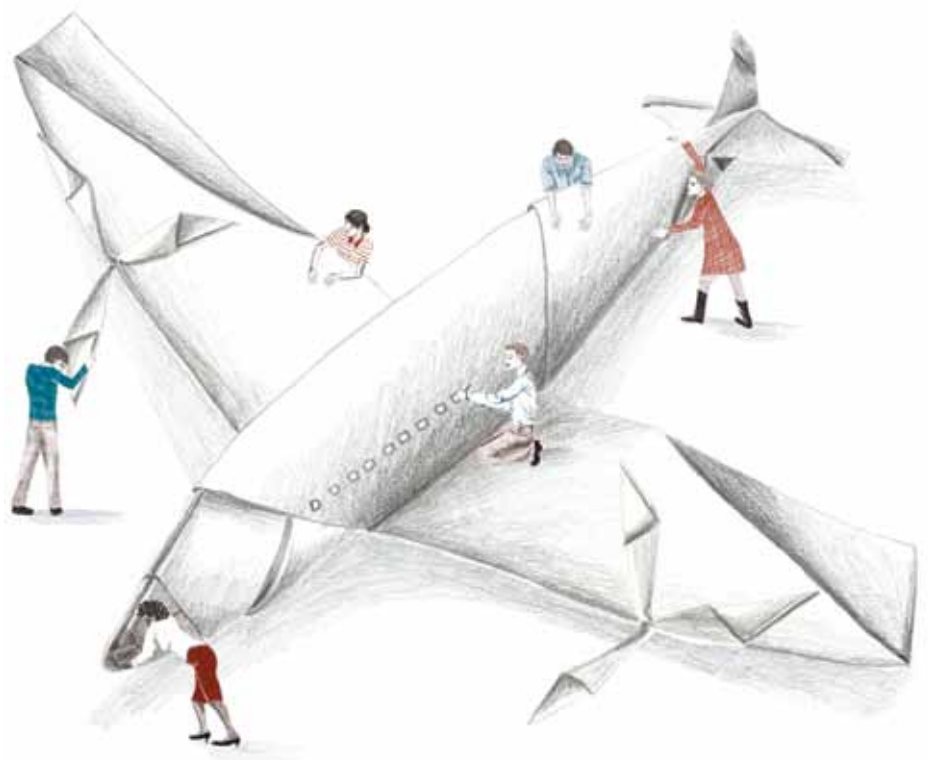


FRS News

June 2010

Welcome to FRS News – an update from **SJ Grant Thornton**. FRS News offers a summary of the more significant developments in Financial Reporting Standards (FRS) along with insights into topical issues and views from **SJ Grant Thornton**.

Firstly, we will consider some immediate challenges in FRS 8 *Operating Segments* that will be faced by companies in preparation of their financial statements for the financial year ending 30 June 2010. Thereafter, we will look into the main changes made to the amended FRS 101 *Presentation of Financial Statements*. We then turn your attention to the practical application issues of applying FRS 132 *Financial Instruments : Presentation* and FRS 139 *Financial Instruments : Recognition and Measurement*. We will then proceed to discussing the impact of IC Interpretation 15 *Agreements for the Construction of Real Estate* on the Company's accounting policy for revenue recognition. We will conclude with an overview on the status of global convergence with IFRS in India, China and Japan.



Questions to consider when adopting FRS 8 *Operating Segments* for the first time

One of the challenges that many companies will be facing in preparing their 30 June 2010 accounts is the MASB's revised Standard on segmental information.

FRS 8 *Operating Segments* is effective for annual periods beginning on or after 1 July 2009, and takes a radically different approach from the previous Standard dealing with this subject (FRS 114 *2004 Segment Reporting*).

Under FRS 8, financial information is generally required to be reported on the same basis as is used internally for evaluating operating segment performance and deciding how to allocate resources to operating segments. The logic behind this is that it allows users of the financial statements to review an entity's operations from the same perspective as its management (the 'management approach').

FRS 8's 'management approach' to segmental reporting is radically different to that of FRS 114 *2004*.

A review conducted by the UK's Financial Reporting Review Panel has highlighted concerns about how companies are reporting the performance of their business under IFRS 8 (FRS 8 equivalents). Although the review looked solely at UK companies, the questions raised are likely to be relevant to all companies applying IFRS 8 and FRS 8 for the first time.

The Financial Reporting Review Panel reviewed a sample of 2009 interim accounts and 2008 annual accounts (in which companies had adopted the Standard early). The report notes that a number of companies were asked to provide explanations regarding their application of the Standard where:

- only one operating segment was reported, but the group appeared to be diverse, with different businesses or with significant operations in different countries
- the operating analysis set out in the management report differed from the operating segments in the financial statements

- the titles and responsibilities of the directors or executive management team implied an organisational structure which was not reflected in the operating segments selected
- the commentary in the management report focused on non-FRS measures whereas the segmental disclosures are based on FRS amounts.

To avoid questions being raised over a company's segmental information, the report suggests a number of questions (see box) that can be used to test whether the presentation of segmental information achieves the 'management approach' required by FRS 8.



Questions to consider when applying IFRS 8 and FRS 8 for the first time

- what are the key operating decisions made in running the business?
- who makes these key operating decisions?
- who are the segment managers (as defined in the Standard) and who do they report to?
- how are the group's activities reported in the information used by management to review performance and make resource allocation decisions between segments?
- is any proposed aggregation of operating segments into one reportable segment supported by the aggregation criteria in the Standard, including consistency with the core principle?
- is the information about reportable segments based on IFRS or FRS measures or on an alternative basis?
- have the reported segment amounts been reconciled to the IFRS or FRS aggregate amounts?
- do the financial statements describe the factors used to identify the reportable segments including the basis on which the company is organised?
- whether the reported segments appear consistent with the company's internal reporting and, if not, why not?



Amendments to FRS 101 Presentation of Financial Statements

The Malaysian Accounting Standards Board (MASB) has released the amendments to FRS 101 *Presentation of Financial Statements* (therein after referred to “amended FRS 101”) in 2008. It is effective for reporting periods beginning on or after 1 January 2010. Early application is allowed, but must be disclosed.

The new rules do not change the recognition, measurement or disclosure of specific transactions and other events required by other Financial Reporting Standards (FRSs).

Changes from old version of FRS 101

The main changes from the old version of FRS 101 are described below.

The term “equity holders” is replaced by “owners”. Owners are defined as “holders of instruments and classified as equity”. All changes in equity arising from transactions with owners in their capacity as holders of equity instruments are termed “owner changes in equity”.

Some FRSs require or permit particular items to be “recognised (credited or charged) directly to equity” (e.g. a change in carrying amount from the revaluation of property, plant and equipment (FRS 116) and exchange differences arising on the translation of the financial statements of a foreign operation (FRS 121). Such items are described in the amended FRS 101 as “recognised outside profit or loss” or “recognised outside profit or loss as a component of other comprehensive income”. Similarly, items previously described as “recognised in the income statement”

are renamed “recognised in profit or loss”. Following the amendments, paragraph 10 of amended FRS 101 states that a complete set of financial statements now comprises of:

- Statement of Financial Position (to replace Balance Sheet),
- Statement of Comprehensive Income (to replace Income Statement),
- Statement of Changes in Equity,
- Statement of Cash Flows (to replace Cash Flow Statement), and
- Notes to the Financial Statements, comprising a summary of significant accounting policies and other explanatory information.

Amended FRS 101.81 allows an entity to present all items of income and expense recognised in the period in a single “Statement of Comprehensive Income” or in two statements: a “separate Income Statement” and a “Statement of Comprehensive Income”.

The title “Statement of Changes in Equity” is retained but the contents are restricted to changes in equity arising from owners in their capacity as owners.

The MASB believes that the new titles better reflect the function of each financial statement and encourage entities to use them. However, use of the new titles is not mandatory (amended FRS 101.10).

Additional comparative disclosure for reclassification or restatement of items

Amended FRS 101 introduces a requirement to present an additional Statement of Financial Position

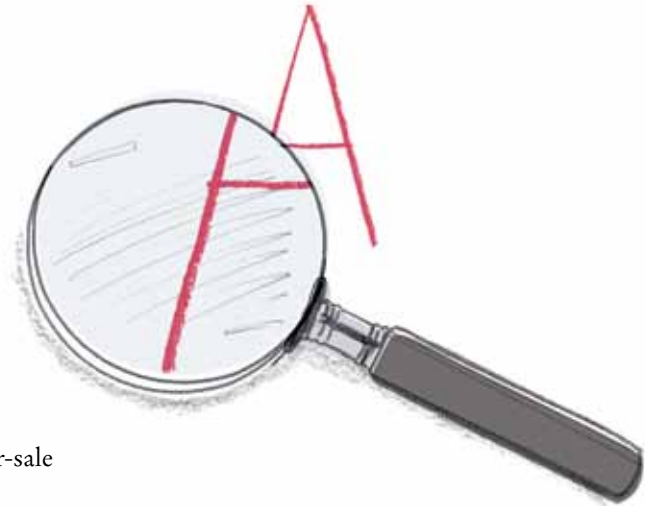
as at the beginning of the earliest comparative period in a set of financial statements in specified circumstances (amended FRS 101.10 (f)). This is required when the entity retrospectively applies an accounting policy or makes a retrospective restatement, as defined in FRS 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, or when it reclassifies items in its financial statements (amended FRS 101.39-40).

Reporting owner changes in equity and comprehensive income

The old version of FRS 101 requires items of income and expense recognised in profit or loss be presented in an “Income Statement”. It also requires a separate “Statement of Changes in Equity” showing either all changes in equity or changes in equity comprising profit or loss, other items of income and expense and the effects of changes in accounting policies and correction of errors. Changes in equity arising from transactions with owners in their capacity as owners are then disclosed in a note to the financial statements.

As mentioned in the previous section, amended FRS 101 requires an entity to present all items of income and expense recognised in the period in a single “Statement of Comprehensive Income” or in two statements: a “Separate Income Statement” and a “Statement of Comprehensive Income” (amended FRS 101.81).

The Income Statement shall disclose income and expense recognised in profit and loss in the same way as the



old version of FRS 101. The Statement of Comprehensive Income shall disclose profit or loss for the period, plus each component of income and expense recognised outside of profit and loss classified by nature (eg gains or losses on available-for-sale assets or translation differences related to foreign operations). Changes in equity arising from transactions with owners are **excluded** from the Statement of Comprehensive Income.

All owner changes in equity shall be presented separately from non-owner changes in equity in a “Statement of Changes in Equity” (amended FRS 101.106). Non-owner changes in the individual components of comprehensive income are not permitted to be disclosed in this statement, they are disclosed in the Statement of Comprehensive Income.

The Statement of Comprehensive Income (and the income statement, if presented separately) and the Statement of Changes in Equity shall be presented with equal prominence (FRS 101.11).

Other comprehensive income - reclassification adjustments and related tax effects

Amended FRS 101 requires an entity to disclose “reclassification adjustments” to provide users with information to assess the effect of reclassifications on profit or loss (amended FRS 101.92). Reclassification adjustments are amounts reclassified to profit or loss in the current period that were recognised in other comprehensive income in previous periods (eg on disposal of a foreign operation (FRS 121) or on

derecognition of an available-for-sale financial asset (FRS 139).

A new requirement introduced in the amended FRS 101 to disclose income tax relating to each component of other comprehensive income, as these components often have tax rates different from those applied to profit or loss. The amount of income tax relating to each component of other comprehensive income may be illustrated either in the Statement of Comprehensive Income or in the notes (amended FRS 101.90).

Presentation of dividends

The old version of FRS 101 permitted disclosure of the amount of dividends recognised as distributions to equity holders (now referred to as ‘owners’) and the related amount per share in the Income Statement, in the Statement of Changes in Equity or in the notes.

The amended FRS 101 now requires dividends recognised as distributions to owners and related amounts per share to be presented in the Statement of Changes in Equity or in the notes. Such disclosures are not permitted in the Statement of Comprehensive Income.

Liability or Equity

Classification of financial instruments is often a challenging issue in practice. This in part reflects the many variations in the rights and obligations of instruments that are found in different types of entities and in different parts of the world. Moreover, some instruments have been structured with the intention of achieving particular tax, accounting or regulatory outcomes with the effect that their substance can be difficult to evaluate.

The basics of FRS 132's classification process

Under FRS 132 *Financial Instruments: Presentation*, a financial instrument can be classified as a liability, as equity or as a compound instrument (an instrument which exhibits elements of both equity and liability classification, which must be accounted for separately).

An equity instrument is defined as “any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities”. Determining whether an instrument is classified as equity is therefore dependent on whether it meets the definition of a financial liability.

a). *Obligations to deliver cash or another financial asset are financial liabilities*

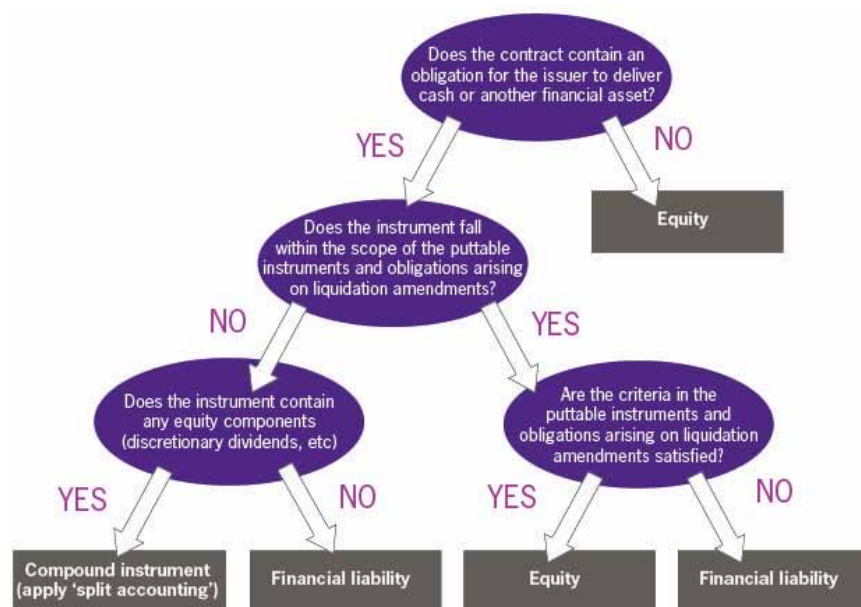
The basic principle of liability classification is that a financial instrument which contains a contractual obligation whereby the issuing entity is or may be required to deliver cash or another financial asset to the instrument holder is a financial liability.

Whether an instrument is classified as either a financial liability or as equity is important as it has a direct effect on an entity's reported results and financial position.

Liability classification typically results in any payments on the instrument being treated as interest and charged to earnings. This may in turn affect the entity's ability to pay dividends on its equity shares (depending upon the requirements of

local law).

Equity classification avoids the negative impact that liability classification has on reported earnings and gearing ratios. It also results in the instrument falling outside the scope of FRS 139 *Financial Instruments: Recognition and Measurement*, thereby avoiding the complicated ongoing measurement requirements of that Standard.

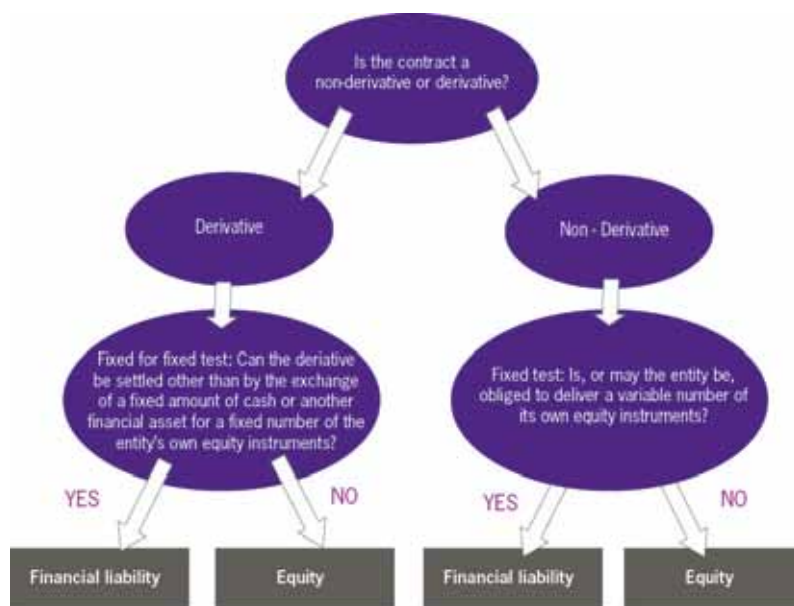


Diagrammatic illustration of the classification of a financial instrument containing an obligation for the issuer to deliver cash or another financial asset

b). Instruments settled in an entity's own equity instruments

Applying the basic principle of liability classification to instruments which may or will be settled in an entity's own equity instruments is more complicated. Classification of these instruments is governed by the so-called 'fixed' test for non-derivatives, and the 'fixed for fixed' test for derivatives.

Under the fixed test, a non-derivative contract will qualify for equity classification only where there is no contractual obligation for the issuer to deliver a variable number of its own equity instruments. Under the fixed for fixed test, a derivative will qualify for equity classification only where it will be settled by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.



Diagrammatic illustration of the classification of a financial instrument containing an obligation for the issuer to deliver cash or another financial asset

c). Compound instruments

Finally, some financial instruments contain both equity and liability components. These are referred to as compound instruments. FRS 132 separates a compound instrument into its equity and liability components on initial recognition, a process sometimes referred to as 'split accounting'.

Parent entity financial guarantee contracts

Financial guarantee contracts are defined in FRS 139 *Financial Instruments: Recognition & Measurement*, paragraph 9. The FRS 139 definition of financial guarantee contracts is quite narrow. In particular, the definition applies only where the guarantee relates to a debt instrument. The definition does not therefore capture product warranties, performance bonds and non-specific “comfort letters” of the type sometimes issued by parent entities to subsidiaries (for example).

Parent entity guarantees Initial recognition

Parent entities sometimes issue financial guarantee contracts to third party lenders in respect of borrowings of a subsidiary (“parent guarantees”). Similar to IAS 39, there is no scope exception in FRS 139 for parent guarantees, as the IASB concluded that scoping out parent guarantees could lead to the omission of material liabilities. Given this focus on the completeness of liability recognition, it is important that parent guarantees are properly assessed and that a supportable fair value is determined.

Determining fair value for parent guarantees will usually require the use of an estimation technique. There is unlikely to be an available quoted price in an active market. Various estimation techniques are possible, including:

- (i) expected losses under the guarantee (i.e. the probability-weighted outcomes); or
- (ii) if applicable, the present value of the reduction in the subsidiary’s interest payments.

The second approach is appropriate when it is evident that the parent guarantee has enabled the subsidiary to borrow at a lower interest rate, when compared to the market rate without the guarantee. This might be clear from bank negotiations or other borrowing transactions. This approach is relatively straightforward to apply and is likely to provide a reasonable estimate (since

the inputs are based on known cash flows and market interest rates).

Parent entity guarantees Subsequent measurement

After initial recognition a guarantee is re-measured to the higher of:

- (i) the amount that would be required in accordance with FRS 137 *Provisions, Contingent Liabilities and Contingent Assets*; and
- (ii) the initial fair value amount less amortisation, when appropriate, in accordance with FRS 139.47(c).

In the case of a single guarantee, FRS 137 would require recognition of a liability only when it is probable (ie more likely than not) that the guarantee will result in a payment. The liability would then be based on the most likely outcome (which may be the full amount guaranteed). For a portfolio of guarantees, an expected value approach should be applied (FRS 137.14 and 40).

When a payment under the guarantee is not probable, the guarantee is measured at its initial fair value less amortisation. We consider that amortisation is appropriate when:

- (i) consideration is received by the guarantor; and
- (ii) the guarantee is for a fixed period over which the associated risk diminishes.

Amortisation on a time proportion basis over the guarantee period may be appropriate. An alternative pattern of amortisation should be used if it is a

better approximation of the extent to which the guarantor has discharged its obligations.

The consideration received in exchange for a parent guarantee is often not in the form of cash. Rather, the parent benefits indirectly because the lender:

- makes a loan to the subsidiary that would not be made without the guarantee; or
- offers improved loan terms to the subsidiary (eg. a lower interest rate).

Subsidiary's separate financial statements

If a parent entity issues a guarantee directly to a lender, the subsidiary is not party to the guarantee contract. It does not therefore account for the guarantee directly. However, the terms of the loan need to be considered. The loan, viewed from the subsidiary's perspective, might not be at "market" terms (e.g. because it has an interest rate that is lower than would be available on a non-guaranteed basis). In that situation the obligations under the loan should be recorded at fair value based on the terms that would have been available without the guarantee. Consistent with the approach suggested for the parent, this fair value amount could be estimated based on the actual payments under the loan discounted at the subsidiary's arm's length cost of borrowing.

This will result in a carrying amount

that is less than the amount of the loan. The difference should be credited to equity, since in substance the parent has made a capital contribution to the subsidiary by issuing a "free" guarantee.

In many cases banks (and other lenders) require parent guarantees as a pre-condition for making loans to subsidiaries (rather than in exchange for reducing the interest rate). This is because lenders wish to protect themselves against a controlling party acting in a way that adversely affects creditors' interests. In this situation, the parent guarantee might not have a determinable effect on the terms of the loan. In these cases, the actual terms of the loan are likely to be the best indicator of "at-market" terms, such that the fair value is equal to the loan amount.

Consolidated financial statements

At group level, the guarantee has no separate accounting implications. In effect, the fair value of the guarantee is part of the fair value of the third party loan to subsidiary.



Revenue recognition



Companies should consider their accounting policy for revenue recognition and whether it states that revenue “is recognised when risk and rewards are transferred” or “by reference to the stage of completion” without giving the reader an understanding of when that might be.

If the answer is yes to either of those quotes then the company may wish to reconsider its revenue recognition accounting policy. The wording above is generic and, in the words of regulators, “boilerplate” unless it is accompanied by detailed and specific explanations of how each revenue stream is recognised.

What do the regulators think?

The reporting of revenue continues to require significant attention. This area continues to be monitored closely by both regulators and investors. Management needs to ensure that the financial statements contain robust and detailed disclosures relating to the entity’s revenue recognition policies and any critical judgements that management has made in relation to the recognition of revenue.

Regulators continue to focus questions on the adequacy of the stated revenue recognition policies. Companies may be asked to provide additional explanation where their disclosure does not appear to cover all apparent significant sources of revenue.

Further questions may be raised

in relation to companies that derive significant revenue from the provision of services but have not adequately explained how management establishes the stage of completion according to which revenue is measured.

Timing of revenue recognition

Continuing changes and uncertainties in many markets around the world may affect a company’s ability to measure revenue reliably. Changes to the timing of revenue recognition and any other changes to revenue policies should be considered carefully by management.

Generally, revenue recognition does not follow milestone payments set out in contracts. Such progress payments and advances received from customers often do not reflect the extent to which services have been performed.

If a company is in the early stages of a contract for services, the outcome of the transaction might not be capable of reliable estimation. In such cases, revenue should be recognised only to the extent of the costs recognised that are recoverable.

Construction contracts

Where the outcome of a construction contract can be estimated reliably, revenue associated with that contract should be recognised by reference to the stage of completion as at the reporting date.

If the outcome cannot be estimated

reliably, revenue should only be recognised to the extent that contract costs incurred are probable to be recovered. Any contract costs should be recognised as an expense in the period in which they are incurred.

Property development

IC Interpretation 15 *Agreements for the Construction of Real Estate* was issued to standardise the accounting treatment of agreements to sell real estate before construction is complete. These arrangements include ‘off plan’ sales by real estate developers of apartments or houses. As issued by the MASB, IC Interpretation 15 is effective for accounting periods commencing on or after 1 July 2010. Early adoption is permitted with disclosure of the fact.

IC Interpretation 15 was introduced because there were two different views as to the applicable revenue recognition practice. Some entities considered off-plan sales to be construction contracts and accounted for them under FRS 111 *Construction Contracts*, whereas others have treated them as a sale of goods under FRS 118 *Revenue*.

IC Interpretation 15 addresses two issues concerning treatment of agreements for construction of real estate before construction is complete:

- is the agreement within the scope of FRS 111 or FRS 118?
- when should revenue from the construction of real estate be recognised?

The consensus reached was that the answers to these questions depend on the terms of the agreements and the surrounding facts and circumstances and require the exercise of judgement. So what is the actual impact of IC Interpretation 15?

If, for example, someone buys a property 'off plan' and has no control over the physical design of the building, but can influence the furnishings, this would be an agreement for the sale of goods under IC Interpretation 15 and therefore within the scope of FRS 118. By contrast, where the buyer is able

to specify major structural elements of the design of the property before construction begins or specify major changes once the construction is in progress, then IC Interpretation 15 clarifies that this is a construction contract within the scope of FRS 111.

This means that for some entities the accounting previously followed may no longer be in line with the requirements of IC Interpretation 15 and retrospective restatement may be necessary.

Measurement of Revenue

Deferred payment terms

If a company makes a sale on deferred payment terms, it is important to consider the impact of discounting on revenue recognition. If the effect of discounting to the present value is material, the revenue should be measured at its present value.

Bad debt risk

Revenue should be measured at the fair value of the consideration receivable. Therefore, if there is a risk of default that is known at the time of the sale, the fair value should take into account that risk of default.

From Global – Status of IFRS Convergence

India reiterates commitment to IFRS

India has reiterated its commitment to converge with IFRS by 2011. India's Ministry of Corporate Affairs is leading the initiatives on transition to IFRS and has set up a core group supported by two sub-groups which are assisting it in identifying changes required in various laws, regulations, accounting standards and ascertaining the preparedness of stakeholders. A roadmap for convergence with IFRS is due to be issued in the near future and is expected to recommend a phased implementation of IFRS in the country.

China aims for full IFRS by 2012

The Ministry of Finance of the People's Republic of China has issued an exposure draft of a 'Roadmap for Continuing and Full Convergence of the Chinese Accounting Standards for Business Enterprises with the International Financial Reporting Standards (IFRSs)'.

The Chinese roadmap targets 2011 as the year for completion of its convergence programme. Once completed, all large and medium-sized enterprises in China will be required to use the revised standards from 2012.

Japan to permit domestic use of IFRSs for current financial year

Listed companies meeting particular criteria have the option to use IFRSs for fiscal years ending on or after 31 March 2010

The Japanese Financial Services Agency has announced changes which give listed companies that meet particular criteria the option to use IFRSs for fiscal years ending on or after 31 March 2010.

The changes follow the roadmap for the 'Application of International Financial Reporting Standards' in Japan published in June of last year, and are an important step towards the adoption of IFRSs in Japan. Japan's roadmap proposed allowing an early adoption of IFRSs followed by mandatory adoption from 2015 or 2016, with a final decision on the mandatory requirements being taken around 2012.

If you would like to find out how Grant Thornton can assist you and your business, please contact any of our offices near you.

KUALA LUMPUR

Level 11, Faber Imperial Court
Jalan Sultan Ismail
P.O.Box 12337
50774 Kuala Lumpur

T (603) 2692 4022
F (603) 2721 5229
E sjgt@gt.com.my

PENANG

51-8-A,
Menara BHL Bank
Jalan Sultan Ahmad Shah
10500 Penang

T (604) 228 7828
F (604) 227 9828
E info@sjgt-pg.com.my

KUANTAN

A-105A, 1st Floor
Sri Dagangan
Jalan Tun Ismail
25000 Kuantan
Pahang

T (609) 515 6124
F (609) 515 6126
E info@sjgt-ktn.com.my

JOHOR BAHRU

Unit 29-08, Level 29
Mailbox 227
Menara Landmark
12 Jalan Ngee Heng
80000 Johor Bahru, Johor

T (607) 223 1848
F (607) 224 9848
E info@sjgt-jb.com.my

