaged or left idle** in affected regions should also be **assessed for impairment**.
- If **inventories** are **slow moving** because of imposed trade sanctions or have been **physically damaged** due to the war
    - should be written down to the lower of their costs and net realisable values
- Companies may decide to **dispose various assets or subsidiaries** to comply with various government sanctions imposed.
    - If so, non-current assets held for sale and discontinued operations should be measured at **lower of carrying amount and fair value less cost of disposal**, and presented separately in the statement of financial position.
    - Assets held for sale must be **available for immediate sale in current condition** and the **sale** must be **highly probable** and **expected to be completed in one year** from the date of classification.

4. New accounting standards

Base Erosion and Profit Shifting (BEPS) Pillar Two

While companies are temporarily exempted from applying deferred tax accounting related to Pillar Two tax reforms, those with annual reporting periods beginning on or after 1 January 2023 are reminded to:

(i) disclose in their FS that they have applied the exception;
(ii) disclose separately their current income tax expense related to Pillar Two income taxes; and
(iii) provide qualitative and quantitative information about the exposure where the Group has operations in countries that have enacted or substantially enacted Pillar Two tax reforms.

ACRA's Tips for Directors:

- ❑ Directors are encouraged to review and understand the new requirements and consider their implications earlier.
- ❑ In compliance with the accounting standards, meaningful disclosures on the impact of adoption of these standards, which have been issued but not yet effective, should be made in the FY2023 FS.

Year - end reminders for year ended 31 December 2023

Year 2023 was yet another "new normal" year with continued COVID-19 impact. As we approach 31 December 2023, while trying to cope with the new normal, our year – end reminders are similar to those as covered in our FKT Financial Reporting Updates 3Q 2023. We have also discussed some of the financial reporting reminders to take note in the preparation of financial statements (FS) for the year ended 31 December 2023 and beyond in our FKT Financial Reporting Updates 3Q 2023, as well as within this publication (see the section above), which are still relevant and applicable for the preparation of financial statements (FS) for the year ended 31 December 2023.

Areas of Changes in SFRS(I)s

SFRS(I)s Update of Standards and Interpretations Issued and effective from the effective date indicated below:

		Effective for financial periods at the end of											
New Pronouncement	***Effective Date***	***Dec***	***Jan***	***Feb***	***Mar***	***Apr***	***May***	***Jun***	***Jul***	***Aug***	***Sept***	***Oct***	***Nov***
SFRS(I)17 *Insurance Contracts*	1 January 2023	2023	2024	2024	2024	2024	2024	2024	2024	2024	2024	2024	2024
Amendments to SFRS(I) 1-1 and SFRS(I) Practice Statement 2: *Disclosure of Accounting Policies*	1 January 2023	2023	2024	2024	2024	2024	2024	2024	2024	2024	2024	2024	2024
Amendments to SFRS(I) 1-8: *Definition of Accounting Estimates*	1 January 2023	2023	2024	2024	2024	2024	2024	2024	2024	2024	2024	2024	2024
Amendments to SFRS(I) 1-12: *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*	1 January 2023	2023	2024	2024	2024	2024	2024	2024	2024	2024	2024	2024	2024
Amendments to SFRS(I) 1-12: *International Tax Reform – Pillar Two Model Rules*	1 January 2023	2023	2024	2024	2024	2024	2024	2024	2024	2024	2024	2024	2024
Amendment to SFRS(I) 17: *Initial Application of SFRS(I) 17 and SFRS(I) 9—Comparative Information*	1 January 2023	2023	2024	2024	2024	2024	2024	2024	2024	2024	2024	2024	2024
Amendments to SFRS(I) 1-1: *Classification of Liabilities as Current or Non-current*	1 January 2024	2024	2025	2025	2025	2025	2025	2025	2025	2025	2025	2025	2025

SFRS(I)s Update of Standards and Interpretations Issued and effective from the effective date indicated below:

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New Pronouncement	**Effective Date**	**Dec**	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sept**	**Oct**	**Nov**
Amendments to SFRS(I) 1-1: *Non-current Liabilities with Covenants*	1 January 2024	2024	2025	2025	2025	2025	2025	2025	2025	2025	2025	2025	2025
Amendments to SFRS(I) 16: *Lease Liability in a Sale and Leaseback*	1 January 2024	2024	2025	2025	2025	2025	2025	2025	2025	2025	2025	2025	2025
Amendments to SFRS(I)1-7 and SFRS(I) 7 *Supplier Finance Arrangements*	1 January 2024	2024	2025	2025	2025	2025	2025	2025	2025	2025	2025	2025	2025
Amendments to SFRS(I) 1-21: *Lack of Exchangeability*	1 January 2025	2025	2026	2026	2026	2026	2026	2026	2026	2026	2026	2026	2026

Contact us

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

Sherrylnn Ong
Director, Professional Standards & Assurance
Foo Kon Tan LLP
1 Raffles Place, #04-61
One Raffles Place Tower 2
Singapore 048616
D +65 6304 2341
F +65 337 2197
E sherrylnn.ong@fookontan.com

For more updates, visit us on our social channels:

www.fookontan.com

https://sg.linkedin.com/company/foo-kon-tan

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