FOO KON TAN

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Financial Reporting Updates - 3Q 2023

This is your quarterly update 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.

July – Sept 2023

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IASB and ASC issued amendments to IFRS / IAS and SFRS(I) / FRS Standards, respectively

During 2023, the International Accounting Standards Board (IASB) and Accounting Standards Committee (ASC) have respectively issued amendments to the following standards:

- Amendments to IAS 12 / SFRS(I) 1-12 / FRS 12 *International Tax Reform—Pillar Two Model Rules*
- Amendments to IAS 7 / SFRS(I) 1-7 / FRS 7 and IFRS 7 / SFRS(I) 7 / FRS 107 *Supplier Finance Arrangements*
- Amendments to IAS 21 / SFRS(I) 1-21 / FRS 21 *Lack of Exchangeability*

Below is summary of the changes arising from the amendments.

Amendments to IAS 12 / SFRS(I) 1-12 / FRS 12 *International Tax Reform—Pillar Two Model Rules*

The amendments give companies temporary relief from accounting for deferred taxes arising from the Organisation for Economic Co-operation and Development's (OECD) international tax reform.

The OECD published the Pillar Two model rules in December 2021 to ensure that large multinational companies would be subject to a minimum 15% tax rate. More than 135 countries and jurisdictions representing more than 90% of global GDP have agreed to the Pillar Two model rules.

The IASB has taken urgent action to respond to stakeholders' concerns about the uncertainty over the accounting for deferred taxes arising from the implementation of the rules.

The amendments will introduce:

- a temporary exception – to the accounting for deferred taxes arising from jurisdictions implementing the global tax rules. This will help to ensure consistency in the financial statements while easing into the implementation of the rules; and
- targeted disclosure requirements – to help investors better understand a company's exposure to income taxes arising from the reform, particularly before legislation implementing the rules is in effect.

Companies can benefit from the temporary exception immediately but are required to provide the disclosures to investors for annual reporting periods beginning on or after 1 January 2023.

The amendments to IAS 12 / SFRS(I) 1-12 / FRS 12 are **effective for annual periods beginning on or after 1 January 2023**.

Amendments to IAS 7 / SFRS(I) 1-7 / FRS 7 and IFRS 7 / SFRS(I) 7 / FRS 107 *Supplier Finance Arrangements*

The amendments require specific disclosures about supplier finance arrangements (SFAs).

The new disclosures will provide information about:

(1) Terms and conditions of SFAs.
(2) Carrying amount of financial liabilities that are part of SFAs and the line items in which those liabilities are presented.
(3) Carrying amount of the financial liabilities in (2) for which suppliers have already received payment from the finance providers.
(4) Range of payment due dates for both the financial liabilities that are part of SFAs, and comparable trade payables that are not part of such arrangements.
(5) Non-cash changes in the carrying amounts of financial liabilities in (2).
(6) Access to SFA facilities and concentration of liquidity risk with the finance providers.

Entities will be required to aggregate the information they provide about SFAs. However, entities should disaggregate information about terms and conditions that are dissimilar, disclose explanatory information when the range of payment due dates is wide, and disclose the type and effect of non-cash changes that are needed for comparability between periods.

The new disclosure requirements will be **effective for annual reporting periods beginning on or after 1 January 2024**.

The following reliefs will be available in the first year of application:
(A) Disclosure of comparative information - Comparative information is not required during the first year the entity applies the amendments, that is, an entity with a closing reporting date of 31 December 2024 will not need to present the comparative information of 2023.

(B) Disclosure of specified opening balances - Quantitative disclosures (2) to (4) are normally required at the opening and closing of each reporting period. However, considering the complexity that may exist for disclosures (3) and (4), in the first year of application, entities are provided with transition relief meaning the disclosures (3) and (4) are only required as of year-end.

(C) Interim financial statements - The required disclosures are only applicable for the annual periods during the first year of application. Therefore, the earliest that the new disclosure requirements are mandated is an annual reporting period ending 31 December 2024.

Amendments to IAS 21 / SFRS(I) 1-21 / FRS 21 *Lack of Exchangeability*

The amendments will require companies to provide more useful information in their financial statements when a currency cannot be exchanged into another currency.

The amendments respond to stakeholder feedback and concerns about diversity in practice in accounting for a lack of exchangeability between currencies. The amendments will help companies and investors by addressing a matter not previously covered in the accounting requirements for the effects of changes in foreign exchange rates.

These amendments will require companies to apply a consistent approach in assessing whether a currency can be exchanged into another currency and, when it cannot, in determining the exchange rate to use and the disclosures to provide.

The amendments are **effective for annual reporting periods beginning on or after 1 January 2025**, with early application permitted.

ISCA issued FRB 10 *Real Property Valuation for Financial Reporting – Fair Value Based on the Highest and Best Use*

On 31 March 2023, Institute of Singapore Chartered Accountants (ISCA) published ISCA Financial Reporting Bulletin 10 (“FRB 10”) *Real Property Valuation for Financial Reporting – Fair Value Based on the Highest and Best Use*.

FRB 10 helps to explain the concepts of ‘fair value’ and ‘market value’, and to highlight that the valuation premise required under SFRS(I) 13 is ‘highest and best use’. If a different valuation premise is used in the valuation report, an assessment needs to be undertaken to determine if the resulting valuation is appropriate for financial reporting purposes.

Depending on the outcome of the assessment performed, entities may be required to obtain a new valuation report that is based on the highest and best use valuation premise. It is, therefore, important for entities to **communicate** to the valuer **upfront** at the planning phase of the valuation process that the **valuation should be performed for financial reporting purposes** and based on the **highest and best use** of the valuation premise.

ACRA issued Fourth Financial Reporting Surveillance Programme (FRSP) Report 2022

In January 2023, ACRA published the Fourth Financial Reporting Surveillance Programme (FRSP) Report 2022.

This FRSP report highlights key findings from review of annual financial statements that were selected by ACRA.

The areas with material non-compliance (NCs) were as follows:
a. business valuations or impairment assessments (8 instances)
b. presentation in cash flow statement (5 instances)
c. consolidation or equity accounting (2 instances)
d. revenue recognition (2 instances)
e. accounting for leases (1 instance)
f. presentation in financial statements (1 instance)
g. accounting for major complex transactions (1 instance)

The root causes of the material NCs were due to the directors' and management's:
- knowledge gap
- insufficient due diligence
- lack of action taken on issues raised by auditors

ISSB issued inaugural global sustainability disclosure standards

On 26 June 2023, the International Sustainability Standards Board (ISSB) has issued its inaugural standards – IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures (Standards)*, ushering in a new era of sustainability-related disclosures in capital markets worldwide. These Standards will help to improve trust and confidence in company disclosures about sustainability to inform investment decisions.

And for the first time, the Standards create a common language for disclosing the effect of climate-related risks and opportunities on a company's prospects.

IFRS S1 provides a set of disclosure requirements designed to enable companies to communicate to investors about the sustainability-related risks and opportunities they face over the short, medium and long term. IFRS S2 sets out specific climate-related disclosures and is designed to be used with IFRS S1.

Both fully incorporate the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). These Standards will become **effective for periods beginning on or after 1 January 2024**.

Climate-related risk considerations in financial reporting and audits of financial statements

As companies ramp up their sustainability efforts, Audit Committees (ACs) should consider the accounting implications. Key risks from climate change include new regulations, increased costs of operation or production, changing consumer preference towards sustainable products and discontinuation of carbon intensive operations.

Next steps – to address the above climate-related risks

ACs should pay attention to the following accounting considerations when preparing their financial statements (FS):

- **impairment** of non-financial assets (climate-related risks will affect the assumptions made in value-in-use calculation);
- impact on useful lives, residual values, and recoverability of assets;
- contingent liabilities and provision for onerous contracts;
- sustainability-linked loan; and
- disclosures about **assumptions** & **estimates**, **judgements** and **going concern** assessment.

ACs should engage their statutory auditor on the following auditing considerations arising from climate related-risks:

- risk assessment and response to assessed risk, considering the entity's business model, industry factors and regulatory factors;
- audit evidence, especially for **estimates** that may be **affected by climate-related risks**;
- engagement of an auditor's specialist, such as a climate-change specialist, where necessary;
- appropriateness of management's use of the **going concern** basis of accounting; and
- key audit matters in the independent auditor's report.

While climate change may have the potential to impact all entities, certain entities or industries may be more susceptible to climate-related risks due to their location, nature of their operations / business models or regulations. For instance, the Task Force on Climate-related Financial Disclosures (TCFD) and SGX have identified the following industries as those which are most affected by climate change and the transition to a lower-carbon economy:
(a) Financial industry;
(b) Agriculture, food and forest products industry;
(c) Energy industry;
(d) Materials and buildings industry; and
(e) Transportation industry.

As a starting point, management, being responsible for preparing the financial statements of the entity in accordance with the applicable financial reporting framework, should assess the likelihood and consequences of climate-related risks on the entity, which would in turn affect the entity's response and may translate into impact to financial reporting, including disclosures (where material). A consideration when assessing what information about climate-related risks and matters to disclose in the entity's financial statements is whether the information is material. Under SFRS(I) standards, information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that primary users of financial statements make on the basis of those financial statements.

When applying the financial reporting standards, management should consider whether and how climate-related matters may have a material effect on the financial statements, including the adequacy of disclosures. When applying judgements and making estimates relating to climate-related matters in the financial statements, management should ensure that such **judgements** and **estimates** are **reasonable** and **supportable**.

The key climate-related risk considerations include but are not limited to the following:

(1) Impairment of non-financial assets

The impact of climate change could be considered as an indicator of impairment, being a significant change with adverse effects on entities in the technological, market, economic or legal environment in which they operate, if such change has already taken place or may take place in the future. In addition, notable decline in the demand or sale prices of products perceived to contribute to climate change could be another impairment indicator as this might suggest that the asset or cash-generating unit, such as a manufacturing facility, has declined in value more significantly than would be expected from the passage of time or normal use. Assets may become impaired in areas vulnerable to physical risk.

(a) Use of reasonable and supportable assumptions in the cash flow projections for estimating the value-in-use (VIU) of non-financial assets

Over time, the impact of climate change may result in changes to an entity's cost base and adjustments to the forecast income expected to be generated from an asset. Consequently, this will affect the assumptions made in VIU calculation. Entities may consider some form of restructuring or enhancements to be made to their assets where capital expenditure is likely to be required to meet their sustainability targets or reduce their carbon footprints.

In addition, it may not always be appropriate for impairment models to assume positive growth rates at the rate of long-term inflation. In the business-as-usual (BAU) scenario where the entity is unable to shift to a viable business model, the growth rates should be flat or negative as a positive growth rate is not justified.

(b) Use of expected cash flow approach

The expected cash flow approach which considers **probability-weighted multiple scenarios** could be more effective in capturing the increased uncertainties arising from climate risk as compared to an approach which uses a single set of cash flows and a single discount rate.

(c) Discount rate

The same risks should not be double-counted in both the discount rate and cash flows. It should also be considered that the discount rate could increase if an entity has higher exposure to climate-related risks than its peers, because providers of finance may demand a higher return for riskier investments.

(2) Impact on useful lives, residual values, and recoverability of assets

The useful lives, residual values, and recoverability of assets will be affected by changes in the entity's business model in response to new / changes in regulations, as measures taken by governments in various jurisdictions to combat climate change.

(3) Contingent liabilities and provision for onerous contracts

Climate change and related legislation may bring about changes in existing provisions for abandonment and decommissioning obligations or even new provisions required for retirement of carbon-intensive assets. The amounts and timings of the expected cash flows for abandoning and decommissioning such assets may be affected when there is new legislation enacted by the regulator on climate-related matters. This will require entities to review their provisions which may result in new provisions being made or existing provisions being revised.

Moreover, an entity will be required to recognise a provision for onerous contracts if the unavoidable costs of meeting the obligations under the contracts exceed the economic benefits expected to be received.

(4) Sustainability-linked loan

An entity should consider whether the green variability features in the loan gives rise to an embedded derivative and, if so, whether that embedded derivative should be accounted for separately from the loan.

(5) Critical accounting estimates, judgements, and assumptions

SFRS(I) 1-1 *Presentation of Financial Statements* requires disclosures about critical accounting estimates, judgements, assumptions, and estimation uncertainty used in the preparation of financial statements. These may include:

- Reduction in useful lives of assets;
- Change in residual values of assets;
- Recoverable amounts of goodwill and property, plant and equipment including the use of multiple scenarios; and
- Recognition or measurement of provision for onerous contracts.

The sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation (including the probabilities assigned to the scenarios) is required to be disclosed when it is necessary to help users of financial statements understand, subjective or complex judgements made by management concerning the future and other key sources of estimation uncertainty.

(6) Going concern assessment

Climate-related risks may affect entities' going concern assessment, or in certain situations, the going concern assumption is no longer appropriate, especially when future profitability or financing ability may be affected adversely. Hence, material uncertainties related to climate change which cast significant doubt upon going concern are required to be considered and disclosed in the financial statements.

In addition, entities are required to consider uncertainties beyond 12 months from the end of the reporting period which may affect their abilities to continue as going concern. Cash flow projections may need to be updated and re-assessed before authorising the financial statements for issuance.

Consistency between information communicated in the financial statements and information communicated to stakeholders outside the financial statements

Management should also consider the financial impact of the entity's climate-related commitments and plans. Management should ensure **consistency** between information communicated in the financial statements and information communicated to stakeholders outside the financial statements (e.g. press releases, management commentaries, sustainability reports).

For more details, please refer to ISCA's Technical Bulletin – *Addressing Climate-Related Risks in Financial Statements and Audits of such Financial Statements*.

Contact us

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

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