Grant Thornton
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Navigating the changes to Singapore Financial Reporting Standards

A briefing for Chief Financial Officers

February 2019

Contents

Introduction

This publication is designed to give Chief Financial Officers a high-level awareness of recent changes to Singapore Financial Reporting Standards that will affect companies' future financial reporting. It covers both new Standards and Interpretations that have been issued and amendments made to existing ones.

This edition is updated for changes to Singapore Financial Reporting Standards that have been published between 1 December 2017 and 30 November 2018.

The publication covers 31 March 2018, 30 June 2018, 30 September 2018, 31 December 2018 and 31 March 2019 financial year ends.

How to use the publication

Using the effective dates table

The effective dates table on the next page lists all the changes covered in the publication, their effective dates, and whether the changes allow early application.

Identifying the changes that will affect you

The effective dates table has been colour coded to help entities planning for a specific financial reporting year end, and identifies:

- changes mandatorily effective for the first time
- changes not yet effective
- changes already in effect.

Where a change is not yet mandatorily effective for a particular year end, it may still be possible for an entity to adopt it early (depending on local legislation and the requirements of the particular change in concern).

Where a change has been made but an entity is yet to apply it, certain disclosures are required to be made under FRS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'. Disclosures required include the fact that the new or amended Standard or Interpretation is in issue but has not yet been applied, and known or reasonably estimable information relevant to assessing its possible impact on the financial statements in the period of initial application.

Identifying the commercial significance of the changes in the publication

For each change covered in the publication, we have included a box on its commercial implications. These sections focus on two questions:

- how many entities will be affected?
- what will be the impact on affected entities?

A traffic light system indicates our assessment of the answers to these questions.

Grant Thornton Singapore Pte Ltd
February 2019

'The publication covers 31 March 2018, 30 June 2018, 30 September 2018, 31 December 2018 and 31 March 2019 financial year ends.'

Effective dates of new Standards

(based on Standards issued at 30 November 2018)

Standard	Title of Standard or Interpretation	Effective for accounting periods beginning on or after	Early Application?	31 Mar 2018 year end	30 Jun 2018 year end	30 Sep 2018 year end	31 Dec 2018 year end	31 Mar 2019 year end
FRS 12	Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to FRS 12)	1 January 2017		Effective for the first time	Effective for the first time	Effective for the first time	Already in mandatory effect	Already in mandatory effect
FRS 7	Disclosure Initiative (Amendments to FRS 7)	1 January 2017						
FRS 112	Annual Improvements to FRS 2014–2016 Cycle	1 January 2017	no					
FRS 101	Annual Improvements to FRS 2014–2016 Cycle	1 January 2018	no	Not yet effective	Not yet effective	Not yet effective	Effective for the first time	Effective for the first time
FRS 28	Annual Improvements to FRS 2014–2016 Cycle	1 January 2018						
FRS 115	Revenue from Contracts with Customers[1]	1 January 2018						
FRS 109	Financial Instruments	1 January 2018	2					
FRS 40	Transfers of Investment Property (Amendments to FRS 40)	1 January 2018						
FRS 104	Applying FRS 109 Financial Instruments with FRS 104 Insurance Contracts (Amendments to FRS 104)	1 January 2018	3					
FRS 102	Classification and Measurement of Share-based Payment Transactions (Amendments to FRS 102)	1 January 2018						
INT FRS 122	Foreign Currency Transactions and Advance Consideration	1 January 2018						
FRS 116	Leases	1 January 2019	4				Not yet effective	Not yet effective
FRS 109	Prepayment Features with Negative Compensation (Amendments to FRS 109)	1 January 2019						
FRS 28	Long-term Interests in Associates and Joint Ventures (Amendments to FRS 28)	1 January 2019						
INT FRS 123	Uncertainty over Income Tax Treatments	1 January 2019						
FRS 12, FRS 23, FRS 103 and FRS 111	Annual Improvements to FRS 2015-2017 Cycle	1 January 2019						
FRS 19	Plan Amendment, Curtailment or Settlement (Amendments to FRS 19)	1 January 2019						
FRS 1 and FRS 8	Definition of Material (Amendments to FRS 1 and FRS 8)	1 January 2020*						
CF	Conceptual Framework for Financial Reporting	1 January 2020						
FRS 103	Definition of a Business (Amendments to FRS 103)	1 January 2020*						
FRS 117	Insurance Contracts	1 January 2021	5					
Practice Statement 2	Making Material Judgements	No effective date as non-mandatory guidance						
FRS 110 and FRS 28	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to FRS 110 and FRS 28)	No effective date as deferred indefinitely						

The colour coding gives an indication of when the changes covered in the publication become effective in relation to the specific financial reporting year ends set out in the table.

Key: Change already in mandatory effect Change effective for the first time Change not yet effective

Notes

1 The article on FRS 115 includes 'Clarifications to FRS 115', amendments made to FRS 115 that are also effective 1 January 2018.
2 Extensive transition rules apply.
3 Temporary exemption from FRS 109 is applied for accounting periods on or after 1 January 2018. Overlay approach is applied when entities first apply FRS 109.
4 Entities that early adopt FRS 116 must apply FRS 115 before or on the same date.
5 Entities that early adopt FRS 117 must apply FRS 109 and FRS 115 before or on the same date.

Proposed

Effective from 1 January 2017

The Standards discussed on pages 4 to 8 are effective for accounting periods beginning on or after 1 January 2017. The Standards are:

- Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to FRS 12)
- Disclosure Initiative (Amendments to FRS 7)
- Annual Improvements to SFRS 2014–2016 Cycle

Note – Included in 'Improvements to SFRS 2014–2016 Cycle' are amendments to FRS 101 and FRS 28 which have an effective date of 1 January 2018.

Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to FRS 12)

The ASC made narrow-scope amendments to FRS 12 'Income Taxes' entitled 'Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to FRS 12)'. The focus of the amendments is to clarify how to account for deferred tax assets related to debt instruments measured at fair value, particularly where changes in the market interest rate decrease the fair value of a debt instrument below cost.

Matters addressed

The amendments add guidance to the Standard in the following areas where diversity in practice previously existed:

Matters addressed by the amendments

Topic	Issue	Clarification
Existence of a deductible temporary difference	Do decreases in the carrying amount of a fixed-rate debt instrument for which the principal is paid on maturity always give rise to a deductible temporary difference if the debt instrument is measured at fair value and if its tax base remains at cost.	The existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount. Consequently, decreases below cost in the carrying amount of a fixed-rate debt instrument measured at fair value for which the tax base remains at cost give rise to a deductible temporary difference.
Recovering an asset for more than its carrying amount	Should an entity assume that it will recover an asset for more than its carrying amount when estimating probable future taxable profit against which deductible temporary differences assessed for utilisation if such recovery is probable (relevant when taxable profit from other sources is insufficient for the utilisation of the deductible temporary differences related to debt instruments measured at fair value).	The estimate of probable future taxable profit may include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this.

Matters addressed by the amendments

Topic	Issue	Clarification
Probable future taxable profit against which deductible temporary differences are assessed for utilisation	When an entity assesses whether it can utilise a deductible temporary difference against probable future taxable profit, does that probable future taxable profit include the effects of reversing deductible temporary differences.	Deductible temporary differences are utilised by deduction against taxable profit, excluding deductions arising from reversal of those deductible temporary differences. Consequently, taxable profit used for assessing the utilisation of deductible temporary differences is different from taxable profit on which income taxes are payable. If those deductions were not excluded, then they would be counted twice.
Combined versus separate assessment	Should an entity assess whether a deferred tax asset is recognised for each deductible temporary difference separately, or in combination with other deductible temporary differences.	The Amendments clarify that an entity should consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of the deductible temporary difference. If tax law imposes no such restrictions, an entity assesses a deductible temporary difference in combination with all of its other deductible temporary differences.

Commercial significance

Some Number of entities affected

The amendments will impact entities with debt instruments measured at fair value.

Low Impact on affected entities

These amendments are narrow in scope and uncontroversial in nature.

'The focus of the amendments is to clarify how to account for deferred tax assets related to debt instruments measured at fair value, particularly where changes in the market interest rate decrease the fair value of a debt instrument below cost.'

Disclosure Initiative (Amendments to FRS 7)

The ASC published narrow scope amendments to FRS 7 'Statement of Cash Flows', entitled 'Disclosure Initiative (Amendments to FRS 7)'. The amendments respond to requests from investors for improved disclosures about an entity's financing activities. As their name suggests, the amendments form another part of the Disclosure Initiative.

The amendments are designed to improve the quality of information provided to users of financial statements about changes in an entity's debt and related cash flows (and non-cash changes).

The amendments:

- require an entity to provide disclosures that enable users to evaluate changes in liabilities arising from financing activities. An entity applies its judgement when determining the exact form and content of the disclosures needed to satisfy this requirement
- suggest a number of specific disclosures that may be necessary in order to satisfy the above requirement, including:
  - changes in liabilities arising from financing activities caused by changes in financing cash flows, foreign exchange rates or fair values, or obtaining or losing control of subsidiaries or other businesses
  - a reconciliation of the opening and closing balances of liabilities arising from financing activities in the statement of financial position including those changes identified immediately above.

Commercial significance

Most Number of entities affected

The amendments will impact all entities in the preparation of their financial statements.

Low Impact on affected entities

These amendments are in the main clarifications which should reduce rather than add to the burden of financial statement preparation. They aim to improve the disclosures about an entity's financing activities and changes in related liabilities.

'The amendments respond to requests from investors for improved disclosures about an entity's financing activities.'

Improvements to SFRS 2014-2016 Cycle (Amendments to FRS 116, FRS 112 and FRS 28)

This publication is a collection of amendments to SFRS resulting from Annual Improvement Process. By presenting the amendments in a single document rather than as a series of piecemeal changes, the standard setters aims to ease the burden of change for all concerned. A summary of the issues addressed is set out below:

Matters addressed by the amendments

Standard affected	Subject	Summary of amendment
FRS 101 'First-time Adoption of International Financial Reporting Standards'	Deletion of short-term exemptions for first-time adopters	A number of short-term exemptions have been deleted because the reliefs provided are no longer available or because they were relevant for reporting periods that have now passed.
FRS 112 'Disclosure of Interests in Other Entities'	Clarification of the scope of the Standard	Clarifies the scope of FRS 112 by specifying that its disclosure requirements (except for those in FRS 112.B17) apply to an entity's interests irrespective of whether they are classified (or included in a disposal group that is classified) as held for sale or as discontinued operations in accordance with FRS 105.
FRS 28 'Investments in Associates and Joint Ventures'	Measuring an associate or a joint venture at fair value	Clarifies that a qualifying entity is able to choose between applying the equity method or measuring an investment in an associate or joint venture at fair value through profit or loss, separately for each associate or joint venture at initial recognition of the associate or joint venture. Similar clarifications have been made for a reporting entity that is not an investment entity and that has an associate or a joint venture that is an investment entity. FRS 28 permits such a reporting entity the choice to retain the fair value measurements used by that investment entity associate or joint venture when applying the equity method. The amendments clarify that this choice is also made separately for each investment in an associate or joint venture that is an investment entity, at the later of the date on which: a the investment entity associate or joint venture is initially recognised b the associate or joint venture becomes an investment entity and c the investment entity associate or joint venture first becomes a parent.

The amendments are effective as follows:

- FRS 101 'First-time Adoption of International Financial Reporting Standards' – for annual periods beginning on or after 1 January 2018
- FRS 112 'Disclosures of Other Entities' – retrospectively in accordance with FRS 8 for annual periods beginning on or after1 January 2017
- FRS 28 'Investments in Associates and Joint Ventures' – retrospectively in accordance with FRS 8 for annual periods beginning on or after 1 January 2018, however early application is permitted.

Commercial significance

Few Number of entities affected

The amendments make changes to relatively narrow areas within IFRS.

Low Impact on affected entities

The Annual Improvements process addresses non-urgent, but necessary minor amendments to SFRS. By their nature then, their commercial significance can be expected to be low. Overall the changes are uncontroversial.

'The Annual Improvements process is used to make necessary, but non-urgent, amendments to SFRS that will not be included as part of any other project.'

Effective from 1 January 2018

The Standards discussed on pages 10 to 26 are effective for accounting periods beginning on or after 1 January 2018.

The Standards are:

- FRS 115 Revenue from Contracts with Customers[1]
- FRS 109 Financial Instruments
- Transfers of Investment Property (Amendments to FRS 40)
- Applying FRS 109 Financial Instruments with FRS 104 Insurance Contracts (Amendments to FRS 104)
- Classification and Measurement of Share-based Payment Transactions (Amendments to FRS 102)
- INT FRS 122 Foreign Currency Transactions and Advance Consideration

[1] Includes 'Clarifications to FRS 115' issued in June 2016

FRS 115 Revenue from Contracts with Customers

FRS 115 'Revenue from Contracts with Customers' is aligned to IFRS 15 which is the product of a major joint project between the IASB and the US Financial Accounting Standards Board. The previous requirements of IFRS and US GAAP were not harmonised and often resulted in different accounting treatments for economically significant transactions. In response, the Boards have developed new, sustantially converged requirements for the recognition of revenue under both IFRS and US GAAP.

FRS 115 Replaces:

- FRS 18 'Revenue', FRS 11 'Construction Contracts' and some revenue-related Interpretations
- establishes a new control-based revenue recognition model
- changes the basis for deciding whether revenue is recognised at a point in time or over time
- provides new and more detailed guidance on specific topics
- expands and improves disclosures about revenue.

FRS 115 at a glance

Features	Key points
Who is affected?	• all entities that enter into contracts with customers with few exceptions
What is the impact?	• entities affected will need to reassess their revenue recognition policies and may need to revise them • the timing and amount of revenue recognised may not change for simple contracts for a single deliverable but most complex arrangements will be affected to some extent • FRS 115 requires more and different disclosures
When are the changes effective?	• annual periods beginning on or after 1 January 2018 • early application is permitted.

A five step model for revenue recognition

1. Identify the contract(s) with the customer
2. Identify the separate performance obligations
3. Determine the transaction price
4. Allocate the transaction price
5. Recognise revenue when or as an entity satisfies performance obligations

FRS 115 is based on a core principle that requires an entity to recognise revenue:

- in a manner that depicts the transfer of goods or services to customers
- at an amount that reflects the consideration the entity expects to be entitled to in exchange for those goods or services.

A "customer" is defined as "a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities."

Applying this core principle involves following a five step model depicted above. The following table expands on the factors to consider in applying this new model.

The 'five step model'

Step	Principal considerations	Other factors to consider

1 **Identify the contract(s) with a customer**	The first step in FRS 115 is to identify the "contract," which FRS 115 defines as "an agreement between two or more parties that creates enforceable rights and obligations."
	
	A contract can be written, oral, or implied by an entity's customary business practices.
	
	In addition the general FRS 115 model applies only when or if:
	• the contract has commercial substance
	• the parties have approved the contract
	• the entity can identify
	  – each party's rights
	  – the payment terms for the goods and services to be transferred
	• it is probable the entity will collect the consideration.
	
	If a customer contract does not meet these criteria, revenue is recognised only when either:
	• the entity's performance is complete and substantially all of the consideration in the arrangement has been collected and is non-refundable
	• the contract has been terminated and the consideration received is non-refundable.
	
	For purposes of FRS 115, a contract does not exist if each party has an enforceable right to terminate a wholly unperformed contract without compensating the other party.
		Guidance is also given on:
		• combining contracts
		• contract modifications.

2 **Identify the separate performance obligations in the contract**	Having identified a contract, the entity next identifies the performance obligations within that contract. A performance obligation is a promise in a contract with a customer to transfer either (1) a good or service, or a bundle of goods or services, that is 'distinct'; or (2) a series of distinct goods or services that are substantially the same and meet certain criteria. Performance obligations are normally specified in the contract but could also include promises implied by an entity's customary business practices, published policies or specific statements that create a valid customer expectation that goods or services will be transferred under the contract.	Guidance is given on the criteria that need to be met in order to determine whether a promised good or service is distinct.
3 **Determine the transaction price**	Under FRS 115, the "transaction price" is defined as the amount of consideration an entity expects to be entitled to in exchange for the goods or services promised under a contract, excluding any amounts collected on behalf of third parties (for example, sales taxes). The transaction price is not adjusted for effects of the customer's credit risk, but is adjusted if the entity (eg based on its customary business practices) has created a valid expectation that it will enforce its rights for only a portion of the contract price.	An entity must consider the effects of all the following factors when determining the transaction price: • variable consideration • the constraint on variable consideration • time value of money • non-cash consideration • consideration payable to the customer.
4 **Allocate the transaction price to the performance obligations**	Under FRS 115, an entity allocates a contract's transaction price to each separate performance obligation within that contract on a relative stand-alone selling price basis at contract inception. FRS 115 defines a stand-alone selling price as "the price at which an entity would sell a promised good or service separately to a customer."	FRS 115 suggests, but does not require, the following three methods as suitable for estimating the stand-alone selling price: • adjusted market assessment approach • expected cost plus margin approach • residual approach.
5 **Recognise revenue when or as an entity satisfies performance obligations**	Under FRS 115, an entity recognises revenue when or as it transfers promised goods or services to a customer. A "transfer" occurs when the customer obtains control of the good or service. A customer obtains control of an asset (good or service) when it can direct the use of and obtain substantially all the remaining benefits from it. Control includes the ability to prevent other entities from directing the use of and obtaining the benefits from an asset. The benefits of an asset are the potential cash flows that can be obtained directly or indirectly from the asset in many ways.	A key part of the model is the concept that for some performance obligations control is transferred over time while for others control transfers at a point in time. Guidance is given in the Standard to help entities decide which is appropriate.

Other matters

In addition to the items discussed above in relation to the five step model, FRS 115 contains guidance on a number of other matters including:

- contract costs
- warranties
- licensing
- rights of return and repurchase obligations.

For more information, please refer to our special edition of Accounting for Revenue - The new normal: FRS 115. The special edition takes readers through the key features of the new Standard and gives practical insights into how it may affect entities. This edition has been updated to incorporate the changes made to FRS 115 when the ASC issued 'Clarifications to FRS 115' in June` 2016. To obtain a copy of the special edition, please get in touch with tour Grant Thornton Singapore contact or go to www.grantthornton.sg

Effective date and transition

FRS 115 is effective for annual reporting periods beginning on or after 1 January 2018. Early adoption is permitted.

Entities are required to apply the new revenue Standard either:

- retrospectively to each prior period presented, subject to some practical expedients or
- retrospectively, with the cumulative effect of initial application recognised in the current period.

An entity that chooses to restate only the current period is required to provide the following additional disclosures in the initial year of adoption:

- the current year impact of applying the new revenue Standard by financial statement line item
- an explanation of the reasons behind the significant impacts.

'In June 2016, the IASB published 'Clarifications to FRS 115 Revenue from Contracts with Customers' making several targeted changes to FRS 115.'

Clarifications to FRS 115

In June 2016 the ASC published 'Clarifications to FRS 115 Revenue from Contracts with Customers' ('the Amendments') making several targeted changes to FRS 115. The Amendments also introduce two practical expedients available for use by entities implementing the new Standard.

The Amendments clarify the application of FRS 115 in three specific areas to reduce the amount of diversity in practice that might otherwise result from differing views on how to implement the requirements of the new standard. They will help companies:

- identify performance obligations (by clarifying how to apply the concept of 'distinct')
- determine whether a company is a principal or an agent in a transaction (by clarifying how to apply the control principle)
- determine whether a licence transfers to a customer at a point in time or over time (by clarifying when a company's activities significantly affect the intellectual property to which the customer has rights).

The Amendments also create two additional practical expedients available for use when implementing FRS 115:

- for contracts that have been modified before the beginning of the earliest period presented, the Amendments allow companies to use hindsight when identifying the performance obligations, determining the transaction price, and allocating the transaction price to the satisfied and unsatisfied performance obligations
- companies applying the full retrospective method are permitted to ignore contracts already complete at the beginning of the earliest period presented.

The Amendments are effective for annual periods beginning on or after 1 January 2018 (the effective date of the new Standard). Earlier application is permitted.

'Get ready for FRS 115 – Recognising revenue in the real estate and construction indusries' is our more detailed look at the issues facing companies as they prepare themselves for FRS 115. To obtain your copy, please get in touch with our Grant Thornton Singapore Contact or go to www.grantthornton.sg

Commercial significance

Most Number of entities affected

FRS 115 impacts all entites that enter into contracts with customers with few exceptions.

High Impact on affected entities

The impact on the top line will very much depend on each entity's specific customer contracts and how the much less detailed existing Standards have been applied. For some it will be a significant shift while others may see only minor changes. Entities should start assessing the impact FRS 115 on their financial statements now if they have not done so already.

FRS 109 Financial Instruments

The IASB began its overhaul of the accounting for financial instruments in the summer of 2009 in response to the widespread criticism of IAS 39 and its alleged role in contributing to the financial crisis of 2007/8. Due to the complexity of the issues involved, the project was completed in a number of stages as follows:

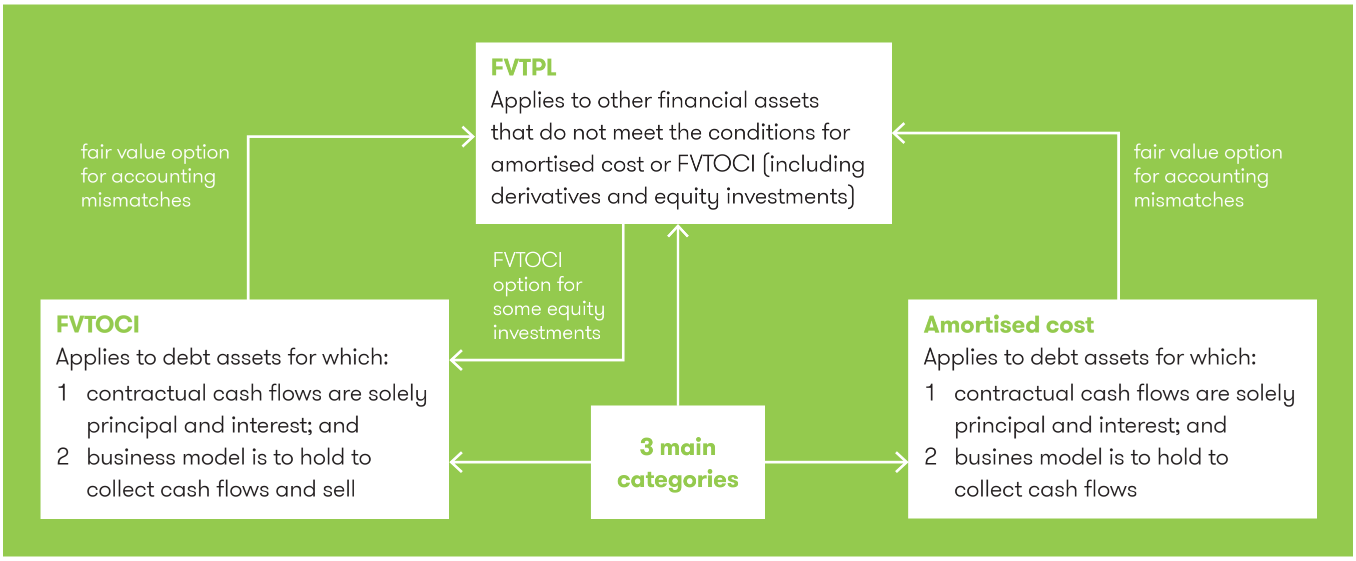
- November 2009: the classification and measurement of financial assets
- October 2010: requirements for classifying and measuring financial liabilities and derecognising financial assets and financial liabilities were added
- November 2013: requirements on hedge accounting were introduced
- July 2014: the IASB issued IFRS 9 (2014) adding requirements on impairment and amending the Standard's classification and measurement requirements.

Following the publication of IFRS 9 (2014) the Standard as a whole is now complete. In Singapore, the ASC issued FRS 109 financial instrument which is fully conveyed with IFRS 9. The different parts of the Standard are discussed in greater detail below.

Classification

Under FRS 109 each financial asset is classified into one of three main classification categories:

- amortised cost
- fair value through other comprehensive income (FVTOCI)
- fair value through profit or loss (FVTPL).



FRS 109 introduces:

- a new approach for financial asset clarification
- a more forward-looking expected loss impairment model
- major new requirements on hedge accounting.

The classification is determined by both:

1 the entity's business model for managing the financial asset ('business model test'); and
2 the contractual cash flow characteristics of the financial asset ('cash flow characteristics test').

The diagramme on the previous page summarises the three main categories and how the business model and cash flow characteristics determine the applicable category.

In addition, FRS 109 contains an option which allows an entity to designate a financial asset at fair value through profit or loss and an additional option to classify investments in equity instruments in a special 'equity – FVTOCI' category.

'Get ready for FRS 109: Classifying and measuring financial Instruments' is the first in a series of publications designed to get you ready for FRS 109. In this issue we bring you up to speed on the Standard's new classification and measurement requirements. To obtain your copy, please get in touch with our Grant Thornton Singapore contact or go to www.grantthornton.sg

The business model test

FRS 109 uses the term 'business model' in terms of how financial assets are managed and the extent to which cash flows will result from collecting contractual cash flows, selling financial assets or both. The Standard positively defines two such 'business models':

- a business model whose objective is to hold the financial asset in order to collect contractual cash flows ('hold to collect'); and
- a business model in which assets are managed to achieve a particular objective by both collecting contractual cash flows and selling financial assets ('hold to collect and sell').

Business models other than the two above result in classification of financial assets at fair value through profit or loss.

The cash flow characteristics test

The second condition for classification in the amortised cost classification or FVTOCI category can be labelled the 'solely payments of principal and interest' (SPPI) test. The requirement is that the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

For the purpose of applying this test, 'principal' is the fair value of the financial asset at initial recognition. 'Interest' consists of consideration for:

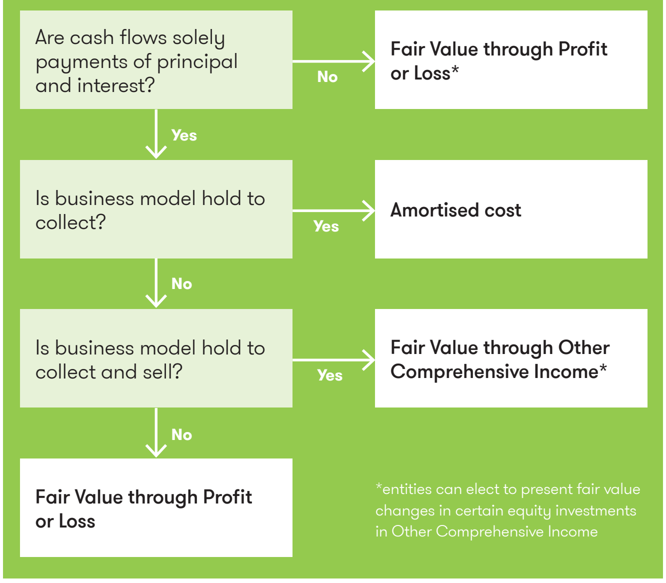
- the time value of money
- the credit risk associated with the principal amount outstanding during a particular period of time
- other basic lending risks and costs
- a profit margin.

Contractual cash flows that are SPPI are consistent with a basic lending arrangement. Contractual terms that introduce exposures to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement however, such as exposure to changes in equity prices or commodity prices, fail the SPPI test. Similarly contracts that increase leverage fail the test as they increase the variability of the contractual cash flows with the result that they do not have the economic characteristics of interest.

Summary of classification model

The diagramme shows how FRS 109's business model test and cash flow characteristics test interact in determining the classification of financial assets.

Summary of FRS 109's classification model for financial assets



Classification and measurement of financial liabilities

Most of FRS 39's requirements have been carried forward unchanged to FRS 109. Changes were however made to address issues related to own credit risk where an entity takes the option to measure financial liabilities at fair value.

Majority of requirements retained

Under FRS 39 most liabilities were measured at amortised cost or bifurcated into a host instrument measured at amortised cost, and an embedded derivative, measured at fair value.

Liabilities that are held for trading (including all derivative liabilities) are measured at fair value. These requirements have been retained.

Own credit risk

The requirements related to the fair value option for financial liabilities have however been changed to address own credit risk. Where an entity chooses to measure its own debt at fair value, FRS 109 now requires the amount of the change in fair value due to changes in the entity's own credit risk to be presented in other comprehensive income. This change addresses the counterintuitive way in which a company in financial trouble was previously able to recognise a gain based on its theoretical ability to buy back its own debt at a reduced cost.

The only exception to the new requirement is where the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in profit or loss, in which case all gains or losses on that liability are to be presented in profit or loss.

Elimination of the exception from fair value measurement for certain derivative liabilities

The new version of FRS 109 also eliminates the exception from fair value measurement for derivative liabilities that are linked to and must be settled by delivery of an unquoted equity instrument. Under FRS 39, if those derivatives were not reliably measurable, they were required to be measured at cost. FRS 109 requires them to be measured at fair value.

Derecognition of financial assets and financial liabilities

The requirements in FRS 39 related to the derecognition of financial assets and financial liabilities were incorporated unchanged into FRS 109.

Hedge accounting

FRS 39's hedge accounting requirements had been heavily criticised for containing complex rules which either made it impossible for entities to use hedge accounting or, in some cases, simply put them off doing so. As an example, hedge effectiveness was judged on both a prospective and a retrospective basis, with a 'bright-line' quantitative range of 80-125% being used to assess retrospective effectiveness on a quantitative basis. Anything outside this range resulted in the discontinuance of hedge accounting, leading to a sharp increase in profit and loss volatility.

In part this complexity was a reflection of the fact that the hedge accounting requirements were an exception to FRS 39's normal requirements. There was however also a perception that hedge accounting did not properly reflect entities' actual risk management activities, thereby reducing the usefulness of their financial statements. FRS 109's new requirements look to rectify some of these problems, aligning hedge accounting more closely with entities' risk management activities by:

- increasing the eligibility of both hedged items and hedging instruments
- introducing a more principles-based approach to assessing hedge effectiveness.

As a result, the new requirements should serve to reduce profit or loss volatility. The increased flexibility of the new requirements are however partly offset by entities being prohibited from voluntarily discontinuing hedge accounting and also by enhanced disclosure requirements. The table below gives a highly summarised view of the new requirements.

Simplifications compared to FRS 39

Features	Key points
Objective of the Standard	• to better align hedging from an accounting point of view with entities' underlying risk management activities
Similarities with FRS 39	• hedge accounting remains an optional choice – the three types of hedge accounting (fair value hedges, cash flow hedges and hedges of a net investment) remain – formal designation and documentation of hedge accounting relationships is required – ineffectiveness needs to be measured and included in profit or loss – hedge accounting cannot be applied retrospectively
The major changes	• increased eligibility of hedged items – increased eligibility of hedging instruments and reduced volatility – revised criteria for hedge accounting qualification and for measuring hedge ineffectiveness – a new concept of rebalancing hedging relationships – new requirements restricting the discontinuance of hedge accounting.

‘Extensive transition provisions have been included due to the complexity of the material and the phased way in which the project has been completed.’

Impairment

FRS 109 contains the Standard’s requirements on impairment, including the recognition of expected credit losses. FRS 39’s impairment requirements had been criticised for being overly complicated and resulting in impairment being recognised at too late a stage. FRS 109 addresses these criticisms by applying the same impairment model to all financial instruments that are subject to impairment accounting and by using more forward-looking information. In applying this more forward-looking approach, a distinction is made between:

- financial instruments that have not deteriorated significantly in credit quality since initial recognition or that have low credit risk and
- financial instruments that have deteriorated significantly in credit quality since initial recognition and whose credit risk is not low.

‘12-month expected credit losses’ are recognised for the first category while ‘lifetime expected credit losses’ are recognised for the second category. There is also a third step to the model in the sense that for assets which actually become credit-impaired after initial recognition, interest is calculated on the asset’s amortised cost (i.e. the amount net of the loss allowance) as opposed to its gross carrying amount.

‘Get ready for FRS 109: Impairment’ is the second in a series of publications designed to get you ready for FRS 109. In this issue we bring you up to speed on the Standard’s new impairment requirements. To obtain your copy, please get in touch with your Grant Thornton Singapore contact or go to www.grantthornton.sg

Expected credit losses

Deterioration in credit quality

Stage 1 – Performing	Stage 2 – Under-performing	Stage 3 – Non-performing
• financial instruments that have not deteriorated significantly in credit quality since initial recognition or that have low credit risk at the reporting date	• financial instruments that have deteriorated significantly in credit quality since initial recognition (unless they have low credit risk at the reporting date) but that do not have objective evidence of a credit loss event	• financial assets that have objective evidence of impairment at the reporting date
• 12-month expected credit losses are recognised • interest revenue is calculated on the gross carrying amount of the asset.	• lifetime expected credit losses are recognised • interest revenue is still calculated on the asset’s gross carrying amount.	• lifetime expected credit losses are recognised • interest revenue is calculated on the net carrying amount (ie reduced for expected credit losses).
Credit risk = low	Credit risk > low	

Effective date and transition disclosures

FRS 109 has a mandatory effective date of accounting periods beginning on or after 1 January 2018.

Commercial significance

Most Number of entities affected

Because the definition of a financial instrument is so wide, most companies can expect to be affected. Even companies with relatively simple debtors and creditors should consider the changes. In addition, the greater alignment of FRS 109's hedge accounting requirements with entities risk management practices may encourage entities who engage in economic hedging to also apply hedge accounting.

High Impact on affected entities

The new Standard, with its reduced number of measurement categories, should help to reduce the complexity in accounting for financial instruments. In the short-term however, it may lead to far reaching changes, with companies needing to re-evaluate the classification of all instruments within the scope of FRS 39.

In addition to the impact on companies' financial position and reported results, many businesses will need to collect and analyse additional data and implement changes to systems in order to implement the new requirements on impairment.

With this Standard effective from 1 January 2018 companies need to start evaluating the new Standard now if they have not done so already.

Transfers of Investment Property (Amendments to FRS 40)

'Transfers of Investment Property (Amendments to FRS 40)' clarifies that transfers to, or from, investment property are required when, and only when, there is a change in use of property supported by evidence.

In addition to clarifying the principle above, the amendments also re-characterise the list of circumstances previously contained in FRS 40 'Investment Property'. This list was previously characterised as a definitive list of circumstances where it would be considered that there has been a change in use of a property. The amendments reposition the list as a non-exhaustive list of examples of evidence that a change in use has occurred. It has also clarified that a change in management's intent, by itself, does not provide sufficient evidence that a change in use has occurred. Evidence of a change in use must be observable.

Transition

The amendments contain transitional provisions, the default being prospective application, however retrospective application is permitted, provided that it is possible without the use of hindsight.

Commercial significance

Some

Number of entities affected

The amendments will impact entities that hold investment properties.

Medium

Impact on affected entities

These amendments could have a fairly significant impact if they result in a change in presentation of an entity's property.

'The amendments reposition the list of circumstances where a change in use is deemed to have occurred as a non-exhaustive list of examples of evidence that a change in use has occurred.'

Applying FRS 109 Financial Instruments with FRS 104 Insurance Contracts (Amendments to FRS 104)

'Applying FRS 109 Financial Instruments with FRS 104 Insurance Contracts' makes narrow scope amendments to FRS 104 'Insurance Contracts'. The amendments were issued to address the temporary accounting consequences of the different effective dates of FRS 109 and the new insurance contracts Standard which was subsequently finalised as FRS 117 'Insurance Contracts' and has an effective date of 1 January 2021. This means the mandatory effective date of the new insurance contracts Standard is after the 2018 effective date of FRS 109. Refer to page 49 for details on FRS 117.

As entities that issue insurance contracts will be affected by both FRS 109 and the new insurance contracts Standard, there was considerable concern over the practical challenges of implementing these two significant accounting changes on different dates. Further concerns were raised over the potential for increased volatility in profit or loss if FRS 109's new requirements for financial instruments come into force before the new insurance accounting rules.

To address these concerns while still fulfilling the needs of users of financial statements, the standard setters responded by amending FRS 104 and introducing the:

- overlay approach – an option for all entities that issue insurance contracts to adjust profit or loss for eligible financial assets by removing any additional accounting volatility that may arise as a result of FRS 109
- temporary exemption – an optional temporary exemption from applying FRS 109 for entities whose activities are predominantly connected with insurance. These entities will be permitted to continue to apply the existing financial instrument requirements of FRS 39.

Overlay approach

The overlay approach aims to remove from profit or loss any additional volatility that may arise if FRS 109 is applied together with FRS 104. All entities would be permitted to apply it but only to certain assets (see below). Furthermore, the approach must be chosen on the initial adoption of FRS 109.

Entities applying the overlay approach are required to apply FRS 109 from its 1 January 2018 effective date. However they are permitted to reclassify from profit or loss to other comprehensive income an amount equal to the difference between:

- the amount reported in profit or loss when FRS 109 is applied to the qualifying financial assets (see below); and
- the amount that would have been reported in profit or loss if FRS 39 were applied to those assets.

The amendments require the reclassification to be shown as a separate line item on the face of the statement of both profit or loss and other comprehensive income, with additional disclosures being given in order to enable users to understand it.

Only financial assets that meet both of the following criteria would qualify for the overlay approach:

- the financial assets are measured at fair value through profit or loss when applying FRS 109 but would not have been so measured in their entirety when applying FRS 39
- the financial assets are designated by the entity as relating to insurance activities for the purposes of the overlay approach.

Temporary exemption

The temporary exemption is an option for entities whose activities are predominantly connected with insurance to defer the application of FRS 109 until the earlier of:

- the application of the new insurance contracts Standard
- 1 January 2021.

(NB The effective date of the new insurance contracts Standard, FRS 117, maybe deffered by 12 months to 1 January 2022)

If an entity elects to use this temporary exemption, it will continue to apply FRS 39 during this period and will be required to provide some key disclosures to assist users of financial statements to make comparisons with entities applying FRS 109.

Entities are eligible for this deferral approach only if they have activities that are predominantly connected with insurance when considering their activities as a whole. This should be considered at the reporting entity level and they must not have previously applied FRS 109.

As eligibility is assessed at a reporting entity level, a separate assessment should be made for separate financial statements and consolidated groups. It is therefore possible for a group still to be eligible for the exemption even if there is a non-qualifying subsidiary (for its individual financial statements) within the group, or vice versa.

Predominance should be assessed by comparing the amount of an entity's insurance contract liabilities with the total amount of its liabilities.

Unlike the overlay approach, the temporary exemption will be applied to all, rather than some, financial assets of the limited population of entities that qualify for and elect to apply this approach.

Effective date

The amendments are effective as follows:

- the overlay approach is applied when entities first apply FRS 109
- a temporary exemption from FRS 109 is applied for accounting periods on or after 1 January 2018.

At the time of writing, the IASB is considering deferring the effective date of these amendments to be consistent with the deferral of FRS 117. Subject to public consultation, they are proposing to defer them by one year.

Some Number of entities affected

High Impact on affected entities

'The IASB issued the amendments to address the temporary accounting consequences of the different effective dates of FRS 109 'Financial Instruments' and the new insurance contracts Standard, FRS 117.'

Classification and Measurement of Share-based Payment Transactions (Amendments to FRS 102)

The amendment made three changes to the standard which are described in more details below.

Effects of vesting conditions on the measurement of a cash-settled share-based payment

Prior to the publication of the amendments, IFRS did not specifically address the impact of vesting and non-vesting conditions on the measurement of the fair value of the liability incurred in a cash-settled share-based payment transaction. The amendments address this lack of guidance by clarifying that these conditions should be accounted for consistently with equity-settled share-based payments in FRS 102.

This means that the fair value of cash-settled awards is measured ignoring service and non-market performance conditions, but taking into account market and non-vesting conditions. This applies when estimating the fair value of the cash-settled share-based payment granted and when re-measuring the fair value at the end of each reporting period and at the date of settlement. The cumulative expense recognised is adjusted based on the number of awards that is ultimately expected to vest (the so-called 'true-up' mechanism).

Classification of share-based payment transactions with a net settlement feature for withholding tax obligations

The second amendment addresses the accounting for a particular type of share-based payment scheme. Many jurisdictions require entities to withhold an amount for an employee's tax obligation associated with share-based payments and transfer the amount (normally in cash) to the taxation authorities. As a result the terms of some schemes require the entity to deduct the number of equity instruments needed to equal the monetary value of the employee's tax obligation from the number of equity instruments that would otherwise be issued to the employee (referred to as a 'net settlement' feature).

The amendment stems from a request for guidance on whether the portion of the share-based payment that is withheld should be classified as cash-settled or equity-settled, where the entire share-based payment would otherwise have been classified as an equity-settled share-based payment transaction.

The amendment adds guidance to FRS 102 to the effect that a scheme with this type of compulsory net-settlement feature would be classified as equity-settled in its entirety (assuming it would be so classified without the net settlement feature). Where necessary, an entity shall disclose an estimate of the amount that it expects to transfer to the tax authority to settle the employee's tax obligation.

Accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled

The third amendment addresses the accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. Such situations were not previously addressed by FRS 102, so the standard setter has amended the Standard so that:

- the share-based payment transaction is measured by reference to the modification-date fair value of the equity instruments granted as a result of the modification
- the liability recognised in respect of the original cash-settled share-based payment is derecognised upon the modification, and the equity-settled share-based payment is recognised (in equity) to the extent that the services have been rendered up to the modification date
- the difference between the carrying amount of the liability as at the modification date and the amount recognised in equity at the same date is recorded in profit or loss immediately.

This guidance also applies to a situation in which the modification changes the vesting period of the share-based payment transaction. The amendments also provide guidance for a grant of equity instruments that has been identified as a replacement for a cancelled cash-settled share-based payment.

Commercial significance

Few Number of entities affected

The amendments will only impact entities with share based payments transactions.

Medium Impact on affected entities

Some of the changes could have a fairly significant impact depending on the type of shared based payment transaction the entity has entered into.

The amendment introduced changes to FRS 102 covering the following matters:

- the accounting for the effects of vesting conditions on the measurement of a cash-settled share-based payment
- the classification of share-based payment transactions with a net settlement feature for withholding tax obligations
- the accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled.

INT FRS 22 Foreign Currency Transactions and Advance Consideration

INT FRS 122 Foreign Currency Transactions and Advance Consideration' looks at what exchange rate to use for translation when payments are made or received in advance of the related asset, expense or income.

Background

Although FRS 21 'The Effects of Changes in Foreign Exchange Rates' sets out requirements about which exchange rate to use when recording a foreign currency transaction on initial recognition in an entity's functional currency, there is diversity in practice in circumstances in which an entity recognises a non-monetary liability arising from advance consideration. The diversity resulted from the fact that some entities were recognising revenue using the spot exchange rate at the date of the receipt of the advance consideration while others were using the spot exchange rate at the date that revenue was recognised.

In carrying out their analysis of the issue, standard setters noted that the issue was not restricted to just revenue transactions. For example, the same issue arises for transactions such as a sale of property, plant and equipment or the purchase of services when consideration is denominated in a foreign currency and is paid or received in advance.

Matters addressed

INT FRS 122 addresses this issue by clarifying that the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.

If there are multiple payments or receipts in advance, the entity shall determine a date of the transaction for each payment or receipt of advance consideration.

Illustrative examples in the Interpretation demonstrate the application of this consensus.

Transition

On initial application, entities have the choice of applying the Interpretation either retrospectively or, alternatively, prospectively to all assets, expenses and income in the scope of the Interpretation initially recognised on or after

i the beginning of the reporting period in which the entity first applies the Interpretation; or

ii the beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which the entity first applies the Interpretation.

Commercial significance

Few — Number of entities affected

The Interpretation has a narrow scope. It will only impact transactions that have been settled in advance and in foreign currency.

Medium — Impact on affected entities

The impact of this Interpretation could be significant depending on how the exchange rate has fluctuated in the period between the advance and receipt of the related asset.

Effective from 1 January 2019

The Standards discussed on pages 28 to 40 are effective for accounting periods beginning on or after 1 January 2019.

The Standards are:

- FRS 116 Leases
- Prepayment Features with Negative Compensation (Amendments to FRS 109)
- Long-term Interests in Associates and Joint Ventures (Amendments to FRS 28)
- INT FRS 123 Uncertainty over Income Tax Treatments
- Improvements to SFRS 2015-2017 Cycle
- Plan Amendment, Curtailment or Settlement (Amendments to FRS 19)

FRS 116 Leases

FRS 116 - based on IFRS 16 - is the result of the IASB's long-running project to overhaul lease accounting & represents the first major change to lease accounting in over 30 years. The new Standard replaces FRS 17 'Leases' along with three Interpretations (INT FRS 104 'Determining whether an Arrangement contains a Lease', INT FRS 15 'Operating Leases-Incentives' and INT FRS 27 'Evaluating the Substance of Transactions Involving the Legal Form of a Lease').

FRS 116 will require lessees to account for leases 'on-balance sheet' by recognising a 'right-of-use' asset and a lease liability. For many businesses, however, exemptions for short-term leases and leases of low value assets will greatly reduce the impact.

FRS 116 also:

- changes the definition of a lease
- sets requirements on how to account for the asset and liability, including complexities such as non-lease elements, variable lease payments and option periods
- changes the accounting for sale and leaseback arrangements
- largely retains FRS 17's approach to lessor accounting
- introduces new disclosure requirements.

The table summarises the main changes at a glance:

FRS 116 Leases at a glance

Issue	Other factors to consider
Who is affected?	• entities that lease assets as a lessee or a lessor
What's the impact on lessees?	• all leases will be accounted for 'on-balance sheet', other than short-term and low value asset leases • lease expense will typically be 'front-loaded' • lease liability will exclude: – option periods unless exercise is reasonably certain – contingent payments that are linked to sales/usage and future changes in an index/rate
What's the impact on lessors?	• only minor changes from the current Standard – FRS 17
Are there other changes?	• a new definition of a lease will result in some arrangements previously classified as leases ceasing to be so, and vice versa • new guidance on sale and leaseback accounting • new and different disclosures
When are the changes effective?	• annual periods beginning on or after 1 January 2019 • various transition reliefs • early application is permitted if FRS 115 'Revenue from Contracts with Customers' is applied.

Scope

FRS 116 applies to all leases for both the lessee and lessor, except for a few scope exclusions. These exclusions, some of which are similar to FRS 17's, are summarised in the table:

Scope exclusions from FRS 116

Scope exclusion	Standard to apply
Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources	None specified. Depending on the circumstances FRS 106 'Exploration for and Evaluation of Mineral Resources' or FRS 38 'Intangible Assets' might apply
Leases of biological assets in scope of FRS 41 held by a lessee	FRS 41 'Agriculture'
Service concession arrangements in scope of IFRIC 12	INT FRS 12 'Service Concession Arrangements'
Licences of intellectual property granted by a lessor in scope of FRS 115	FRS 115 'Revenue from Contracts with Customers'
Rights held under licensing agreements in scope of FRS 38 for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights*	FRS 38 'Intangible Assets'

* for leases of other types of intangible asset a lessee is permitted to apply FRS 116 but not required to do so

Definition of a lease

Because the new lease accounting model brings many more leases 'on-balance sheet', the evaluation of whether a contract is (or contains) a lease becomes even more important than it is today.

Under FRS 116 a lease is defined as: 'a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration'. A contract is, or contains, a lease if:

- fulfilment of the contract depends on the use of an identified asset; and
- the contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.

In practice, the main impact of FRS 116's new definition and supporting guidance is likely to be on contracts that are not in the legal form of a lease but involve the use of a specific asset and may therefore contain a lease.

Lessee accounting

Subject to the optional accounting simplifications discussed below, a lessee will be required to recognise its leases on the balance sheet. This involves recognising:

- a 'right-of-use' asset; and
- a lease liability.

The lease liability is initially measured as the present value of future lease payments. For this purpose, lease payments include fixed, non-cancellable payments for lease elements, amounts due under residual value guarantees, certain types of contingent payments and amounts due during optional periods to the extent that extension is 'reasonably certain'.

In subsequent periods, the right-of-use asset is accounted for similarly to a purchased asset and depreciated or amortised. The lease liability is accounted for similarly to a financial liability using the effective interest method.

‘FRS 116 will require lessees to account for leases ‘on-balance sheet’ by recognising a ‘righ-of-use-asset’ and a lease liability.’

Optional accounting simplifications

FRS 116 provides important reliefs or exemptions for:

- short-term leases (a lease is short-term if it has a lease term of 12 months or less at the commencement date)
- low-value asset leases (the assessment of value is based on the absolute value of the leased asset when new and therefore requires judgement. In the Basis for Conclusions which accompanies the IFRS 16, however, the IASB notes that they had in mind leases of assets with a value when new of around US $5,000 or less). FRS 116 does not discuss any quantitative threshold for low value assets.

If these exemptions are used, the accounting is similar to operating lease accounting under the current Standard FRS 17 ‘Leases’. Lease payments are recognised as an expense on a straight-line basis over the lease term or another systematic basis (if more representative of the pattern of the lessee’s benefit).

Lessor accounting

FRS 116’s requirements for lessor accounting are similar to FRS 17’s. In particular:

- the distinction between finance and operating leases is retained
- the definitions of each type of lease, and the supporting indicators of a finance lease, are substantially the same as FRS 17’s
- the basic accounting mechanics are also similar, but with some different or more explicit guidance in a few areas. These include variable payments; sub-leases; lease modifications; the treatment of initial direct costs; and lessor disclosures.

Sale and leaseback accounting

FRS 116 makes significant changes to sale and leaseback accounting.

If an entity (the seller-lessee) transfers an asset to another entity (the buyer-lessor) and leases that asset back from the buyer-lessor, both the seller-lessee and the buyer-lessor determine whether the transfer qualifies as a sale. This determination is based on the requirements for satisfying a performance obligation in FRS 115.

Effective date and transition

FRS 116 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted for entities that apply FRS 115 'Revenue from Contracts with Customers' at or before the date of initial application of this standard.

In terms of transition, FRS 116 provides lessees with a choice between two broad methods:

- full retrospective application – with restatement of comparative information in accordance with FRS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'
- partial retrospective application – without restating comparatives. Under this approach the cumulative effect of initially applying FRS 116 is recognised as an adjustment to equity at the date of initial application. If a lessee chooses this method, a number of more specific transition requirements and optional reliefs also apply.

Commercial significance

Most

Number of entities affected

FRS 116 will affect most companies that are involved in leasing.

High

Impact on affected entities

FRS 116 will have a substantial impact on the financial statements of lessees of property and high value equipment.

Bringing all leases on-balance sheet is controversial. The standard setters have therefore made compromises to reduce the controversy, in particular exemptions for short-term and low value asset leases. As a result businesses that lease only assets such as printers and laptops will face only a limited impact. For businesses that lease 'big-ticket' assets, such as property and high-value equipment, this will however be a major change. Whatever your views on the new Standard, businesses would be well-advised to start an impact analysis sooner rather than later.

Prepayment Features with Negative Compensation (Amendments to FRS 109)

The amendments allow companies to measure particular prepayable financial assets with negative compensation at amortised cost or at fair value through other comprehensive income – instead of measuring those assets at fair value through profit or loss.

The amendments also include clarifications to the modification or exchange of a financial liability that does not result in derecognition.

After FRS 109 was issued, clarification was requested on how to apply the FRS 109 requirements for recognising and measuring financial instruments to certain debt instruments where the borrower is permitted to prepay the instrument at an amount that could be less than the unpaid principal and interest owed. Such a prepayment feature is often referred to as including potential 'negative compensation'.

Under the then existing requirements of FRS 109, a company would have measured a financial asset with negative compensation at fair value through profit or loss as the 'negative compensation' feature would have been viewed as introducing potential cash flows that were not solely payments of principal and interest.

However, to improve the usefulness of the information provided, in particular on the instrument's effective interest rate and expected credit losses, amendments were issued so that entities will now be able to measure some prepayable financial assets with negative compensation at amortised cost.

Another issue – Modification or exchange of a financial liability that does not result in derecognition

Concurrent with the amendment for prepayment features with negative compensation, the IASB discussed the accounting for a modification or exchange of a financial liability measured at amortised cost that does not result in the derecognition of the financial liability. Specifically, the IASB considered whether, when applying IFRS 9, an entity should recognise any adjustment to the amortised cost of the financial liability arising from such a modification or exchange in profit or loss at the date of the modification or exchange.

The IASB concluded that no change needed to be made to the Standard itself but has clarified the existing position by adding text to the Basis for Conclusions on IFRS 9 in these amendments.

The change to the accounting for a modification or exchange of a financial liability that does not result in derecognition is effective from 2018 as this text merely clarifies the existing Standard as opposed to amending it.

To summarise, the IASB believes that IFRS 9 provides an adequate basis for an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition. The text which has been added in the amendments highlights that the requirements in IFRS 9 for adjusting the amortised cost of a financial liability when a modification (or exchange) does not result in the derecognition of the financial liability are consistent with the requirements for adjusting the gross carrying amount of a financial asset when a modification does not result in the derecognition of the financial asset. Those requirements state that when contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset, an entity shall recalculate the gross carrying amount of the financial asset and shall recognise a modification gain or loss in profit or loss.

While the ASC has made no changes to clarify the accounting or modification of financial liabilities, we believe that the clarification under IFRS 9 can be applied under FRS 109 as well.

Ironically, the 'other issue' clarifying the accounting for a modification or exchange of a financial liability that does not result in derecognition may well result in the most significant change in accounting as modification gains and losses will now be recognised immediately in profit or loss in such situations.

'Prepayment Features with Negative Compensation – Amendments to FRS 109' is effective for annual periods beginning on or after 1 January 2019, with earlier application permitted.

Commercial significance

Some Number of entities affected

The amendments will have most relevance to financial institutions who hold these types of financial instruments, although it is possible that some other entities will be affected.

High Impact on affected entities

The 'Prepayment Features with Negative Compensation' is an important one as otherwise financial institutions would have had to account for what are essentially debt-type financial assets at fair value as opposed to amortised cost, which may not have provided the most useful information to users.

The 'other issue'could have an even more significant impact and must be applied at the same time FRS 109 is applied.

'Ironically, the 'other issue' clarifying the accounting for a modification or exchange of a financial liability that does not result in derecognition may well result in the most significant change in accounting as modification gains and losses will now be recognised immediately in profit or loss in such situations.'

Long-term Interests in Associates and Joint Ventures (Amendments to FRS 28)

FRS 109 excludes interests in associates and joint ventures accounted for in accordance with FRS 28. However, some stakeholders expressed an opinion that it was not clear whether that exclusion applies only to interests in associates and joint ventures to which the equity method is applied or whether it applies to all interests in associates and joint ventures.

In the amendments, the standard setters clarifies that the exclusion in FRS 109 applies only to interests accounted for using the equity method. Therefore, a company applies FRS 109 to other interests in associates and joint ventures, including long-term interests to which the equity method is not applied and which, in substance, form part of the net investment in those associates and joint ventures.

The IASB has also published an example that illustrates how entities apply the requirements in IFRS 9 and IAS 28 to long-term interests in an associate or joint venture. This example can be considered when applying these amendments to FRS 28.

Commercial significance

Some Number of entities affected

The amendments will impact entities that have interests in associates and joint ventures to which the equity method is applied.

High Impact on affected entities

The amendment is significant as it means holdings in debt-type instruments issued by an associate or joint venture will be subject to FRS 109's impairment requirements.

'FRS 109 excludes interests in associates and joint ventures accounted for in accordance with FRS 28.'

INT FRS 123 Uncertainty over Income Tax Treatments

A new Interpretation INT FRS 123 'Uncertainty over Income Tax Treatments' has been published, specifying how entities should reflect uncertainty in accounting for income taxes.

FRS 12 'Income Taxes' specifies how to account for current and deferred tax but not how to reflect the effects of uncertainty. INT FRS 123 addresses this previous lack of guidance.

INT FRS 123 addresses uncertainty over how tax treatments should affect the accounting for income taxes. The table illustrates the main issues that are addressed by the Interpretation.

Main issues addressed by INT FRS 123

Issue	Proposal
When and how the effect of uncertainty over income tax treatments should be included in the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates	• an entity is required to consider whether it is probable that a taxation authority will accept an uncertain tax treatment • if it is, the entity would determine taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment used or planned to be used in its income tax filings • if the entity concludes that it is not probable that the taxation authority will accept an uncertain tax treatment, it uses either the most likely amount or the expected value in determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates (depending on which method is expected to better predict the resolution of the uncertainty).
The assumptions that an entity should make about the examination of tax treatments by taxation authorities	• an entity is required to assume that a tax authority will examine amounts it has a right to examine and will have full knowledge of all relevant information when making those examinations.
Changes in facts and circumstances	• entities are also required to reassess their judgements and estimates if facts and circumstances change (eg upon reaching a time limit where the taxation authority is no longer able to challenge an entity's tax treatments) or as a result of new information that affects the judgement or estimate becoming available.
Whether uncertain tax treatments should be considered separately	• entities would be required to use judgement to determine whether each uncertain tax treatment should be considered separately, or whether some uncertain tax treatments should be considered together. In determining the approach to be followed, entities shall consider which approach better predicts the resolution of the uncertainty.

Main issues addressed by INT FRS 123

Issue	Proposal
Disclosure	• when addressing uncertainty over income tax treatments, entities are required to disclose judgements, assumptions and estimates made in accordance with the normal requirements of FRS 1 'Presentation of Financial Statements' • in addition, if an entity concludes it is probable that a taxation authority will accept an uncertain tax treatment, it should consider whether to disclose the potential effect of the uncertainty as a tax-related contingency under FRS 12.
Transition	• entities shall apply INT FRS 123: – retrospectively by applying FRS 8, if that is possible without the use of hindsight; or – retrospectively with the cumulative effect of initially applying the effect of the changes being recognised in the opening balance of retained earnings (or another component of equity) in the period of first application, without adjusting comparative information.

Commercial significance

Many

Number of entities affected

This Interpretation is applicable to any entity where there is uncertainty over whether a tax treatment will be accepted or disputed by the tax authorities. It includes all tax items (taxable profits and losses, tax bases, unused tax bases, unused tax credits and tax rates), and therefore could have a widespread impact.

Medium

Impact on affected entities

If an entity concludes there is uncertainty over the tax treatment of an item, it must account for the uncertain treatment accordingly. It could therefore have a significant impact on some entities depending on the item.

> **'It was observed that there was diversity in practice for various issues on the recognition and measurement of a tax liability or asset in circumstances where there is uncertainty in the application of the tax law in concern.'**

Annual Improvements to SFRS 2015–2017 Cycle (Amendments to FRS 12, FRS 23, FRS 103 and FRS 111)

This publication is a collection of amendments to SFRS during the 2015-2017 cycle. Amendments made as part of this process either clarify the wording in a Standard or correct relatively minor oversights or conflicts between existing requirements of SFRS. By presenting the amendments in a single document rather than as a series of piecemeal changes, the standard setters aims to ease the burden of change for all concerned. A summary of the issues addressed is set out below:

Matters addressed by the amendments

Standard affected	Subject	Summary of amendment
FRS 12 'Income Taxes'	Income tax consequences of payments on instruments classified as equity	The amendments to FRS 12 clarify that the income tax consequences of dividends are recognised in profit or loss, other comprehensive income or equity according to where the entity originally recognised those past transactions or events.
FRS 23 'Borrowing Costs'	Borrowing costs eligible for capitalisation	FRS 23 specifies how to determine the amount of borrowing costs eligible for capitalisation when an entity borrows funds generally and uses them to obtain a qualifying asset. FRS 23 requires an entity, when determining the funds that it borrows generally, to exclude 'borrowings made specifically for the purpose of obtaining a qualifying asset'. It was observed that an entity might misinterpret those words to mean that funds borrowed generally would exclude funds outstanding that were originally borrowed specifically to obtain a qualifying asset that is now ready for its intended use or sale. The amendments therefore clarify that when a qualifying asset is ready for its intended use or sale, an entity treats any outstanding borrowing made specifically to obtain that qualifying asset as part of the funds that it has borrowed generally. The amendments are to be applied prospectively (ie only to borrowing costs incurred on or after the beginning of the annual reporting period in which the amendments are first applied) as the costs of gathering the information required to capitalise borrowing costs retrospectively may exceed the potential benefits.
FRS 103 'Business Combinations'	Previously held interests in a joint operation	The amendment clarifies that when an entity obtains control of a joint operation, it accounts for this transaction as a business combination achieved in stages, including remeasuring its previously held interest in the joint operation at its acquisition-date fair value. The logic behind the amendment is that obtaining control results in a significant change in the nature of, and economic circumstances surrounding, the interest held.
FRS 111 'Joint Arrangements'	Previously held interests in a joint operation	In contrast to the clarifications to FRS 103, an entity does not remeasure its previously held interest in a joint operation when it obtains joint control of the joint operation.

The amendments are effective for annual periods beginning on or after 1 January 2019, with earlier application permitted. The amendments are to be applied retrospectively, except for the amendments to FRS 23 as explained above.

Commercial significance

Few

Number of entities affected

The amendments make changes to relatively narrow areas within SFRS.

Low

Impact on affected entities

The Annual Improvements addresses non-urgent, but necessary minor amendments to SFRS. By their nature then, their commercial significance can be expected to be low. Overall the changes are uncontroversial. We note however that the amendments to FRS 12 do not include requirements on how to determine whether payments on financial instruments classified as equity are distributions of profits. This means that it is likely that challenges will remain when determining whether to recognise the income tax effects on a payment in profit or loss or in equity.

Plan Amendment, Curtailment or Settlement (Amendments to FRS 19)

The amendments require companies to use updated actuarial assumptions to determine pension expenses following changes to a defined benefit pension plan.

FRS 19 'Employee Benefits' requires a company to remeasure its net defined benefit liability or asset when an amendment to, or a curtailment or settlement of a defined benefit plan takes place. However, FRS 19 was not explicit on how to determine the expenses incurred after the change to the defined benefit plan has taken place.

The amendments to FRS 19, now require a company, when a defined benefit plan is amended, curtailed or settled during a period and the net defined benefit liability or asset is remeasured as a result of one of these transactions, to:

- determine the current service costs and the net interest for the period after the remeasurement using the assumptions used for the remeasurement; and
- determine the net interest for the remaining period based on the remeasured net defined benefit liability or asset.

These amendments could change whether and when an entity remeasures its net defined benefit liability or asset. When assessing whether remeasuring the net defined benefit liability or asset will have a material impact, an entity will not only consider the effect on past service cost, or a gain or loss on settlement, but also the effects of using the updated assumptions for determining current service cost and net interest for the remainder of the annual reporting period after the plan amendment, curtailment or settlement.

Effective date and transition

These amendments are effective for annual reporting periods beginning on or after 1 January 2019, with early application permitted.

The amendments are only to be applied prospectively as the the benefits of applying the amendments retrospectively would not exceed the cost of doing so as entities might need to revisit plan amendments, curtailments and settlements that occurred several years previously and remeasure the net defined benefit liability or asset as of those dates. Also, it was concluded that requiring a retrospective application would not provide useful trend information.

Grant Thornton view

We believe using updated assumptions to determine current service cost and net interest for the remainder of an annual reporting period following a change will provide more useful information to users of the financial statements.

Commercial significance

Some Number of entities affected

The amendments will impact entities with defined benefit plans.

Medium Impact on affected entities

The amendments could change whether an entity remeasures its net defined benefit liability and the timing of this remeasurement.

Effective from 1 January 2020

The Standards discussed on pages 42 are effective for accounting periods beginning on or after 1 January 2020.

The standards on page 44 to 47 have been issued by the IASB but are yet to be notified by the ASC in Singapore. The Standards are:

- Definition of Material (Amendments to IAS 1 and IAS 8)
- Definition of a Business (Amendments to IFRS 3)

Conceptual Framework for Financial Reporting

In January 2019, the ASC published a revised 'Conceptual Framework for Financial Reporting' (Conceptual Framework). Although it is not a Standard and will not immediately change or override any existing Standards, it may affect entities that develop or select accounting policies in accordance with the previous version of the Conceptual Framework.

Background

The Conceptual Framework describes the objective of, and the concepts for, general purpose financial reporting. It is mainly a tool for the standard setter to develop and revise Standards that are based on consistent concepts, but entities might also use it when they have to develop accounting policies when no Standard applies or when a Standard allows a choice of accounting policy.

The last version included two revised chapters on the objective of financial reporting and the qualitative characteristics of useful financial information but, for example, did not contain a chapter on the reporting entity or guidance on measurement or reporting financial performance. In addition to lacking guidance in certain areas, some existing guidance was not as clear as desired or was outdated.

Main issues addressed by the revised Conceptual Framework

The revised Conceptual Framework now sets out a more complete set of concepts in eight chapters:

1. The objective of general purpose financial reporting
2. The qualitative characteristics of useful financial information
3. Financial statements and the reporting entity
4. The elements of financial statements
5. Recognition and derecognition
6. Measurement
7. Presentation and disclosure
8. Concepts of capital and capital maintenance.

The guidance on measurement, financial performance, derecognition, and the reporting entity is new to the Conceptual Framework. In addition, some of the existing guidance has been updated. For example, the concept of prudence to support a faithful representation has been reintroduced and it has been clarified that measurement uncertainty can impact a faithful representation.

The revised Conceptual Framework also updates some existing concepts like the definitions of assets and liabilities. Although both definitions worked well in the past, the revised definitions now focus more on describing an asset as an economic resource and a liability as an obligation to transfer an economic resource rather than describing both in terms of a flow of benefits.

Consequential amendments and effects on preparers

Alongside the revised Conceptual Framework, the ASC has published 'Amendments to References to the Conceptual Framework in SFRS Standards'. This publication updates nearly all of the references to previous versions with references to the 2019 Conceptual Framework. The updated references will have no impact on preparers of financial statements as the Conceptual Framework is not a Standard and does not change or override requirements of any existing Standards.

However, some references have not been updated or allow preparers to continue applying the old Conceptual Framework. To avoid unintended consequences, preparers are required to apply the definitions of assets and liabilities from the old Conceptual Framework when accounting for business combinations under FRS 103.

Also, preparers will continue using the old definitions of assets and liabilities when accounting for regulatory account balances. This means preparers will not have to change their accounting for rate-regulated assets and liabilities twice within a short period of time as the ASC is planning to replace the interim Standard FRS 114 'Regulatory Deferral Accounts' in the near future.

Effective date and transition

The Conceptual Framework is not a Standard and will not change or override any existing Standards. It is primarily a tool for the standard setter to help them develop Standards based on consistent concepts.

However, entities that develop accounting policies using the Conceptual Framework, or that are in any other way affected by the amendments to SFRS Standards, will have to apply the changes from 1 January 2020.

Commercial Significance

Most Number of entities affected

The Conceptual Framework applies to all entities using SFRS.

Low Impact on affected entities

'The guidance on measurement, financial performance, derecognition, and the reporting entity is new to the Conceptual Framework.'

Definition of Material (Amendments to IAS 1 and IAS 8)

In October 2018, the IASB issued 'Definition of Material' making amendments to IAS 1 'Presentation of Financial Statements' and IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.

The amendments are a response to findings that some companies experienced difficulties using the previous definition when judging whether information was material for inclusion in the financial statements. In fact, up to now, the wording of the definition of material in the Conceptual Framework for Financial Reporting differed from the wording used in IAS 1 and IAS 8. The existence of more than one definition of material was potentially confusing, leading to questions over whether the definitions had different meanings or should be applied differently.

The old definition

Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements.

The new definition

Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

Grant Thornton insight – 'obscuring'

Including 'obscuring' in the definition of material addresses concerns that the former definition could be perceived by stakeholders as focusing only on information that cannot be omitted (material information) and not also on why it may be unhelpful to include immaterial information. However, this does not mean that entities are prohibited from disclosing immaterial information.

The amendments give a number of examples of circumstances that may result in material information being obscured.

Grant Thornton insight – 'reasonably be'

This wording reflects wording broadly previously used in IAS 40 and helps to address concerns raised by some parties that the threshold 'could influence' in the existing definition of material is too low and might be applied too broadly.

Grant Thornton insight – 'primary users'

The amendments note that many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial statements for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial statements are directed.

The amendments are designed to rectify this problem and make it easier for companies to define materiality judgements. They do this by:

- including in the definition guidance that until now has featured elsewhere in IFRS
- improving the explanations that accompany the definition
- ensuring that the definition of material is consistent across all IFRS.

Transition

The changes are effective from 1 January 2020, but companies can decide to apply them earlier.

At the time of writing this publication, similar amendments to FRS 1 and FRS 8 have not been issued by ASC. We expect these amendments to be incorporated in SFRS with effective date of 1 January 2020.

Commercial significance

Most Number of entities affected

The concept of materiality is used by most entities.

Few Number of entities affected

The amendments are intended to make the definition easier to understand and are not intended to alter the concept of materiality in IFRS. As such, we do not expect the amendments to change significantly how materiality judgements are made in practice or to significantly affect entities' financial statements. We do however expect that they will improve the understanding of this important area.

'The amendments note that many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial statements for much of the financial information they need.'

Definition of a Business (Amendments to IFRS 3)

In October 2018, the IASB issued 'Definition of a Business' making amendments to IFRS 3 'Business Combinations'.

The amendments are a response to feedback received from the post-implementation review of IFRS 3. They clarify the definition of a business, with the aim of helping entities to determine whether a transaction should be accounted for as an asset acquisition or a business combination.

The amendments:

- clarify the minimum attributes that the acquired assets and activities must have to be considered a business
- remove the assessment of whether market participants can acquire the business and replace missing inputs or processes to enable them to continue to produce outputs
- narrow the definition of a business and the definition of outputs
- add an optional concentration test that allows a simplified assessment of whether an acquired set of activities and assets is not a business.

New definition of a business
An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

What are the minimum requirements to meet the definition of a business?

The amendments acknowledge that despite most businesses having outputs, outputs are not necessary for an integrated set of assets and activities to qualify as a business. In order to meet the definition of a business the acquired set of activities and assets must have inputs and substantive processes that can collectively significantly contribute to the creation of outputs.

Is the acquired process substantive?

The amendments add guidance and illustrative examples to assist entities in assessing whether a substantive process has been acquired. The guidance explains that those entities that do not have outputs are new entities that have not yet generated revenue. If the acquired set of activities and assets is generating revenue at the acquisition date it is considered to have outputs.

For activities and assets that do not have outputs at the acquisition date, the acquired process is substantive if:

- it is critical to being able to develop or convert an acquired input into an output
- the inputs acquired include both:
  - an organised workforce that has the skills, knowledge or experience to perform the process
  - other inputs that the organised workforce could develop or convert into outputs (eg. Technology, in-process research and development projects, real estate and mineral interests).

For activities and assets that have outputs at the acquisition date, the acquired process is substantive if:

- it is necessary to being able to continue to produce outputs, and the acquired inputs include an organised workforce with the necessary skills, knowledge or experience to perform the process
- it significantly contributes to being able to continue producing outputs and is deemed to be unique or scarce or it cannot be replaced without significant cost, effort or delay in producing outputs.

How have the amendments changed the definition?

The amendments replace the wording in the definition of a business from:

- 'providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants' to
- 'providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.'

This narrows the definition by focussing on goods or services rather than returns.

Accounting topic	Business combination	Asset purchase
Recognition of identifiable assets and liabilities	• measured at fair value	• total cost is allocated to individual items based on relative fair values
Goodwill or gain on bargain purchase	• recognised as an asset (goodwill) or as income (gain on bargain purchase)	• not recognised
Transaction costs	• expensed when incurred	• typically capitalised
Deferred tax on initial temporary differences	• recognised as assets and liabilities	• not recognised unless specific circumstances apply

What is the optional concentration test?

The amendments introduce an optional test (the concentration test) that allows the acquirer to carry out a simple assessment to determine whether the set of activities and assets acquired is not a business. If the test is successful, then the set of activities and assets acquired is not a business and no further assessment is required. If the test is not met or the entity does not carry out the test, then the entity needs to assess whether or not the acquired set of assets and activities meets the definition of a business in the normal way.

The test is met if substantially all of the fair value of the gross assets acquired is concentrated in one or a group of similar identifiable assets. Gross assets exclude cash and cash equivalents, deferred tax assets and goodwill from the effects of deferred tax liabilities. The amendments also provide guidance on what a single identifiable asset or a group of similar identifiable assets would be.

Transition

The changes are to be applied prospectively to business combinations and asset acquisitions for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020. Companies can apply them earlier if they disclose this fact. ASC in Singapore has not issued similar amendments. We expect these to be issued shortly & effective from 1 January 2020.

Asset purchase versus business combination

It is important to distinguish business combinations from asset purchases because the IFRS requirements are very different. Some of the key differences are summarised in the table above.

Commercial Significance

Some

Number of entities affected

The amendments could impact all business combinations and purchases where it is unclear whether an asset or a business has been acquired.

Medium

Impact on affected entities

The impact could be significant if the outcome as to whether there is a business changes.

'The amendments are a response to feedback received from the post-implementation review of IFRS 3.'

Effective from 1 January 2021

The Standard discussed on pages 49 to 52 is effective for accounting periods beginning on or after 1 January 2021.

- FRS 117 Insurance Contracts

FRS 117 Insurance Contracts

In May 2017, the IASB published IFRS 17 Insurance Contract. In March 2018, the ASC published FRS 117 'Insurance Contracts' aligned with IFRS 17.

The new Standard replaces FRS 104 'Insurance Contracts'. FRS 104 was designed to be an interim Standard and therefore allowed entities issuing insurance contracts to carry on accounting for them using policies that had been developed under their previous local accounting standards. This meant that entities continued to use a multitude of different approaches for accounting for insurance contracts, making it difficult to compare and contrast the financial performance of otherwise similar entities.

FRS 117 solves the comparison problems created by FRS 104 by requiring all insurance contracts to be accounted for in a consistent manner, benefiting both investors and insurance companies. We briefly discuss some of the areas covered by the new Standard below:

Scope

FRS 117 applies to all insurance contracts that an entity issues (including those for reinsurance); reinsurance contracts it holds; and investment contracts with a discretionary participation feature, provided the entity also issues insurance contracts.

FRS 117 defines an insurance contract as one under which one party (the issuer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

This definition is similar to that in FRS 104. In addition, FRS 117 provides guidance on how to assess the significance of insurance risk based on the possibility of a loss on a present value basis (rather than nominal), and how to evaluate changes in the level of insurance risk.

Measurement

FRS 117 requires an entity that issues insurance contracts to report them on the balance sheet as the total of:

a the fulfilment cash flows – the current estimates of amounts that the insurer expects to collect from premiums and pay out for claims, benefits and expenses, including an adjustment for the timing and risk of those cash flows and

b the contractual service margin – the expected profit for providing future insurance coverage (ie unearned profit).

The measurement of the fulfilment cash flows reflects the current value of any interest rate guarantees and financial options included in the insurance contracts.

To better reflect changes in insurance obligations and risks, FRS 117 requires an entity to update the fulfilment cash flows at each reporting date, using current estimates that are consistent with relevant market information. This means that insurance obligations will be accounted for using current values instead of historical cost, ending the practice of using data from when a policy was taken out.

Current discount rates are also required to be used. These will reflect the characteristics of the cash flows arising from the insurance contract liabilities, a change from the previous situation where many entities used discount rates based on the expected return on assets backing the insurance contract liabilities.

Revenue is no longer equal to written premiums but to the change in the contract liability covered by consideration.

Insurance performance

FRS 117 requires an entity to provide information that distinguishes two ways insurers earn profits from insurance contracts:

a the insurance service result, which depicts the profit earned from providing insurance coverage
b the financial result, which captures:
  - investment income from managing financial assets
  - insurance finance expenses from insurance obligations – the effects of discount rates and other financial variables on the value of insurance obligations.

When applying FRS 117, changes in the estimates of the expected premiums and payments that relate to future insurance coverage will adjust the expected profit – ie the contractual service margin for a group of insurance contracts will be increased or decreased by the effect of those changes.

The effect of such changes in estimates will then be recognised in profit or loss over the remaining coverage period as the contractual service margin is earned by providing insurance coverage.

Onerous contracts

To make differences in profitability among insurance contracts visible, FRS 117 requires an entity to distinguish groups of contracts expected to be loss-making from other contracts.

Companies should first identify portfolios of insurance contracts that are subject to similar risks and managed together. Once an entity has identified portfolios of contracts, it divides each portfolio into groups considering differences in the expected profitability of the contracts.

If the amounts that the insurer expects to pay out on a contract in the form of claims, benefits and expenses exceed the amounts that the insurer expects to collect from premiums, either at the inception of the contracts or subsequently, the contracts are loss making and the difference will be recognised immediately in profit or loss.

Reinsurance contracts

A separate measurement model applies to reinsurance contracts held. Modifications are allowed for qualifying short-term contracts and participating contracts.

Presentation

Statement of financial position

The statement of financial position should present in separate captions the assets and liabilities arising under insurance contracts issued and reinsurance contracts held.

In contrast to practices existing under various local GAAPs, entities should adopt a grossed-up presentation where contracts, which are assets, are not netted off against contracts, which are liabilities and vice versa. FRS 117 does not mandate a layout for the statement of financial position. The reporting entities should follow the general requirements of FRS 1 'Presentation of Financial Statements' but need to ensure that certain captions are presented as a minimum on the face of the statement.

Statement of financial performance – measurement of revenue and expenses

FRS 117 does not mandate a layout for the statement of financial performance. Reporting entities should follow the principle requirements of FRS 1 and the measurement rules of FRS 117, which require that revenue and incurred expenses presented in profit or loss exclude any investment components.

Measurement of insurance contract revenue

Revenue recognition is an area where FRS 117 principles represent a significant change from practices previously followed in various local GAAPs. Previously revenue was reported by reference to premium cash received or receivable.

Under FRS 117, revenue represents the total change in the liability for remaining coverage that relates to coverage and services during the period for which the entity expects to receive consideration.

Supporting materials issued by the IASB

The IASB has announced various initiatives to support entities with the adoption of the Standard, including a dedicated implementation support page for IFRS 17 and a webinar on the Standard.

The IASB has also established a Transition Resource Group which discusses questions from stakeholders about the new accounting requirements. Grant Thornton is represented on the Group.

Disclosure

The objective of the disclosure requirements of FRS 117 is to disclose information which allows the users of financial statements to assess the effect that contracts within the scope of the Standard have on the entity's financial position, financial performance and cash flows. Entities should provide quantitative and qualitative information about amounts recognised in the financial statements, significant judgements (and changes thereof), and the nature and extent of risks arising from contracts within the scope of the Standard.

Reporting entities are required to follow FRS 1's requirements on materiality and aggregation when deciding what aggregation bases are appropriate for disclosure. The type of contract, geographical area or reportable segment as defined in

FRS 108 'Operating Segments' are all examples suggested but not mandated by the Standard.

Effective date and transition

FRS 117 has an effective date of 1 January 2021 but may be applied earlier provided the entity applies FRS 109 'Financial Instruments' and FRS 115 'Revenue from Contracts with Customers' at or before the date of initial application of the Standard (and subject to any considerations imposed by local legislation).

At the time of writing, the IASB is considering deferring the effective date of IFRS 17. Subject to public consultation, they are proposing to defer it by one year. The IASB will also discuss whether there is a need to propose (narrow focus) changes to IFRS 17 in the coming months. These changes may also impact adoption of FRS 117 in Singapore.

'FRS 117 solves the comparison problems created by FRS 104 by requiring all insurance contracts to be accounted for in a consistent manner, benefiting both investors and insurance companies.'

Commercial significance

Some Number of entities affected

FRS 117 is a Standard about insurance contracts, not a Standard for the insurance industry. While insurance companies will be most affected, its effect will also be felt beyond the entities authorised to carry out regulated (re) insurance activities in a jurisdiction.

High Impact on affected entities

FRS 117 fundamentally changes the accounting for insurance contracts. It will have a substantial impact on the financial statements of those with insurance contracts. Presently there is a huge diversity in the way insurance contracts are accounted for, FRS 117 is set to uniform these accounting practices and will transform data, people, technology solutions and investor relations. Implementation costs are likely to be high as entities get to grips with the new Standard.

'To better reflect changes in insurance obligations and risks, FRS 117 requires an entity to update the fulfilment cash flows at each reporting date, using current estimates that are consistent with relevant market information.'

No effective date

The Practice Statement discussed on pages 54 to 55 can be applied from 1 August 2018. The Practice Statement is not a Standard and its application is
not mandatory or required in order to state compliance with SFRS. The Practice Statement is:

- SFRS Practice Statement 2: Making Materiality Judgements

The Standard discussed on pages 56 to 57 was due to become effective for accounting periods beginning on or after 1 January 2016; however its effective date has been postponed indefinitely.

Entities are still permitted to adopt the Standard and therefore it has been included within this publication. The Standard is:

- Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to FRS 110 and FRS 28)

IFRS Practice Statement 2: Making Material Judgements

In August 2018, the ASC published its second Practice Statement 'Making Materiality Judgements' (the 'Practice Statement'). The Practice Statement encourages entities to apply judgement so that financial statements focus on the information that is useful to investors rather than trying to comply with an SFRS 'checklist'. This non-authoritative guidance, which can be applied immediately, marks the next step in the ongoing 'Disclosure Initiative'.

The concept of materiality is important in the preparation of financial statements, because it helps companies determine which information to include in and exclude from their reports. The 'Conceptual Framework for Financial Reporting' discusses materiality as follows[1]:

- Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

However, management is often faced with uncertainty in applying that concept. Such uncertainty is encountered when making decisions about recognition and measurement but most of all when deciding what information to disclose in the notes and how to present that information.

This uncertainty has led to some entities using the disclosure requirements in SFRS Standards as a checklist rather than judging which information would be most useful to investors and other stakeholders.

In publishing the Practice Statement, the standard setter is providing support to companies when making materiality judgements and in doing so hopes to encourage behavioural change.

The Practice Statement gathers all the materiality requirements in SFRS Standards and adds practical guidance and examples entities may find helpful in deciding whether information is material.

The Practice Statement sets out a four-step process to making decisions on materiality:

Four-step process to making decisions on materiality

Steps	Action
Step 1 – Identify	• Identify information that has the potential to be material.
Step 2 – Assess	• Assess whether the information identified in Step 1 is, in fact, material.
Step 3 – Organise	• Organise the information within the draft financial statements in a way that communicates the information clearly and concisely to primary users.
Step 4 – Review	• Review the draft financial statements to determine whether all material information has been identified and materiality considered from a wide perspective and in aggregate, on the basis of the complete set of financial statements.

[1] FRS 1 'Presentation of Financial Statements' and FRS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' provide definitions which are similar in nature to this.

The Practice Statement also gives guidance on specific topics such as:

- prior-period information
- errors
- information about covenants
- materiality judgements for interim reporting.

The Practice Statement is not a Standard and its application is not mandatory or required in order to state compliance with SFRS. It does not change existing requirements or introduce new ones. Instead, it aims to provide guidance to assist management in applying the concept of materiality when preparing their financial statements. The guidance in the Practice Statement can be applied from its date of publication, 1 August 2018 .

Commercial significance

Many Number of entities affected

Many companies face uncertainty in applying the concept of materiality in the preparation of financial statements so this Practice Statement will be useful to the majority of companies.

Low Impact on affected entities

The Practice Statement provides principle based guidance which, if applied, may or may not impact the materiality decision. The Practice Statement provides non-mandatory guidance, which does not have the same authority as an SFRS.

‘The Practice Statement encourages entities to apply judgement so that financial statements focus on the information that is useful to investors rather than trying to comply with an SFRS ‘checklist’.`

Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to FRS 110 and FRS 28)

The Amendments to FRS 110 and FRS 28 address an acknowledged inconsistency between FRS 110 'Consolidated Financial Statements' and FRS 28 (2011) 'Investments in Associates'. This relates to accounting for transactions in which a parent entity loses control of a subsidiary by contributing it to an associate or joint venture.

The inconsistency stemmed originally from a conflict between the requirements of FRS 27 'Consolidated and Separate Financial Statements (Revised 2008)' and INT FRS 13 'Jointly Controlled Entities – Non-Monetary Contributions by Venturers'. While FRS 27 required the full gain or loss to be recognised on the loss of control of a subsidiary, INT FRS 13 required a partial gain or loss recognition in transactions between an investor and its associate or joint venture. Although FRS 110 supersedes FRS 27, and FRS 28 (2011) supersedes both FRS 28 and INT FRS 13, the conflict remained.

The amendments alter FRS 110 so that:

- the current requirements for the partial gain or loss recognition for transactions between an investor and its associate or joint venture only apply to the gain or loss resulting from the sale or contribution of assets that do not constitute a business, as defined in FRS 103
- the gain or loss from the sale or contribution of assets that constitute a business between an investor and its associate or joint venture is recognised in full.

Corresponding amendments have been made to FRS 28 (2011) to reflect these changes. In addition FRS 28 (2011) has been amended to clarify that when determining whether assets that are sold or contributed constitute a business, an entity shall consider whether the sale or contribution of those assets is part of multiple arrangements that should be accounted for as a single transaction.

Postponement of the effective date

The 2014 amendments were due to become effective for accounting periods beginning on or after 1 January 2016. A number of questions were raised over the application of the amendments however such as how the transfer of assets would be recognised if the investor receives both assets and an equity interest, and how other requirements of FRS 28 interact with the changes made to FRS 110. In deliberating these issues, the Board decided that it would be better to address them as part of the research project on the equity method rather than make changes now.

In 2015, the ASC issued 'Effective Date of Amendments to FRS 110 and FRS 28', which defers indefinitely the mandatory effective date of the 2014 amendments. Entities are still permitted to apply the 2014 amendments as the board does not wish to prohibit the application of better accounting. Any proposal to insert a new effective date will be exposed for public comment.

Point of view

We agree with the proposal to defer the effective date of the 2014 amendments. We believe it does not make sense to require entities to change the way they apply FRS 28 now if further amendments are likely to arise from the research project on the equity method of accounting in the near future.

Commercial significance

Few Number of entities affected

The scope of the amendments is narrow in nature.

Medium Impact on affected entities

The amendments offer a pragmatic solution to a well-known conflict between FRS 110 and FRS 28.

'The Amendments to FRS 110 and FRS 28 address an acknowledged inconsistency between FRS 110 'Consolidated Financial Statements' and FRS 28 (2011) 'Investments in Associates'. They can still be applied even though the effective date of the amendments has been deferred indefinitely.'

About Financial Reporting Advisory Services (FRAS)

In today's competitive business environment and fast changing regulatory & reporting landscape, dynamic organisations face several challenges with respect to financial reporting which could potentially impact the value of the businesses.

There is a greater need for accurate and timely financial information now. As a part of our Audit and Assurance practice, Financial Reporting Advisory Services (FRAS) has developed innovative solutions to make financial reporting process smooth, time-bound and auditable.

The FRAS team at Grant Thornton is a multi-disciplinary team that designs and implements creative solutions to address these complexities. Most of our team members are former auditors and assist Companies design 'auditor ready' solutions such as whitepaper, reporting packages, reconciliations supporting financial report disclosures.

What differentiates us

- We pre-empt problems and draft solutions to them
- Most of our professionals have auditing experience, which helps them appreciate practical complexities in financial reporting
- Our team combines accounting knowledge with technological skills to deliver efficient and sustainable financial reporting solutions
- Our senior professionals are chosen experts with deep technical accounting knowledge and vast experience of advising clients on accounting matters
- Our size and structure create advantages for you. We adapt a flatter structure, with shorter decision making chains, empowered teams and no complex chains of command. Our teams are more responsive
- Access to wide pool of IFRS experts from our offices in the region as well as our office in US, UK. India and Ireland.

About Grant Thornton Singapore

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