



# Singapore Financial Reporting Standard

Pocket Guide  
2009 Edition

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# Singapore Financial Reporting Standards Pocket guide 2009

This pocket guide provides a summary of the recognition and measurement requirements of Singapore Financial Reporting Standards (SFRS) issued up to June 2009, and the presentation and disclosure requirements of FRS 1 (revised), 'Presentation of financial statements'. However, it does not address most disclosure requirements under other SFRS.

There is a choice within FRS 1 (revised) of presenting income and expense as a single statement or as two statements. The sections below assume the adoption of the two-statement approach for the presentation of income and expense (that is, an 'income statement' and a 'statement of comprehensive income'), with the exception of section 3, 'Presentation of financial statements under FRS 1 (revised)'. This assumes the adoption of the single statement approach (that is, a 'statement of comprehensive income').

The information in this guide is arranged in six sections:

- Accounting rules and principles
- Income statement and related notes
- Balance sheet and related notes
- Consolidated and separate financial statements
- Other subjects
- Industry-specific topics

More detailed guidance and information on these topics can be found in other publications from PricewaterhouseCoopers LLP.

*SFRS pocket guide 2009* is designed for the information of readers. While every effort has been made to ensure accuracy, information contained in this publication may not be comprehensive or may have been omitted which may be relevant to a particular reader. In particular, this booklet is not intended as a study of all aspects of the Singapore Financial Reporting Standards and does not address the disclosure requirements for each standard. The booklet is not a substitute for reading the Standards when dealing with points of doubt or difficulty. No responsibility for loss to any person acting or refraining from acting as a result of any material in this publication can be accepted by PricewaterhouseCoopers LLP. Recipients should not act on the basis of this publication without seeking professional advice.



## Contents

<b>Introduction</b>	4
<b>Accounting rules and principles</b>	
1. Accounting principles and applicability of SFRS	4
2. First-time adoption of SFRS – FRS 101	5
3. Presentation of financial statements – FRS 1 (revised)	6
4. Accounting policies, accounting estimates and errors – FRS 8	9
5. Financial instruments – FRS 32, FRS 39 and FRS 107	10
6. Foreign currencies – FRS 21, FRS 29	17
7. Insurance contracts – FRS 104	17
<b>Income statement and related notes</b>	
8. Revenue – FRS 18, FRS 11 and FRS 20	19
9. Segment reporting – FRS 108	20
10. Employee benefits – FRS 19	21
11. Retirement benefit plans – FRS 26	23
12. Share-based payment – FRS 102	23
13. Taxation – FRS 12	24
14. Earnings per share – FRS 33	25
<b>Balance sheet and related notes</b>	
15. Intangible assets	26
16. Property, plant and equipment – FRS 16	27
17. Investment property – FRS 40	28
18. Impairment of non-financial assets – FRS 36	29
19. Lease accounting – FRS 17	29
20. Inventories – FRS 2	30
21. Provisions and contingencies – FRS 37	30
22. Post-balance-sheet events and financial commitments – FRS 10	32
23. Share capital and reserves	33
<b>Consolidated and separate financial statements</b>	
24. Consolidated and separate financial statements – FRS 27	34
24a. Consolidated and separate financial statements – FRS 27 (revised)	35
25. Business combinations – FRS 103	35
25a. Business combinations – FRS 103 (revised)	36
26. Disposals of subsidiaries, businesses and non-current assets – FRS 105	38
27. Associates – FRS 28	38
28. Joint ventures – FRS 31	39
<b>Other subjects</b>	
29. Related-party disclosures – FRS 24	40
30. Statements of Cash Flows – FRS 7	40
31. Interim reports – FRS 34	41
<b>Industry-specific topics</b>	
32. Service concession arrangements – INT FRS 29 and INT FRS 112	42
33. Agriculture – FRS 41	43
34. Extractive industries – FRS 106	43

## Introduction

Since 2003, all companies incorporated in Singapore and all Singapore branches of foreign companies are required by the Companies Act (Cap.50) to prepare and present financial statements that comply with the Singapore Financial Reporting Standards (SFRS). SFRS is principally based on and substantially similar to the International Financial Reporting Standards (IFRS) that are issued by the International Accounting Standards Board (IASB). SFRS will converge with IFRS by 2012 for use by listed companies.

Recent years have seen major changes in financial reporting worldwide. Most obvious is the continuing adoption of IFRS worldwide. Many territories have been using IFRS for some years, and more are planning to come on stream from 2011. The next wave of transitioning countries includes Korea, India, Japan, much of South and Central America and Canada. The key country in this regard – but still something of an unknown quantity – is the US. The decision about adoption of IFRS in the US is still to be taken although many US companies are acting as if it will definitely happen. Despite this, the likely adoption date is now more often quoted as 2016 rather than 2014. Convergence between IFRS and US GAAP continues in the meantime.

An important recent development is the extent to which IFRS is affected by politics. The credit crunch, the problems in the banking sector and the attempts of politicians to resolve these questions have resulted in much pressure on standard setters to amend, often at short notice, their standards, primarily those on financial instruments. This pressure is unlikely to disappear, at least in the short-term. The IASB is working hard to respond to this; we can therefore expect a continuous stream of changes to the standards in the next few months and years.

## Accounting rules and principles

### 1. Accounting principles and applicability of SFRS

The IASB has the authority to set IFRS and to approve interpretations of those standards. In Singapore, the Accounting Standards Council (ASC) has the statutory authority to issue SFRS for adoption.

IFRSs and SFRSs are intended to be applied by profit-oriented entities. These entities' financial statements give information about performance, position and cash flow that is useful to a range of users in making financial decisions. These users include shareholders, creditors, employees and the general public. A complete set of financial statements includes a:

- Statement of financial position (commonly referred to as “Balance Sheet”)
- Statement of comprehensive income
- Statement of changes in equity
- Statement of cash flows
- A description of accounting policies
- Notes to the financial statements

The concepts underlying accounting practices under SFRS are set out in the ‘Framework for the preparation and presentation of financial statements’.

## 2. First-time adoption of SFRS – FRS 101

An entity preparing for the first time financial statements in accordance with SFRS should apply these requirements. The basic requirement is the full retrospective application of all SFRSs effective at the reporting date for an entity's first FRS financial statements. For example, if an entity prepares its financial statements in accordance with SFRS for the first time in the financial year ended 31 December 2009, all the SFRSs effective for this financial year will have to be applied for all comparative financial periods. However, there are a number of exemptions and four exceptions to the requirement for retrospective application.

The exemptions cover standards for situations where retrospective application could prove to be too difficult or could result in a cost likely to exceed any benefits to users. The exemptions are optional. Any, all or none of the exemptions may be applied.

The exemptions relate to:

- Business combinations
- Share-based payment transactions
- Insurance contracts
- Fair value or revaluation as deemed cost for property, plant and equipment and other assets
- Leases
- Employee benefits
- Cumulative translation differences
- Investments in subsidiaries, jointly controlled entities and associates
- Assets and liabilities of subsidiaries, associates and joint ventures
- Compound financial instruments
- Designation of previously recognised financial instruments
- Fair value measurement of financial assets or financial liabilities at initial recognition
- Decommissioning liabilities included in the cost of property, plant and equipment.
- Service concession arrangements
- Borrowing costs

The exceptions cover areas in which retrospective application of the SFRS requirements is considered inappropriate. The exceptions are mandatory, not optional.

The exceptions relate to:

- Estimates.
- Derecognition of financial assets and financial liabilities.
- Hedge accounting.
- Some aspects of accounting for non-controlling interests.

Comparative information is prepared and presented on the basis of SFRS. Almost all adjustments arising from the first-time application of SFRS are against opening retained earnings of the first period that is presented on an SFRS basis.

Certain reconciliations from previous GAAP to SFRS are also required.

### 3. Presentation of financial statements – FRS 1 (revised)

The ASC issued FRS 1 (revised), 'Presentation of financial statements' in March 2008 to replace the existing FRS 1 (2005) for annual periods beginning on or after 1 January 2009. Early adoption is permitted.

The objective of financial statements is to provide information that is useful in making financial decisions. The objective of FRS 1 (revised) is to ensure comparability of presentation of that information with the entity's financial statements of previous periods and with the financial statements of other entities.

Financial statements are prepared on a going concern basis unless management intends either to liquidate the entity or to cease trading, or has no realistic alternative but to do so. An entity prepares its financial statements, except for cash flow information, under the accrual basis of accounting.

A complete set of financial statements comprises a statement of financial position (or 'balance sheet'), a statement of comprehensive income, a statement of changes in equity, a statement of cash flows (collectively described as the primary statements) and explanatory notes (including accounting policies).

The implementation guidance to FRS 1 (revised) contains illustrative examples of acceptable formats of presenting the primary statements.

Financial statements disclose corresponding information for the preceding period (comparatives) unless a standard or interpretation permits or requires otherwise.

#### Statement of financial position

The statement of financial position presents an entity's financial position at a specific point in time. Subject to meeting certain minimum presentation and disclosure requirements, management may use its judgement regarding the form of presentation, such as whether to use a vertical or a horizontal format, which sub-classifications to present and which information to disclose on the face of the statement or in the notes.

The following items, as a minimum, are presented on the face of the balance sheet:

- Assets – property, plant and equipment; investment property; intangible assets; financial assets; investments accounted for using the equity method; biological assets; deferred tax assets; current tax assets; inventories; trade and other receivables; and cash and cash equivalents.
- Equity – issued capital and reserves attributable to the owners of the parent; and minority (or non-controlling) interest.
- Liabilities – deferred tax liabilities; current tax liabilities; financial liabilities; provisions; and trade and other payables.
- Assets and liabilities held-for-sale – the total of assets classified as held-for-sale and assets included in disposal groups classified as held-for-sale; and liabilities included in disposal groups classified as held-for-sale in accordance with FRS 105, 'Non-current assets held-for-sale and discontinued operations'.

Current and non-current assets and current and non-current liabilities are presented as separate classifications in the statement of financial position unless presentation based on liquidity provides information that is reliable and more relevant.



## Statement of comprehensive income

The statement of comprehensive income presents an entity's performance over a specific period. Entities have a choice of presenting this in a single statement or as two statements. The statement of comprehensive income under the single-statement approach includes all items of income and expense recognised in profit and loss followed by each component of other comprehensive income classified by nature recognised in equity directly. Under the two statement approach, all components of profit or loss are presented in an income statement, followed immediately by a statement of comprehensive income. The latter statement begins with the total profit or loss for the period, followed by all components of other comprehensive income.

### *Items to be presented in statement of comprehensive income*

The following items, as a minimum, are presented in the statement of comprehensive income:

- Revenue.
- Finance costs.
- Share of the profit or loss of associates and joint ventures accounted for using the equity method.
- Tax expense.
- Post-tax profit or loss of discontinued operations aggregated with any post-tax gain or loss recognised on the measurement to fair value less costs to sell (or on the disposal) of the assets or disposal group(s) constituting the discontinued operation.
- Profit or loss for the period.
- Each component of other comprehensive income classified by nature.
- Share of the other comprehensive income of associates and joint ventures accounted for using the equity method.
- Total comprehensive income.

Profit or loss for the period and total comprehensive income are allocated in the statement of comprehensive income to the amounts attributable to minority interest and to the owners of the parent.

Additional line items or sub-headings are presented in this statement when such presentation is relevant to an understanding of the entity's financial performance.

### *Material items*

The nature and amount of items of income and expense are disclosed separately, where they are material. Disclosure may be in the statement or in the notes. Such income/expenses may include items such as restructuring costs; write-downs of inventories or property, plant and equipment; litigation settlements; and gains or losses on disposals of non-current assets.

### *Extraordinary items*

All items of income and expense are deemed to arise from an entity's ordinary activities. This categorisation is therefore prohibited.

Components of other comprehensive income include:

- Changes in carrying values recognised directly in equity (e.g. fair value changes in available-for-sale financial assets, currency translation differences on foreign operations and revaluation gains on property, plant and equipment).
- Reclassification adjustments such as reversal of cumulative fair value gains from fair value reserve to profit and loss on disposal of the investment.

### *Tax on components of other comprehensive income*

An entity presents each component of other comprehensive income in the statement either (i) net of its related tax effects, or (ii) before its related tax effects, with the aggregate tax effect of these components shown separately.

### **Statement of changes in equity**

The following items are presented in the statement of changes in equity:

- Total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to minority interest.
- For each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with FRS 8, 'Accounting policies, changes in accounting estimates, and errors'.
- Amounts of transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners.
- For each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing each change.

### **Statement of cash flows**

Cash flow statements are addressed in section 30.

### **Notes to the financial statements**

The notes are an integral part of the financial statements. Notes provide information additional to the amounts disclosed in the primary statements. They include accounting policies and critical accounting estimates and judgements.

## 4. Accounting policies, accounting estimates and errors – FRS 8

The accounting policies that an entity adopts are often those required by the specific SFRS. However, in some situations, SFRS can offer a choice of alternative accounting treatments. Management shall apply its judgement in selecting or adopting accounting policies that will result in reliable information that are relevant to the users.

Reliable financial statements shall:

- Faithfully represent the financial position, financial performance and cash flows of the entity.
- Reflect economic substance of transactions, events and conditions, and not merely the legal form.
- Be neutral.
- Be prudent.
- Be complete in all material respects.

If there is no specific SFRS standard that is applicable to a transaction or event, management shall consider the applicability of:

- The requirements and guidance in SFRS on similar and related issues.
- The definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.

Management may also consider the most recent pronouncements of other standard-setting bodies that have a similar concept framework to developing accounting standards, other accounting literature and accepted industry practices, where these do not conflict with SFRS.

Accounting policies shall be applied consistently to similar transactions and events.

### Changes in accounting policies

Changes in accounting policies made on adoption of a new standard are accounted for in accordance with the transition provisions (if any) contained within that standard. If specific transition provisions do not exist, a change in policy (whether required or voluntary) is accounted for retrospectively (that is, by restating comparative figures as if the new accounting policy had always been applied) unless this is impracticable.

### Issue of new/revised standards

Revised or new standards are normally published well in advance of their required implementation dates. In the intervening period, management shall disclose the fact that a new standard has been issued but is not yet effective. They shall also provide the known or reasonably estimable information relevant to assessing the impact that the application of the revised or new standard will have on the entity's financial statements in the period of initial application.

## Changes in accounting estimates

Many items of the financial statements cannot be measured with precision and estimates are often made. For example:

- Estimated future cash flows in the determination of the impairment allowance of receivables, goodwill and other non-financial assets.
- Fair values of financial assets and liabilities.
- Useful lives of property, plant and equipment.
- Warranty obligations.

An estimate is revised to reflect new information or changes in circumstances on which the estimate is based on. A revision of accounting estimate is not the correction of an error relating to prior periods.

Changes in accounting estimates are accounted for prospectively by including the effects of change in the income statement in the period that is affected (the period of the change and future periods). However, to the extent that the change in estimate gives rise to changes in the carrying amounts of assets, liabilities or equity, it shall be recognised by adjusting the carrying amount of the related asset, liability or equity in the period of the change.

## Errors

Errors may arise from mistakes and oversights or misinterpretation of information and are sometimes not discovered until a subsequent period. Material prior-period errors are adjusted retrospectively (that is, by restating comparative figures) unless this is impracticable

## 5. Financial instruments – FRS 32, FRS 39 and FRS 107

### Objectives and scope

The objective of the three standards is to establish requirements for all aspects of accounting for financial instruments, including distinguishing debt from equity, net presentation, recognition, derecognition, measurement, hedge accounting and disclosures.

The scope of the standards cover all types of financial instruments, including receivables, payables, investments in bonds and shares, borrowings, derivatives and equity instruments of the entity such as ordinary and preference shares. They also apply to certain contracts to buy or sell non-financial assets (such as commodities) that can be net-settled in cash or another financial instrument.

### Nature and characteristics of financial instruments

Financial instruments represent contractual rights or obligations to receive or pay cash or other financial assets. Non-financial items have a more indirect, non-contractual relationship to future cash flows.

A financial asset is:

- Cash.
- An equity instrument of another entity.
- A contractual right to receive cash or another financial asset.
- A contractual right to exchange financial assets or liabilities with another entity under conditions that are potentially favourable.

A financial liability is:

- A contractual obligation to deliver cash or another financial asset.
- A contractual obligation to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable.

An equity instrument is any contract that evidences a residual interest in the entity's assets after deducting all of its liabilities.

A derivative is a financial instrument that derives its value from an underlying price or index; requires little or no initial net investment; and is settled at a future date.

### **Embedded derivatives in host contracts**

Some financial instruments and other contracts combine, in a single contract, both a derivative and a non-derivative. The derivative part of the contract is referred to as an 'embedded derivative'. Its effect is that some of the contract's cash flows vary in a similar way to a stand-alone derivative. For example, the principal amount of a bond may vary with changes in a stock market index. In this case, the embedded derivative is an equity derivative on the relevant stock market index.

Embedded derivatives that are not 'closely related' to the rest of the contract are separated and accounted for as stand-alone derivatives (that is, measured at fair value and changes in fair value, generally recognised in profit or loss). An embedded derivative is not 'closely related' if its economic characteristics and risks are different from those of the rest of the contract. FRS 39 sets out many examples to help determine when this test is (and is not) met.

Analysing contracts for potential embedded derivatives is one of the more challenging aspects of FRS 39.

## Classification of financial instruments

The way that financial instruments are classified under FRS 39 drives how they are subsequently measured and where changes in measurement bases are accounted for. There are four classes of financial assets under FRS 39: available-for-sale, held-to-maturity, loans and receivables, and fair value through profit or loss. The factors to take into account when classifying financial assets include:

- Are the cash flows arising from the instrument fixed or determinable? Does the instrument have a maturity date?
- Are the assets held for trading? Does management intend to hold the instruments to maturity?
- Is the instrument a derivative or, does it contain an embedded derivative?
- Is the instrument quoted on an active market?
- Has management designated the instrument into a particular classification at inception?

Financial liabilities are at fair value through profit or loss if they are designated as such (subject to various conditions), if they are held for trading or if they are derivatives (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument). Otherwise they are classified as 'other liabilities' and accounted for in accordance with FRS 37, 'Provision, contingent liabilities and contingent assets'.

Financial assets and liabilities are measured either at fair value or at amortised cost, depending on their classification. Changes are taken to either the income statement or directly to equity depending on their classification.

An amendment to FRS 39, 'Financial instruments: Recognition and measurement', and FRS 107, 'Financial instruments: Disclosures', in October 2008, allows the reclassification of certain financial assets previously classified as 'held-for-trading' or 'available-for-sale' to another category under limited circumstances. Derivatives and assets designated as 'at fair value through profit or loss' under the fair value option are not eligible for this reclassification. This amendment was effective for annual periods beginning or after 1 July 2008, although a subsequent amendment confirmed that any reclassifications made on or after 1 November 2008 should take effect only from the date of the reclassification and may not be back-dated.

## Financial liability or equity?

The classification of a financial instrument by the issuer as either a liability (debt) or equity can have a significant impact on an entity's apparent gearing (debt-to-equity ratio) and reported earnings. It could also affect the entity's debt covenants.

The critical feature of debt is that under the terms of the instrument, the issuer has an unavoidable obligation to deliver either cash or another financial asset to the holder; it cannot avoid this obligation. For example, a debenture, under which the issuer is required unconditionally to make interest payments and redeem the debenture for cash, is a financial liability.

An instrument is classified as equity when it represents a residual interest in the issuer's assets after deducting all its liabilities, or when the issuer has no obligation under the terms of the instrument to deliver cash or other financial assets to another entity. Ordinary shares, or common stock, where all the payments are at the discretion of the issuer are examples of equity of the issuer.

The classification of the financial instrument into either debt or equity is based on the substance of the contractual arrangement of the instrument, rather than its legal form. This means, for example, that a mandatorily redeemable preference share, which is economically the same as a bond, is accounted for in the same way as the bond. Therefore, the mandatorily redeemable preference share is treated as a liability rather than equity, even though legally it is a share of the issuer.

Other instruments may not be as straightforward. An analysis of all the relevant terms of the instrument is necessary, particularly as some financial instruments contain both debt and equity features. Such instruments, such as bonds that are convertible into a fixed number of equity shares, are split into debt and equity (being the option to convert) components.

The treatment of interest, dividends, losses and gains in the income statement follows the classification of the related instrument. If a preference share is classified as debt, its coupon is shown as interest. However, the coupon on an instrument that is treated as equity is shown as a distribution, i.e. deducted against equity directly.

An amendment to FRS 32, 'Financial instruments: Presentation', and FRS 1, 'Presentation of financial statements', in August 2008, allows entities to classify the following types of financial instrument as equity, provided they have particular features and meet specific conditions:

- Puttable financial instruments (for example, some shares issued by co-operative entities and some partnership interests).
- Instruments or components of instruments that impose on the entity an obligation to deliver to another party a *pro rata* share of the net assets of the entity only on liquidation (for example, some shares issued by limited life entities).

This amendment is effective for annual periods beginning 1 January 2009.

## Recognition and derecognition

### *Recognition*

Recognition issues for financial assets and financial liabilities tend to be straightforward. An entity recognises a financial asset or a financial liability at the time it becomes a party to a contract.

### *Derecognition*

Derecognition is the term used for ceasing to recognise a financial asset or financial liability on an entity's balance sheet. The rules on derecognition are complex.

## *Assets*

An entity that holds a financial asset may raise finance using the asset as security for the finance, or as the primary source of cash flows from which to repay the finance. The derecognition requirements of FRS 39 determines whether the transaction is a sale of the financial assets (and therefore the entity ceases to recognise the assets) or whether finance has been secured on the assets (and the entity recognises a liability for any proceeds received). This evaluation might be straightforward. For example, it is clear with little or no analysis that a financial asset is derecognised in an unconditional transfer of it is to an unconsolidated third party, with no risks and rewards of the asset being retained. Conversely, derecognition is not allowed where an asset has been transferred but substantially all the risks and rewards of the asset have been retained through the terms of the agreement. However, in many other cases, the analyses are more complex. Securitisation and debt factoring are examples of more complex transactions where derecognition will need careful consideration.

## *Liabilities*

An entity may only cease to recognise (derecognise) a financial liability when it is extinguished – that is, when the obligation is discharged, cancelled or expired, or when the debtor is legally released from the liability by law or by the creditor agreeing to such a release.

## **Measurement of financial assets and liabilities**

All financial instruments are measured initially at fair value. The fair value of a financial instrument is normally the transaction price, i.e. the amount of the consideration given or received. However, in some circumstances, the transaction price may not be indicative of fair value. In such a situation, an appropriate fair value is determined using data from current observable transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets.

The measurement of financial instruments after initial recognition depends on their initial classification. All financial assets are measured at fair value except for loans and receivables, held-to-maturity assets and, in rare circumstances, unquoted equity instruments whose fair values cannot be measured reliably, or derivatives linked to and that must be settled by the delivery of such unquoted equity instruments that cannot be measured reliably.

Loans and receivables and held-to-maturity investments are measured at amortised cost. The amortised cost of a financial asset or financial liability is measured using the 'effective interest method'.

Available-for-sale financial assets are measured at fair value, with changes in fair value recognised in other comprehensive income. For available-for-sale debt securities, interest is recognised in income using the 'effective interest method'. Dividends on available-for-sale equity securities are recognised in income as the holder becomes entitled to them.

Derivatives (including separated embedded derivatives) are measured at fair value. All fair value gains and losses are recognised in profit or loss except where they qualify as hedging instruments in cash flow hedges.



Financial liabilities are measured at amortised cost using the effective interest method unless they are classified at fair value through profit or loss.

Financial assets and financial liabilities that are designated as hedged items may require further adjustments under the hedge accounting requirements.

All financial assets, except those measured at fair value through profit or loss, are subject to review for impairment. Where there is objective evidence that such a financial asset may be impaired, the impairment loss is calculated and recognised in profit or loss.

## Hedge accounting

'Hedging' is the process of using a financial instrument (usually a derivative) to mitigate all or some of the risk of a hedged item. 'Hedge accounting' changes the timing of recognition of gains and losses on either the hedged item or the hedging instrument so that both are recognised in profit or loss in the same accounting period.

To qualify for hedge accounting, an entity (a) at the inception of the hedge, formally designates and documents a hedge relationship between a qualifying hedging instrument and a qualifying hedged item; and (b) both at inception and on an ongoing basis, demonstrates that the hedge is highly effective.

There are three types of hedge relationship:

- Fair value hedge – a hedge of the exposure to changes in the fair value of a recognised asset or liability, or a firm commitment.
- Cash flow hedge – a hedge of the exposure to variability in cash flows of a recognised asset or liability, a firm commitment or a highly probable forecast transaction.
- Net investment hedge – a hedge of the foreign currency risk on a net investment in a foreign operation.

For a fair value hedge, the hedged item is adjusted for the gain or loss attributable to the hedged risk. That element is included in the income statement where it will offset the gain or loss on the hedging instrument.

For a cash flow hedge, gains and losses on the hedging instrument, to the extent it is an effective hedge, are initially included in equity. They are reclassified to profit or loss when the hedged item affects the income statement. If the hedged item is the forecast acquisition of a non-financial asset or liability, the entity may choose an accounting policy of adjusting the carrying amount of the non-financial asset or liability for the hedging gain or loss at acquisition.

Hedges of a net investment in a foreign operation are accounted for similarly to cash flow hedges. INT FRS 116, 'Hedges of a net investment in a foreign operation', issued in September 2008, clarifies that net investment hedging relates to differences in functional currency not presentation currency, and that hedging instruments may be held anywhere in the group. The requirements of FRS 21, 'The effects of changes in foreign exchange rates', still apply to the hedged item. This interpretation is effective for periods beginning on or after 1 October 2008.

An amendment to FRS 39 in December 2008 regarding 'eligible hedged items' has made two significant changes. It prohibits designating inflation as a hedgeable component of a fixed rate debt. It also prohibits including time value in the one-sided hedged risk when designating options as hedges. This amendment is effective for accounting periods beginning on or after 1 July 2009 and is applied retrospectively.

## Presentation and disclosure

There have been significant developments in risk management concepts and practices in recent years. New techniques have evolved for measuring and managing exposures to risks arising from financial instruments. This, coupled with the significant volatility experienced in the financial markets, has increased the need for more relevant information and greater transparency about an entity's exposures arising from financial instruments and how those risks are managed. Financial statement users and other investors need such information to make more informed judgements about risks that entities run from the use of financial instruments and their associated returns.

FRS 107 sets out disclosure requirements that are intended to enable users to evaluate the significance of financial instruments for an entity's financial position and performance, and to understand the nature and extent of risks arising from those financial instruments to which the entity is exposed. Both qualitative and quantitative disclosures are required. The qualitative disclosures describe management's objectives, policies and processes for managing those risks. The quantitative disclosures provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel.

FRS 107 does not just apply to banks and financial institutions. All entities that have financial instruments are affected – even simple instruments such as borrowings, accounts payable and receivable, cash and investments.

As part of the IASB's response to the financial crisis and addresses the G20 conclusions aimed at improving transparency and enhance accounting guidance, an amendment to IFRS 7 was published in March 2009. The amendment increased the disclosure requirements about fair value measurement and reinforced existing principles for disclosure about liquidity risk. It introduced a three-level hierarchy for fair value measurement disclosure and requires some specific quantitative disclosures for financial instruments at the lowest level in the hierarchy. It also clarifies and enhances existing requirements for the disclosure of liquidity risk, primarily requiring a separate liquidity risk analysis for derivative and non-derivative financial liabilities. The amendment is effective for accounting periods starting on or after 1 January 2009. Comparatives are not required for the first year of application.

Locally, the ASC issued the local equivalent amendments to FRS 107 in April 2009 with an identical effective date.

## 6. Foreign currencies – FRS 21, FRS 29

Many entities do business with overseas suppliers or customers, or have overseas operations. This gives rise to two main accounting issues:

- Some transactions (for example, those with overseas suppliers or customers) may be denominated in foreign currencies. These transactions are expressed in the entity's own currency ('functional currency') for financial reporting purposes.
- An entity may have foreign operations – such as overseas subsidiaries, branches or associates – that maintain their accounting records in their local currency. Because it is not possible to combine transactions measured in different currencies, the foreign operation's results and financial position are translated into a single currency, namely that in which the group's consolidated financial statements are reported ('presentation currency').

The methods required for each of the above circumstances are summarised below.

### *Expressing foreign currency transactions in the entity's functional currency*

A foreign currency transaction is expressed in the functional currency using the exchange rate at the transaction date. Foreign currency balances representing cash or amounts to be received or paid in cash ('monetary items') are reported at the end of the reporting period using the exchange rate on that date. Exchange differences on such monetary items are recognised as income or expense for the period. Non-monetary balances that are not re-measured at fair value and are denominated in a foreign currency are expressed in the functional currency using the exchange rate at the transaction date. Where a non-monetary item is re-measured at fair value in the financial statements, the exchange rate at the date when fair value was determined is used.

### *Expressing foreign operations in the group's presentation currency*

The financial statements of a foreign operation are translated into the group's presentation currency. The assets and liabilities are translated at the closing rate at the end of the reporting period. The income statement is translated at exchange rates at the dates of the transactions or at the average rate if that approximates the actual rates. All resulting exchange differences are recognised as a separate component of equity.

The financial statements of a foreign operation that has the currency of a hyperinflationary economy as its functional currency are first restated in accordance with FRS 29, 'Financial reporting in hyperinflationary economies'. All components are then translated to the presentation currency at the closing rate at the end of the reporting period.

## 7. Insurance contracts – FRS 104

Insurance contracts are contracts where an entity accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if the insured event adversely affects the policyholder. The risk transferred in the contract must be insurance risk, which is any risk except for financial risk.

FRS 104 applies to all issuers of insurance contracts whether or not the entity is legally an insurance company. It does not apply to accounting for insurance contracts by policyholders. Accounting for insurance contracts issued by insurance and financial services companies can be complex and differ from country to country; the contracts are not considered further here.

## Measurement

FRS 104 is an interim standard pending completion of Phase 2 of the IASB's project on insurance contracts. It allows entities to continue with their existing accounting policies for insurance contracts if those policies meet certain minimum criteria. However, the amount of the insurance liability is subject to a liability adequacy test. This liability adequacy test considers current estimates of all contractual and related cash flows. If the liability adequacy test identifies that the insurance liability is inadequate, the entire deficiency is recognised in the income statement.

Accounting policies modelled on FRS 37, 'Provisions, contingent liabilities and contingent assets', are appropriate in cases where the insurer is not an insurance company.

## Disclosure

Disclosure is particularly important for information relating to insurance contracts, as insurers can continue to use their existing accounting policies. FRS 104 has two main principles for disclosure. Insurers should disclose:

- Information that identifies and explains the amounts in its financial statements arising from insurance contracts.
- Information that enables users of its financial statements to evaluate the nature and extent of risks arising from insurance contracts.

## Income statement and related notes

### 8. Revenue – FRS 18, FRS 11 and FRS 20

#### Revenue – FRS 18

Revenue is measured at the fair value of the consideration received or receivable.

Revenue arising from the sale of goods is recognised when an entity transfers the significant risks and rewards of ownership and gives up managerial involvement usually associated with ownership and control, if it is probable that economic benefits will flow to the entity and the amount of revenue and costs can be measured reliably.

Examples of transactions where the entity retains significant risks and rewards of ownership and revenue is not recognised are when:

- The entity retains an obligation for unsatisfactory performance not covered by normal warranty provisions.
- The receipt of revenue from a particular sale is contingent on the buyer in turn obtaining revenue from its sale of the goods.
- The buyer has the power to rescind the purchase for a reason specified in the sales contract and the entity is uncertain about the probability of return.
- When the goods are shipped subject to installation and that installation is a significant part of the contract.

Revenue from the rendering of services is recognised when the outcome of the transaction can be estimated reliably, by reference to the stage of completion of the transaction at the balance sheet date, using requirements similar to those for construction contracts. The outcome of a transaction can be estimated reliably when the amount of revenue can be measured reliably, it is probable that economic benefits will flow to the entity, the stage of completion can be measured reliably and the costs incurred and costs to complete can be reliably measured.

When the substance of a single transaction indicates that it includes separately identifiable components, revenue should be allocated to these components by reference to their fair values, and recognised for each component separately by applying the recognition criteria below. For example, when a product is sold with a subsequent service, revenue will be allocated initially to the product component and the service component, and recognised separately thereafter when the criteria for revenue recognition are met for each component.

Interest income is recognised using the effective interest rate method. Royalties are recognised on an accruals basis in accordance with the substance of the relevant agreement. Dividends are recognised when the shareholder's right to receive payment is established.

#### Construction contracts – FRS 11

A construction contract is a contract specifically negotiated for the construction of an asset, or combination of assets, including contracts for the rendering of services directly related to the construction of the asset (such as project managers and architects services). Such contracts are typically fixed-price or cost-plus contracts.

Revenue and expenses on construction contracts are recognised using the percentage-of-completion method. This means that revenue, expenses and therefore profit are recognised gradually as contract activity occurs.

When the outcome of the contract cannot be estimated reliably, revenue is recognised only to the extent of those costs incurred and are recoverable; contract costs are recognised as an expense as incurred. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

## **Government grants – FRS 20**

Government grants are recognised when there is reasonable assurance that the entity will comply with the conditions related to them and that the grants will be received.

Grants related to income are recognised in the income statement over the periods necessary to match them with the related costs that they are intended to compensate. The timing of such recognition in the income statement will depend on the fulfilment of any conditions or obligations attaching to the grant.

Grants related to assets are either offset against the carrying amount of the relevant asset or presented as deferred income (liability) in the balance sheet. The income statement will be affected either by a reduced depreciation charge or by recognising deferred income in the income statement systematically over the useful life of the related asset.

## **9. Segment reporting – FRS 108**

The IASB issued IFRS 8, 'Operating segments', in November 2006 as part of convergence with US GAAP. IFRS 8 is similar to the US standard SFAS 131. It replaces IAS 14. It is effective for periods beginning on or after 1 January 2009; earlier application is permitted. Locally, the ASC issued the local equivalent FRS 108 in February 2007 with an identical effective date.

All entities with listed or quoted equity or debt instruments or that are in the process of obtaining a listing or quotation of debt or equity instruments in a public market are required to disclose segment information.

Operating segments are components of an entity, identified based on internal reports on each segment that are regularly used by the entity's chief operating decision-maker (CODM) to allocate resources to the segment and to assess its performance.

Operating segments are separately reported if they meet the definition of a reportable segment. A reportable segment is an operating segment or group of operating segments that exceed the quantitative thresholds set out in the standard. An entity may, however, disclose any additional operating segment if it chooses to do so.

All reportable segments are required to provide a measure of profit and assets in the format viewed by the CODM, as well as disclosure of the revenue from customers for each group of similar products and services, revenue by geography and dependence on major customers. Other detailed disclosures of performance and resources are required if the CODM reviews these amounts. A reconciliation of the totals of revenue, profit and loss, assets and other material items reviewed by the CODM to the primary financial statements, is required.

## 10. Employee benefits – FRS 19

Employee benefits accounting – for pensions in particular, is complex. The liabilities in defined benefit pension plans are frequently material. They are long-term and difficult to measure, and this gives rise to difficulty in measuring the cost attributable to each year.

Employee benefits are all forms of consideration given or promised by an entity in exchange for services rendered by its employees. These benefits include salary-related benefits (such as wages, profit-sharing, bonuses and compensated absences, such as paid holiday and long-service leave), termination benefits (such as severance and redundancy pay) and post-employment benefits (such as retirement benefit plans). Share-based payments are addressed in FRS 102.

Post-employment benefits include pensions, post-employment life insurance and medical care. Pensions are provided to employees either through defined contribution plans or defined benefit plans.

Recognition and measurement for short-term benefits is straightforward, because actuarial assumptions are not required and the obligations are not discounted. However, long-term benefits, particularly post-employment benefits, give rise to more complicated measurement issues.

### Defined contribution plans

Accounting for defined contribution plans is straightforward: the cost of defined contribution plans for an accounting period is the contribution payable by the employer for that accounting period.

### Defined benefit plans

Accounting for defined benefit plans is complex because actuarial assumptions and valuation methods are required to measure the balance sheet obligation and the expense. The expense recognised in a period is not necessarily the contributions made in that period.

The amount reflected on the balance sheet is the defined benefit obligation less plan assets adjusted for actuarial gains and losses (see ‘corridor approach’ below).

To calculate the defined benefit obligation, estimates (actuarial assumptions) about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries and medical costs) are input into a valuation model. The benefit is then discounted to present value using the projected unit credit method. This normally requires the expertise of an actuary.

Where defined benefit plans are funded, the plan assets are measured at fair value using discounted cash flow estimates if market prices are not available. Plan assets are tightly defined, and only assets that meet the definition of plan assets may be offset against the plan’s defined benefit obligations – that is, the net surplus or deficit is shown on the balance sheet.

The re-measurement at each balance sheet date of the plan assets and the defined benefit obligation gives rise to actuarial gains and losses. There are three permissible methods under FRS 19 for recognising actuarial gains and losses:

- Under the 'Other Comprehensive Income approach', actuarial gains and losses are recognised immediately in other comprehensive income.
- Under the 'Corridor approach', any actuarial gains and losses that fall outside the higher of 10 per cent of the present value of the defined benefit obligation or 10 per cent of the fair value of the plan assets (if any) are amortised over no more than the remaining working life of the employees.
- Faster recognition, including immediate recognition in full, in profit and loss is allowed.

FRS 19 analyses the changes in the plan assets and liabilities into various components, the net total of which is recognised as an expense or income in profit and loss. These components include:

- Current service cost (the present value of the benefits earned by active employees in the current period).
- Interest cost (the unwinding of the discount on the defined benefit obligation) .
- Expected return on any plan assets (expected interest, dividends and capital growth of plan assets).
- Actuarial gains and losses, to the extent they are recognised in profit and loss (see above).
- Past-service costs (the change in the present value of the plan liabilities relating to employee service in prior periods arising from changes to post-employment benefits).

Past-service costs are recognised as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits are already vested, the past service cost is recognised as an expense immediately. Gains and losses on the curtailment or settlement of a defined benefit plan are recognised in profit and loss when the curtailment or settlement occurs.

When plan assets exceed the defined benefit obligation, INT FRS 114, 'FRS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction', provides guidance on assessing the amount that can be recognised as an asset. It also explains how the pension asset or liability may be affected by a statutory or contractual minimum funding requirement.



## 11. Retirement benefit plans – FRS 26

Financial statements for retirement benefit plans prepared in accordance with FRS should comply with FRS 26, 'Accounting and reporting by retirement benefit plans'.

For a defined contribution plan, the report includes:

- A statement of net assets available for benefits.
- A statement of changes in net assets available for benefits.
- A summary of significant accounting policies.
- A description of the plan and the effect of any changes in the plan during the period.
- A description of the funding policy.

For a defined benefit plan, the report includes:

- Either a statement that shows the net assets available for benefits, the actuarial present value of promised retirement benefits and the resulting excess or deficit, or a reference to this information in an accompanying actuarial report.
- A statement of changes in net assets available for benefits.
- A cash flow statement.
- A summary of significant accounting policies.
- A description of the plan and the effect of any changes in the plan during the period.

The report also explains the relationship between the actuarial present value of promised retirement benefits and the net assets available for benefits, and the policy for the funding of promised benefits. Investments held by all retirement plans (whether defined benefit or defined contribution) are carried at fair value.

## 12. Share-based payment – FRS 102

Share-based payment transactions are transactions in which entities receive goods or services as consideration for either:

- Equity instruments of the entity (or the entity's parent or another entity within the same group) – 'equity-settled share-based payment'; or
- Cash or other assets, where the amount is based on the price or value of the entity's shares – 'cash-settled share-based payment'.

The most common application is to employee share schemes, such as share option schemes. However, entities sometimes also pay for other expenses such as professional fees, and for the purchase of assets, by means of share-based payment.

The accounting treatment under FRS 102 is based on the fair value of the instruments. The accounting can be difficult, due to the complex models that need to be used to calculate the fair value of options and also due to the variety and complexity of schemes. In addition, the standard requires extensive disclosures. The result generally is to reduce reported profits, especially in entities that use share-based payment extensively as part of their remuneration strategy.

All transactions involving share-based payment are recognised as expenses or assets over any vesting period.

Equity-settled share-based payment transactions are measured at the grant date fair value for employee services; and, for non-employee transactions, at the fair value of the goods or services received at the date on which the entity recognises the goods or services. If the fair value of the goods or services cannot be estimated reliably – such as employee services and circumstances in which the goods or services cannot be specifically identified – the entity uses the fair value of the equity instruments granted. Since the publication of INT FRS108, 'Scope of FRS 102', in 2006, management needs to consider if there are any unidentifiable goods or services received or to be received by the entity, as these also have to be measured in accordance with FRS 102.

Equity-settled share-based payment transactions are not re-measured once the grant date fair value has been determined.

The treatment is different for cash-settled share-based payment transactions: cash-settled awards are measured at the fair value of the liability. The liability is re-measured at each balance sheet date up to the date of settlement, with changes in fair value recognised in the income statement.

### **13. Taxation – FRS 12**

FRS 12 only deals with taxes on income, comprising current tax and deferred tax.

Current tax expense for a period is based on the taxable and deductible amounts that will be shown on the tax return for the current year. An entity recognises a liability in the balance sheet in respect of current tax expense for the current and prior periods to the extent unpaid. It recognises an asset if current tax has been overpaid.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

Tax payable based on taxable profit seldom matches the tax expense that might be expected based on pre-tax accounting profit. The mismatch can occur because FRS recognition criteria for items of income and expense are different from the treatment of items under tax law.

Deferred tax accounting seeks to deal with this mismatch. It is based on the temporary differences between the tax base of an asset or liability and its carrying amount in the financial statements. For example, if an investment property is revalued upwards but not sold, the revaluation creates a temporary difference (the carrying amount of the asset in the financial statements is greater than the tax base of the asset), and the tax consequence is a deferred tax liability.

Deferred tax is provided in full for all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements, except when the temporary difference arises from:

- Initial recognition of goodwill (for deferred tax liabilities only).
- Initial recognition of an asset or liability in a transaction that is not a business combination and that affects neither accounting profit nor taxable profit.
- Investments in subsidiaries, branches, associates and joint ventures, but only where certain criteria apply.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. Discounting of deferred tax assets and liabilities is not permitted.

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the entity expects, at the balance sheet date, to recover or settle the carrying amount of its assets and liabilities. The expected manner of recovery for land with an unlimited life is always through sale. For other assets, the manner in which management expects to recover the asset (that is, through use or sale or a combination of both) should be considered at each balance sheet date.

Management only recognises a deferred tax asset for deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised. This also applies to deferred tax assets for unused tax losses carried forward.

Current and deferred tax is recognised in profit or loss for the period, unless the tax arises from a business combination or a transaction or event that is recognised outside profit or loss, either in other comprehensive income or directly in equity in the same or different period. The tax consequences that accompany, for example, a change in tax rates or tax laws, a reassessment of the recoverability of deferred tax assets or a change in the expected manner of recovery of an asset are recognised in profit or loss, except to the extent that they relate to items previously charged or credited outside profit or loss.

## 14. Earnings per share – FRS 33

Earnings per share (EPS) is a ratio that is widely used by financial analysts, investors and others to gauge a company's profitability and to value its shares. EPS is normally calculated in the context of common shares of the entity. Earnings attributable to common shareholders are therefore determined by deducting from net income the earnings attributable to holders of more senior equity instruments.

An entity whose ordinary shares or potential ordinary shares are publicly traded, or that are in the process of issuing such shares or potential shares in public markets, is required to disclose both basic and diluted EPS with equal prominence in its separate or individual financial statements, or in its consolidated financial statements if it is a parent.

EPS is normally calculated in the context of ordinary shareholders of the parent. Net profit is therefore reduced by distribution to holders of more senior equity instruments to arrive at earnings attributable to ordinary shareholders for the purpose of computing EPS.

Basic EPS is calculated by dividing the profit or loss for the period attributable to the equity holders of the parent by the weighted average number of ordinary shares outstanding (including adjustments for bonus and rights issues).

Diluted EPS is calculated by adjusting the profit or loss and the weighted average number of ordinary shares by taking into account the conversion of any dilutive potential ordinary shares. Potential ordinary shares are those financial instruments and contracts that may result in issuing ordinary shares such as convertible bonds and options (including employee stock options).

Basic and diluted EPS for both continuing and total operations are presented with equal prominence in the statement of comprehensive income – or in the separate income statement where one is presented – for each class of ordinary shares. Separate EPS figures for discontinued operations are disclosed in the same statements or in the notes.

## Balance sheet and related notes

### 15. Intangible assets

An intangible asset is an identifiable non-monetary asset without physical substance. The identifiable criterion is met when the intangible asset is separable (that is, when it can be sold, transferred or licensed), or where it arises from contractual or other legal rights.

#### *Separately acquired intangible assets*

Separately acquired intangible assets are recognised initially at cost. Cost comprises the purchase price, including import duties and non-refundable purchase taxes and any directly attributable costs of preparing the asset for its intended use. The purchase price of a separately acquired intangible asset incorporates assumptions about the probable economic future benefits that may be generated by the asset.

#### *Internally generated intangible assets*

The process of generating an intangible asset is divided into a research phase and a development phase. No intangible assets arising from the research phase may be recognised. Intangible assets arising from the development phase are recognised when the entity can demonstrate:

- Its technical feasibility.
- Its intention to complete the developments.
- Its ability to use or sell the intangible asset.
- How the intangible asset will generate probable future economic benefits (for example, the existence of a market for the output of the intangible asset or for the intangible asset itself).
- The availability of resources to complete the development.
- Its ability to measure the attributable expenditure reliably.

Any expenditure written off during the research or development phase cannot subsequently be capitalised if the project meets the criteria for recognition at a later date.

In addition, internally generated brands, mastheads, customer lists, publishing titles and goodwill are specifically not to be recognised as intangible assets. Research, start-up and advertising costs are also not considered intangible assets.

#### *Intangible assets acquired in a business combination*

If an intangible asset is acquired in a business combination, both the probability and measurement criterion are always considered to be met. An intangible will therefore always be recognised, regardless of whether it has been previously recognised in the acquiree's financial statements.

### **Subsequent measurement**

Intangible assets are amortised unless they have an indefinite useful life. Amortisation is carried out on a systematic basis over the useful life of the intangible asset. An intangible asset has an indefinite useful life when, based on an analysis of all the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

Intangible assets with finite useful lives are considered for impairment when there is an indication that the asset has been impaired. Intangible assets with indefinite useful lives and intangible assets not yet in use are tested annually for impairment and whenever there is an indication of impairment.

## **16. Property, plant and equipment – FRS 16**

Property, plant and equipment (PPE) is recognised when the cost of an asset can be reliably measured and it is probable that the entity will obtain future economic benefits from the asset.

PPE is measured initially at cost. Cost includes the fair value of the consideration given to acquire the asset (net of discounts and rebates) and any directly attributable cost of bringing the asset to working condition for its intended use (inclusive of import duties and non-refundable purchase taxes).

Directly attributable costs include the cost of site preparation, delivery, installation costs, relevant professional fees and the estimated cost of dismantling and removing the asset and restoring the site (to the extent that such a cost is recognised as a provision). Classes of PPE are carried at historical cost less accumulated depreciation and any accumulated impairment losses (the cost model), or at a revalued amount less any accumulated depreciation and subsequent accumulated impairment losses (the revaluation model). The depreciable amount of PPE (being the gross carrying value less the estimated residual value) is depreciated on a systematic basis over its useful life.

Subsequent expenditure relating to an item of PPE is capitalised if it meets the recognition criteria.

PPE may comprise parts with different useful lives. Depreciation is calculated based on each individual part's life. In case of replacement of one part, the new part is capitalised to the extent that it meets the recognition criteria of an asset, and the carrying amount of the parts replaced is derecognised.

The cost of a major inspection or overhaul of an item occurring at regular intervals over the useful life of the item is capitalised to the extent that it meets the recognition criteria of an asset. The carrying amounts of the parts replaced are derecognised.

## **Borrowing costs**

Under FRS 23 (revised 2007), 'Borrowing costs', entities no longer have a policy choice to capitalise or expense borrowing costs incurred that are directly attributable to the acquisition, production or construction of a qualifying asset. FRS 23 (revised) requires borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset to be capitalised.

FRS 23 (revised) is effective for accounting periods beginning on or after 1 January 2009. Earlier application is permitted.

## **17. Investment property – FRS 40**

Certain properties are classified as 'investment properties' for financial reporting purposes, as the characteristics of these properties differ significantly from owner-occupied properties. It is the current value of such properties and changes to those values that are relevant to users of financial statements.

An investment property is property (land or a building, or part of a building or both) held by an entity to earn rentals and/or for capital appreciation and includes one that is being developed for future use as an investment property. Any other properties are accounted for as property, plant and equipment (PPE) in accordance with FRS 16, 'Property, plant and equipment', if they are held for use in the production or supply of goods or services; or as inventory in accordance with FRS 2, 'Inventories', if they are held-for-sale in the ordinary course of business. Owner-occupied property does not meet the definition of investment property.

Initial measurement of an investment property is the fair value of its purchase consideration plus any directly attributable costs. Subsequent to initial measurement, management may choose as its accounting policy either to carry investment properties at fair value or at cost. The policy chosen is applied consistently to all the investment properties that the entity owns.

Fair value is the price at which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction. Changes in fair value are recognised in profit or loss in the period in which they arise.

The cost model requires investment properties to be carried at cost less accumulated depreciation and any accumulated impairment losses consistent with the treatment of PPE; the fair values of these properties disclosed in the notes.

## 18. Impairment of non-financial assets – FRS 36

Nearly all assets – current and non-current – are subject to an impairment test to ensure that they are not overstated on balance sheets.

The basic principle of impairment is that an asset may not be carried on the balance sheet above its recoverable amount. Recoverable amount of a non-financial asset is defined as the higher of the asset's fair value less costs to sell and its value in use. Fair value less costs to sell is the amount obtainable from a sale of an asset in an arm's length transaction between knowledgeable, willing parties, less costs of disposal. Value in use requires management to estimate the future cash flows to be derived from the asset and discount them using a pre-tax market rate that reflects current assessments of the time value of money and the risks specific to the asset.

All assets subject to the impairment guidance are tested for impairment where there is an indication that the asset may be impaired. Certain assets (goodwill, indefinite lived intangible assets and intangible assets that are not yet available for use) are also tested for impairment annually even if there is no impairment indicator.

When considering whether an asset is impaired, both external indicators (for example, significant adverse changes in the technological, market, economic or legal environment or increases in market interest rates) and internal indicators (for example, evidence of obsolescence or physical damage of an asset or evidence from internal reporting that the economic performance of an asset is, or will be, worse than expected) are considered.

Recoverable amount is calculated at the individual asset level. However, an asset seldom generates cash flows independently of other assets, and most assets are tested for impairment in groups of assets described as cash-generating units (CGUs). A CGU is the smallest identifiable group of assets that generates inflows that are largely independent from the cash flows from other CGUs.

The carrying value of an asset is compared to the recoverable amount (being the higher of value in use or fair value less costs to sell). An asset or CGU is impaired when its carrying amount exceeds its recoverable amount. Any impairment is allocated to the asset or assets of the CGU, with the impairment loss recognised in the profit or loss.

Goodwill acquired in a business combination is allocated to the acquirer's CGUs or groups of CGUs that are expected to benefit from the synergies of the business combination. However, the largest group of CGUs permitted for goodwill impairment testing is at the operating segment level, as defined in FRS 108 paragraph 5, before the aggregation permitted by FRS 108, paragraph 12.

## 19. Lease accounting – FRS 17

A lease gives one party (the lessee) the right to use an asset over an agreed period of time in return for payment to the lessor. Leasing is an important source of medium- and long-term financing; accounting for leases can have a significant impact on lessees' and lessors' financial statements.

Leases are classified as finance or operating leases at inception, depending on whether substantially all the risks and rewards of ownership transfer to the lessee. Under a finance lease, the lessee has substantially all of the risks and reward of ownership. All other leases are operating leases. Leases of land and buildings are considered separately under FRS.

Under a finance lease, the lessee recognises an asset held under a finance lease and a corresponding finance lease liability. The lessee depreciates the asset.

The lessor recognises the future lease as a receivable. The receivable is measured at the 'net investment' in the lease – the minimum lease payments receivable, discounted at the internal rate of return of the lease, plus the unguaranteed residual which accrues to the lessor.

Under an operating lease, the lessee does not recognise an asset and lease obligation. The lessor continues to recognise the leased asset and depreciates it. The rentals paid are normally charged to the income statement of the lessee and credited to that of the lessor on a straight-line basis.

Linked transactions with the legal form of a lease are accounted for on the basis of their substance – for example, a sale and leaseback where the seller is committed to repurchase the asset may not be a lease in substance if the 'seller' retains the risks and rewards of ownership and substantially the same rights of use as before the transaction. Conversely, some transactions that do not have the legal form of a lease are in substance leases if they are dependent on a particular asset that the purchaser can control physically or economically.

## **20. Inventories – FRS 2**

Inventories are initially recognised at cost. Cost of inventories includes import duties, non-refundable taxes, transport and handling costs and any other directly attributable costs less trade discounts, rebates and similar items.

Inventories are valued at the lower of cost and net realisable value (NRV). NRV is the estimated selling price in the ordinary course of business, less the estimated costs of completion and estimated selling expenses.

FRS 2, 'Inventories', requires the cost for items that are not interchangeable or that have been segregated for specific contracts to be determined on an individual-item basis. The cost of other items of inventory used is assigned by using either the first-in, first-out (FIFO) or weighted average cost formula. Last-in, first-out (LIFO) is not permitted. An entity uses the same cost formula for all inventories that have a similar nature and use to the entity. A different cost formula may be justified where inventories have a different nature or use. The cost formula used is applied on a consistent basis from period to period.

## **21. Provisions and contingencies – FRS 37**

A liability is a 'present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits'. A provision falls within the category of liabilities and is defined as 'a liability of uncertain timing or amount'.



### *Recognition and initial measurement*

A provision is recognised when: the entity has a present obligation to transfer economic benefits as a result of past events; it is probable (more likely than not) that such a transfer will be required to settle the obligation; and a reliable estimate of the amount of the obligation can be made.

The amount recognised as a provision is the best estimate of the expenditure required to settle the obligation at the balance sheet date, measured at the expected cash flows discounted for the time value of money. Provisions are not recognised for future operating losses.

A present obligation arises from an obligating event and may take the form of either a legal obligation or a constructive obligation. An obligating event leaves the entity no realistic alternative to settling the obligation. If the entity can avoid the future expenditure by its future actions, it has no present obligation, and no provision is required. For example, an entity cannot recognise a provision based solely on the intent to incur expenditure at some future date or the expectation of future operating losses (unless these losses relate to an onerous contract).

An obligation does not generally have to take the form of a 'legal' obligation before a provision is recognised. An entity may have an established pattern of past practice that indicates to other parties that it will accept certain responsibilities and as a result has created a valid expectation on the part of those other parties that it will discharge those responsibilities (that is, the entity is under a constructive obligation).

If an entity has an onerous contract (one where the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it), the present obligation under the contract is recognised as a provision. Impairments of any related assets are recognised before making a provision.

### *Restructuring provisions*

There are specific requirements for restructuring provisions. A provision is recognised when there is: (a) a detailed formal plan identifying the main features of the restructuring; and (b) a valid expectation in those affected that the entity will carry out the restructuring by starting to implement the plan or by announcing its main features to those affected.

A restructuring plan does not create a present obligation at the balance sheet date if it is announced after that date, even if it is announced before the financial statements are approved. No obligation arises for the sale of an operation until the entity is committed to the sale (that is, there is a binding sale agreement).

The provision only includes incremental costs necessarily resulting from the restructuring and not those associated with the entity's ongoing activities. Any expected gains on the sale of assets are not considered in measuring a restructuring provision.

### *Reimbursements*

An obligation and any anticipated recovery are presented separately as a liability and an asset respectively; however, an asset can only be recognised if it is virtually certain that settlement of the obligation will result in a reimbursement, and the amount recognised for the reimbursement should not exceed the amount of the provision. The amount of any expected reimbursement is disclosed. Net presentation is permitted only in the income statement.

### *Subsequent measurement*

Management performs an exercise at each balance sheet date to identify the best estimate of the expenditure required to settle the present obligation at the balance sheet date, discounted at an appropriate rate. The increase in provision due to the passage of time is recognised as interest expense.

### *Contingent liabilities*

Contingent liabilities are possible obligations whose existence will be confirmed only on the occurrence or non-occurrence of uncertain future events outside the entity's control, or present obligations that are not recognised because: (a) it is not probable that an outflow of economic benefits will be required to settle the obligation; or (b) the amount cannot be measured reliably.

Contingent liabilities are not recognised but are disclosed and described in the notes to the financial statements, including an estimate of their potential financial effect and uncertainties relating to the amount or timing of any outflow, unless the possibility of settlement is remote.

### *Contingent assets*

Contingent assets are possible assets whose existence will be confirmed only on the occurrence or non-occurrence of uncertain future events outside the entity's control. Contingent assets are not recognised. When the realisation of income is virtually certain, the related asset is not a contingent asset; it is recognised as an asset.

Contingent assets are disclosed and described in the notes to the financial statements, including an estimate of their potential financial effect if the inflow of economic benefits is probable.

## **22. Post-balance-sheet events and financial commitments – FRS 10**

It is not generally practicable for preparers to finalise financial statements without a period of time elapsing between the balance sheet date and the date on which the financial statements are authorised for issue. The question therefore arises as to the extent to which events occurring between the balance sheet date and the date of approval (that is, 'events after the reporting period') should be reflected in the financial statements.

Events after the reporting period are either adjusting events or non-adjusting events. Adjusting events provide further evidence of conditions that existed at the balance sheet date – for example, determining after the year end the consideration for assets sold before the year end. Non-adjusting events relate to conditions that arose after the balance sheet date – for example, announcing a plan to discontinue an operation after the year end.

The carrying amounts of assets and liabilities at the balance sheet date are adjusted only for adjusting events or events that indicate that the going concern assumption in relation to the whole entity is not appropriate. Significant non-adjusting post-balance-sheet events, such as the issue of shares or major business combinations, are disclosed.

Dividends proposed or declared after the balance sheet date but before the financial statements have been authorised for issue are not recognised as a liability at the balance sheet date. Details of these dividends are, however, disclosed.

An entity discloses the date on which the financial statements were authorised for issue and the persons authorising the issue and, where necessary, the fact that the owners or other persons have the ability to amend the financial statements after issue.

### **23. Share capital and reserves**

Equity, along with assets and liabilities, is one of the three elements representing an entity's financial position. Equity is defined in the Framework as the residual interest in the entity's assets after deducting all its liabilities. The term 'equity' is often used to encompass an entity's equity instruments and reserves. Equity is given various descriptions in the financial statements. Corporate entities may refer to it as owners' equity, shareholders' equity, capital and reserves, shareholders' funds and proprietorship. Equity includes various components with different characteristics.

Determining what constitutes an equity instrument for the purpose of SFRS and how it should be accounted for falls within the scope of the financial instrument standard FRS 32, 'Financial instruments: Presentation'.

Different classes of share capital may be treated as either debt or equity, or a compound instrument with both debt and equity components. Equity instruments (for example, issued, non-redeemable ordinary shares) are generally recorded at the proceeds of issue net of transaction costs. Equity instruments are not re-measured after initial recognition. Reserves include retained earnings, together with fair value reserves, hedging reserves, asset revaluation reserves and foreign currency translation reserves and other statutory reserves.

#### *Treasury shares*

Treasury shares are deducted from equity. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of an entity's own treasury shares.

#### *Minority interests*

Minority interests (also known as 'non-controlling interests') in consolidated financial statements are presented as a component of equity, separately from the parent shareholders' equity.

## Disclosures

FRS 1 (revised), 'Presentation of financial statements', requires various disclosures. These include the total issued share capital and reserves, presentation of a statement of changes in equity, capital management policies and dividend information.

## Consolidated and separate financial statements

### 24. Consolidated and separate financial statements – FRS 27

This section is based on FRS 27, 'Consolidated and separate financial statements'. Revised requirements on consolidated and separate financial statements – FRS 27 (revised) – apply for annual periods beginning on or after 1 July 2009 (see section 24A).

Consolidated financial statements are prepared in respect of a group, subject to certain exceptions. All subsidiaries are consolidated. A subsidiary is an entity that is controlled by the parent. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. It is presumed to exist when the investor directly or indirectly holds more than 50 per cent of the investee's voting power; this presumption may be rebutted if there is clear evidence to the contrary. Control may also exist where less than 50 per cent of the investee's voting power is held and the parent has the power to control through, for example, the board of directors.

Consolidation of a subsidiary takes place from the date of acquisition. This is the date on which control of the net assets and operations of the acquiree is effectively transferred to the acquirer. A consolidation is prepared to show the effect as if the parent and all the subsidiaries were one entity. Transactions within the group (for example, sales from one subsidiary to another) are eliminated.

An entity with one or more subsidiaries (a parent) presents consolidated financial statements unless all the following conditions are met:

- It is itself a subsidiary (subject to no objection from any shareholder).
- Its debt or equity are not publicly traded.
- It is not in the process of issuing securities to the public.
- The ultimate or intermediate parent of the entity publishes consolidated financial statements.

There are no exemptions if the group is small or if certain subsidiaries are in a different line of business.

From the date of acquisition, the parent (the acquirer) should incorporate into the consolidated statement of comprehensive income the financial performance of the acquiree and recognise in the consolidated balance sheet the acquired assets and liabilities (at fair value), including any goodwill arising on the acquisition.

A subsidiary held exclusively for disposal that meets the definition of an asset held-for-sale is not excluded from consolidation. It is measured and accounted for under FRS 105, 'Non-current assets held-for-sale and discontinued operations', at fair value less costs to sell. The investments in subsidiaries are carried at cost or as financial assets in accordance with FRS 39, in the separate (non-consolidated) financial statements of a parent entity.

## Special purpose entities

A special purpose entity (SPE) is an entity created to accomplish a narrow, well-defined objective. It may operate in a pre-determined way so that no other party has explicit decision-making authority over its activities after formation. An entity consolidates an SPE when the substance of the relationship between the entity and the SPE indicates that the SPE is controlled by the entity. Control may arise at the outset through the pre-determination of the activities of the SPE or otherwise. An entity may be deemed to control an SPE if it is exposed to the majority of risks and rewards incidental to its activities or its assets.

### 24a. Consolidated and separate financial statements – FRS 27 (revised)

FRS 27, 'Consolidated and separate financial statements', was revised and issued in June 2009. The revised standard is effective for annual periods beginning on or after 1 July 2009. The previous version of FRS 27 is addressed in section 24.

The standard has been revised to require the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control ('economic entity model').

In addition, when control over a previous subsidiary is lost, any investment retained in the entity is re-measured to fair value and the resulting gain or loss is recognised in the statement of comprehensive income

A further revision requires profit or loss to be attributed to both the group and to the non-controlling interest even if this results in the non-controlling interest having a deficit balance. This differs from the existing FRS 27, which requires losses that create a deficit non-controlling interest to be allocated against the majority interest, except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

### 25. Business combinations – FRS 103

This overview is based on FRS 103, 'Business combinations'. Revised requirements for business combinations – FRS 103 (revised) – apply for annual periods beginning on or after 1 July 2009 (see section 25a) was issued in June 2009.

A business combination is the bringing together of separate entities or businesses into one reporting entity. A business combination may be structured in a variety of ways for tax, legal or other reasons. An acquirer is identified for accounting purposes in all business combinations. The acquirer is the entity that has obtained control of one or more other entities or businesses (the acquiree). Control is defined as the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities. A number of factors may influence which entity has control. These include equity shareholding, control of the board and control agreements. There is a presumption of control if an entity owns more than 50 per cent of the equity shareholding in another entity.

The acquirer measures the cost of the combination at the acquisition date (the date on which it obtains control over the net assets of the acquiree). The cost of the combination includes cash and cash equivalents and the fair value of any non-cash consideration given, plus any costs directly attributable to the acquisition. Any shares issued as part of the consideration are fair valued. If any of the consideration is deferred, it is discounted to reflect its present value at the acquisition date.

A portion of the consideration may be contingent on the outcome of future events or the acquired entity's performance ('contingent consideration'). Contingent consideration that can be reliably estimated and where payment is probable is recognised at fair value at the date of the business combination. Contingent consideration is adjusted against goodwill to reflect the actual outcome.

The cost of consideration, once established, is compared to the fair value of the acquiree's identifiable assets (including intangible assets not previously recognised), liabilities and contingent liabilities. The acquiree's assets and liabilities are fair valued (that is, their value is determined by reference to an arm's length transaction; the intention of the acquirer is not relevant). If the acquisition is for less than 100 per cent of the acquiree, there is a minority interest (also called 'non-controlling interest'). The minority interest represents the portion of the fair value of the net identifiable assets of an entity not owned by the parent.

The difference between the cost of acquisition and the fair value of the identifiable assets and liabilities represents goodwill. After recognising all intangibles, the goodwill balance represents synergies and certain unrecognised intangibles such as the entity's workforce. Goodwill is recognised as an asset and tested annually for impairment. If the fair value of the assets and liabilities acquired exceeds the cost of acquisition, this difference is recognised in profit and loss. This is likely to occur only in rare circumstances – for example, where there has been a bargain purchase.

## **25a. Business combinations – FRS 103 (revised)**

FRS 103, 'Business combinations', was revised and issued in June 2009. The revised standard is effective for annual periods beginning on or after 1 July 2009

A business combination is a transaction or event in which an acquirer obtains control of one or more businesses ('acquiree(s)'). Control is defined as the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities. A number of factors may influence which entity has control, including: equity shareholding, control of the board and control agreements. There is a presumption of control if an entity owns more than 50 per cent of the equity shareholding in another entity.

Business combinations occur in a variety of structures. FRS focuses on the substance of the transaction, rather than the legal form. The overall result of a series of transactions is considered if there are a number of transactions among the parties involved. For example, any transaction contingent on the completion of another transaction may be considered linked. Judgement is required to determine when transactions should be linked.

All business combinations are accounted for using the acquisition method. The acquisition method can be summarised in the following steps:

- Identify the acquirer.
- Determine the acquisition date.
- Recognise and measure the identifiable assets and liabilities and non-controlling interest.
- Recognise and measure the consideration transferred for the acquiree.
- Recognise and measure goodwill or a gain from a bargain purchase.

The acquisition method looks at a business combination from the perspective of the acquirer – that is, the entity that obtains control over another business. It first involves identifying the acquirer. The acquirer measures the consideration, fair value assets and liabilities acquired, goodwill and any non-controlling interests as of the acquisition date (the date on which it obtains control over the net assets of the acquiree).

The acquiree's identifiable assets (including intangible assets not previously recognised), liabilities and contingent liabilities are generally recognised at their fair value. Fair value is determined by reference to an arm's length transaction; the intention of the acquirer is not relevant. If the acquisition is for less than 100 per cent of the acquiree, there is a non-controlling interest. The non-controlling interest represents the equity in a subsidiary that is not attributable, directly or indirectly to the parent. The parent can elect to measure the non-controlling interest at its fair value or at its proportionate share of the identifiable net assets.

The consideration of the combination includes cash and cash equivalents and the fair value of any non-cash consideration given. Any shares issued as part of the consideration are fair valued. If any of the consideration is deferred, it is discounted to reflect its present value at the acquisition date, if the effect of discounting is material.

A portion of the consideration may be contingent on the outcome of future events or the acquired entity's performance ('contingent consideration'). Contingent consideration is also recognised at its fair value at the date of acquisition. The accounting for contingent consideration after the date of acquisition depends on whether it is classified as a liability (likely to be re-measured to fair value each reporting period through profit and loss) or equity (no re-measurement), using the guidance in FRS 32.

Goodwill is recognised for the future economic benefits arising from the other assets acquired that are not individually identified and separately recognised. If the non-controlling interest is measured at its fair value, goodwill includes amounts attributable to the non-controlling interest. If the non-controlling interest is measured at its proportionate share of identifiable net assets, goodwill includes only amounts attributable to the controlling interest – that is, the parent.

Goodwill is recognised as an asset and tested annually for impairment, or more frequently if there is an indication of impairment.

In rare situations – for example, a bargain purchase as a result of a distressed sale, it is possible that no goodwill will result from the transaction. Rather, a gain will be recognised.

## 26. Disposals of subsidiaries, businesses and non-current assets – FRS 105

FRS 105, 'Non-current assets held-for-sale and discontinued operations', is relevant when any disposal occurs or is planned. This standard applies to non-current assets (or disposal groups) whose value will be recovered principally through sale rather than through continuing use. It does not apply to assets that are being scrapped, wound down or abandoned. A disposal group is a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction.

The non-current asset (or disposal group) is classified as 'held-for-sale' if it is available for its immediate sale in its present condition and its sale is highly probable. A sale is 'highly probable' where: there is evidence of management commitment; there is an active programme to locate a buyer and complete the plan; the asset is actively marketed for sale at a reasonable price; and the sale will normally be completed within 12 months from the date of classification.

Assets (or disposal groups) classified as held-for-sale are:

- Carried at the lower of the carrying amount and fair value less costs to sell.
- Not depreciated or amortised.
- Presented separately on the face of the balance sheet (within current assets).

A discontinued operation is a component of an entity that represents a separate major line of business or geographical area that can be distinguished operationally and financially and that the entity has disposed of or classified as 'held-for-sale'. It could also be a subsidiary acquired exclusively for resale.

An operation is classified as discontinued at the date on which the operation meets the criteria to be classified as held-for-sale or when the entity has disposed of the operation. There is no retrospective classification if the criteria for that classification are not met until after the balance sheet date.

Discontinued operations are presented separately in the income statement and the cash flow statement. There are additional disclosure requirements in relation to discontinued operations.

The date of disposal of a subsidiary or disposal group is the date on which control passes. The consolidated income statement includes the results of a subsidiary or disposal group up to the date of disposal; the gain or loss on disposal is the difference between (a) the carrying amount of the net assets plus any attributable goodwill and exchange/available-for-sale amounts held in equity, and (b) the proceeds of sale.

## 27. Associates – FRS 28

An associate is an entity in which the investor has significant influence, but which is neither a subsidiary nor a joint venture of the investor. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but not to control those policies. It is presumed to exist when the investor holds at least 20 per cent of the investee's voting power. It is presumed not to exist when less than 20 per cent is held. These presumptions may be rebutted.



Associates are accounted for using the equity method unless they meet the criteria to be classified as 'held-for-sale' under FRS 105, 'Non-current assets held-for-sale and discontinued operations'. Under the equity method, the investment in the associate is initially carried at cost. It is increased or decreased to recognise the investor's share of the profit or loss of the associate after the date of acquisition.

Investments in associates are classified as non-current assets and presented as one line item in the balance sheet (inclusive of goodwill arising on acquisition). Investments in associates are tested for impairment in accordance with FRS 36, 'Impairment of assets', as single assets if there are impairment indicators under FRS 39, 'Financial instruments: Recognition and measurement'.

If an investor's share of its associate's losses exceeds the carrying amount of the investment, the carrying amount of the investment is reduced to nil. Recognition of further losses is discontinued, unless the investor has an obligation to fund the associate or the investor has guaranteed to support the associate.

In the separate (non-consolidated) financial statements of the investor, the investments in associates are carried at cost or as financial assets in accordance with FRS 39.

## **28. Joint ventures – FRS 31**

A joint venture is a contractual arrangement whereby two or more parties (the venturers) undertake an economic activity that is subject to joint control. Joint control is defined as the contractually agreed sharing of control of an economic activity.

Joint ventures fall into three categories: jointly controlled entities, jointly controlled operations and jointly controlled assets. The accounting treatment depends on the type of joint venture.

A jointly controlled entity involves the establishment of a separate entity, which may be, for example, a corporation or partnership. Jointly controlled entities are accounted for under FRS 31, 'Interest in joint ventures', using either proportionate consolidation or equity accounting. INT FRS 13, 'Jointly controlled entities – non-monetary contributions by venturers', addresses non-monetary contributions to a jointly controlled entity in exchange for an equity interest.

Jointly controlled operations and jointly controlled assets do not involve the creation of an entity that is separate from the venturers themselves. In a joint operation, each venturer uses its own resources and carries out its own part of a joint operation separately from the activities of the other venturer(s). Each venturer owns and controls its own resources that it uses in the joint operation. Jointly controlled assets involve the joint ownership of one or more assets.

Where an entity has an interest in jointly controlled operations or jointly controlled assets, it accounts for its share of the assets, liabilities, income and expenses and cash flows under the arrangement.

## Other subjects

### 29. Related-party disclosures – FRS 24

Disclosures are required in respect of an entity's transactions with related parties. Related parties include:

- Subsidiaries.
- Fellow subsidiaries.
- Associates.
- Joint ventures.
- The entity's and its parent's key management personnel (including close members of their families).
- Parties with control/joint control/significant influence over the entity (including close members of their families, where applicable).
- Post-employment benefit plans.

The name of the ultimate parent entity is disclosed if it is not mentioned elsewhere in information published with the financial statements. The names of the immediate and the ultimate controlling parties (which could be an individual or a group of individuals) are disclosed irrespective of whether there have been transactions with those related parties.

Where there have been related-party transactions, management discloses the nature of the relationship, the amount of transactions, and outstanding balances and other elements necessary for a clear understanding of the financial statements (for example, volume and amounts of transactions, amounts outstanding and pricing policies). The disclosure is made by category of related parties and by major types of transaction. Items of a similar nature may be disclosed in aggregate, except when separate disclosure is necessary for an understanding of the effects of related-party transactions on the reporting entity's financial statements.

Disclosures that related-party transactions were made on terms equivalent to those that prevail for arm's length transactions are made only if such terms can be substantiated.

### 30. Statements of Cash Flows – FRS 7

The cash flow statement is one of the primary statements in financial reporting (along with the statement of comprehensive income, the statement of financial position and the statement of changes in equity). It presents the generation and use of 'cash and cash equivalents' by category (operating, investing and finance) over a specific period of time. It provides users with a basis to assess the entity's ability to generate and utilise its cash.

Operating activities are the entity's revenue-producing activities. Investing activities are the acquisition and disposal of non-current assets (including business combinations) and investments that are not cash equivalents. Financing activities are changes in the equity and borrowings.

Management may present operating cash flows by using either the direct method (gross cash receipts/payments) or the indirect method (adjusting net profit or loss for non-operating and non-cash transactions, and for changes in working capital).

Cash flows from investing and financing activities are reported separately gross (that is, gross cash receipts and gross cash payments) unless they meet certain specified criteria.

The cash flows arising from dividends and interest receipts and payments are classified on a consistent basis and are separately disclosed under the activity appropriate to their nature. Cash flows relating to taxation on income are classified and separately disclosed under operating activities unless they can be specifically attributed to investing or financing activities.

The total that summarises the effect of the operating, investing and financing cash flows is the movement in the balance of cash and cash equivalents for the period.

Separate disclosure is made of significant non-cash transactions (such as the issue of equity for the acquisition of a subsidiary or the acquisition of an asset through a finance lease). Non-cash transactions include impairment losses/reversals; depreciation; amortisation; fair value gains/losses; and statement of comprehensive income charges for provisions.

### **31. Interim reports – FRS 34**

There is no FRS requirement for an entity to publish interim financial statements. The SGX Listing Manual does not require quarterly or interim financial information issued by SGX-listed companies to comply with FRS 34, 'Interim financial reporting'.

FRS 34 applies where an entity publishes an interim financial report in accordance with SFRS. FRS 34 sets out the minimum content that an interim financial report should contain and the principles that should be used in recognising and measuring the transactions and balances included in that report.

Entities may either prepare full SFRS financial statements (conforming to the requirements of FRS 1) or condensed financial statements. Condensed reporting is the more common approach. Condensed financial statements include a condensed statement of financial position, a condensed statement of comprehensive income, a condensed statement of cash flow, a condensed statement of changes in equity and selected note disclosures.

An entity generally uses the same accounting policies for recognising and measuring assets, liabilities, revenues, expenses and gains and losses at interim dates as those to be used in the current-year annual financial statements.

There are special measurement requirements for certain costs that can only be determined on an annual basis (for example, items such as tax that is calculated based on a full-year effective rate), and the use of estimates in the interim financial statements. An impairment loss recognised in a previous interim period in respect of goodwill, or an investment in an available-for-sale equity financial asset, is not reversed.

As a minimum, current period and comparative figures are disclosed as follows:

- Statement of financial position – as of the current interim period end with comparatives for the immediately preceding year end.
- Statement of comprehensive income – current interim period, financial year to date and comparatives for the same preceding periods (interim and year to date).
- Cash flow statement and statement of changes in equity – financial year to date with comparatives for the same year to date period of the preceding year.

FRS 34 does not mandate a list of specific disclosure requirements; instead it sets out some criteria to determine what information should be disclosed. These include:

- Materiality to the overall interim financial statements.
- Unusual or irregular items.
- Changes since previous reporting periods that have a significant effect on the interim financial statements (of the current or previous reporting financial year).
- Relevance to the understanding of estimates used in the interim financial statements.

The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period.

## Industry-specific topics

### 32. Service concession arrangements – INT FRS 29 and INT FRS 112

INT FRS 112 applies to public-to-private service concession arrangements in which the public sector body (the grantor) controls and/or regulates the services provided with the infrastructure by the private sector entity (the operator). The regulation also addresses to whom the operator should provide the services and at what price. The grantor controls any significant residual interest in the infrastructure.

As the infrastructure is controlled by the grantor, the operator does not recognise the infrastructure as its property, plant and equipment; nor does the operator recognise a finance lease receivable for leasing the public service infrastructure to the grantor, regardless of the extent to which the operator bears the risk and rewards incidental to ownership of the assets.

The operator recognises a financial asset to the extent that it has an unconditional contractual right to receive cash irrespective of the usage of the infrastructure.

The operator recognises an intangible asset to the extent that it receives a right (a licence) to charge users of the public service.

Under both the financial asset and the intangible asset models, the operator accounts for revenue and costs relating to construction or upgrade services in accordance with FRS 11, 'Construction contracts'. The operator recognises revenue and costs relating to operation services in accordance with FRS 18, 'Revenue'. Any contractual obligation to maintain or restore infrastructure, except for upgrade services, is recognised in accordance with FRS 37, 'Provisions, contingent liabilities and contingent assets'.

INT FRS 112 is applicable for accounting periods beginning on or after 1 January 2008. Earlier application is permitted. The change in accounting policy is accounted for retrospectively, except when this is impractical, in which case, special transition rules apply.

INT FRS 29, 'Service concession arrangements: disclosures', contains disclosure requirements in respect of public-to-private service arrangements but does not specify how they are accounted for. As a result, an interpretation on service concession arrangements is issued.

### **33. Agriculture – FRS 41**

Agricultural activity is defined as the managed biological transformation and harvest of biological assets (living animals and plants) for sale or for conversion into agricultural produce (harvested product of biological assets) or into additional biological assets.

All biological assets are measured at fair value less estimated costs to sell (referred to as 'point of sale costs' prior to 1 January 2009), with the change in the carrying amount reported as part of profit or loss from operating activities. Agricultural produce harvested from an entity's biological assets is measured at fair value less estimated costs to sell at the point of harvest.

Costs to sell include commissions to brokers and dealers, levies by regulatory agencies and commodity exchanges, and transfer taxes and duties. Costs to sell exclude transport and other costs necessary to get assets to market.

The fair value is measured using an appropriate quoted price where available. If an active market does not exist for biological assets or harvested agricultural produce, the following may be used in determining fair value: the most recent transaction price (provided that there has not been a significant change in economic circumstances between the date of that transaction and the balance sheet date); market prices for similar assets, with adjustments to reflect differences; and sector benchmarks, such as the value of an orchard expressed per export tray, bushel or hectare, and the value of cattle expressed per kilogram of meat. When any of this information is not available, the entity uses the present value of the expected net cash flows from the asset discounted at a current market-determined rate.

### **34. Extractive industries – FRS 106**

FRS 106, 'Exploration for and evaluation of mineral resources', addresses the financial reporting for the exploration for and evaluation of mineral resources. It does not address other aspects of accounting by entities engaged in the exploration for and evaluation of mineral reserves (such as activities before an entity has acquired the legal right to explore or after the technical feasibility and commercial viability to extract resources have been demonstrated). Activities outside the scope of FRS 106 are accounted for according to the applicable standards (such as FRS 16, 'Property, plant and equipment', FRS 37, 'Provisions, contingent liabilities and contingent assets', and FRS 38, 'Intangible assets'.)

The accounting policy adopted for the recognition of exploration and evaluation assets should result in information that is relevant and reliable. As a concession, certain further rules of FRS 8, 'Accounting policies, changes in accounting estimates and errors', need not be applied.

Exploration and evaluation assets are initially measured at cost. They are classified as tangible or intangible assets, according to the nature of the assets acquired. Management applies that classification consistently.

After recognition, management applies either the cost model or the revaluation model to the exploration and evaluation assets, based on FRS 16, 'Property, plant and equipment', or FRS 38, 'Intangible assets', according to nature of the assets. As soon as technical feasibility and commercial viability are determined, the assets are no longer classified as exploration and evaluation assets.

The exploration and evaluation assets are tested for impairment when facts and circumstances suggest that the carrying amounts may not be recovered. The assets are also tested for impairment before reclassification out of exploration and evaluation. The impairment is measured, presented and disclosed according to FRS 36, 'Impairment of assets', except that exploration and evaluation assets are allocated to cash-generating units or groups of cash-generating units no larger than a segment.

Management discloses the accounting policy adopted as well as the amount of assets, liabilities, income and expense and investing cash flows arising from the exploration and evaluation of mineral resources.

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