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RISING TO THE CHALLENGES OF FINANCIAL REPORTING

Codification Framework And Guidances On Property Valuation And Cryptoassets Issued

SINGAPORE'S FINANCIAL REPORTING LANDSCAPE has witnessed many changes during the last decade. Most notably, 2018 and 2019 saw Singapore embracing full convergence with the International Financial Reporting Standards (IFRS) and three new accounting standards – Singapore Financial Reporting Standard (International) or SFRS(I) 9 *Financial Instruments*, SFRS(I) 15 *Revenue from Contracts with Customers* and SFRS(I) 16 *Leases*. With change comes challenges in the form of practical issues faced by the accountancy profession in applying and implementing these new standards.

ISCA, through its Financial Reporting Committee (FRC), is committed to support the accountancy profession in rising to these challenges in order to continue to uphold technical excellence. FRC's initiatives cover three broad areas: (i) contribution towards the global accounting standard-setting process via submission of comment letters featuring Singapore's perspective to the International Accounting Standards Board (IASB) and IFRS Interpretations Committee (IFRIC); (ii) issuance of ISCA guidances to address application and implementation challenges, and

to promulgate ISCA's views and best practices in areas with divergence in practice or uncertainties faced by the profession, and (iii) reaching out to ISCA members and the profession via seminars and focus group sessions.

With the objective of reaching out to ISCA members and the profession and keeping them abreast of emerging trends and developments impacting the profession, FRC and the ASEAN Federation of Accountants (AFA) jointly organised the ISCA FRC-AFA Financial Reporting & Business Conference (the Conference) at One Farrer Hotel on 26 November 2019. The participants included delegates and business leaders from the 10 ASEAN countries and senior members of the Singapore accountancy profession.

At the Conference, Reinhard Klemmer, Chairman of FRC and FRC Core Sub-Committee and Partner, KPMG Singapore, and several FRC members shared useful insights into the application challenges arising from

¹ IFRS 9 is identical to SFRS(I) 9 *Financial Instruments* and FRS 109 *Financial Instruments*

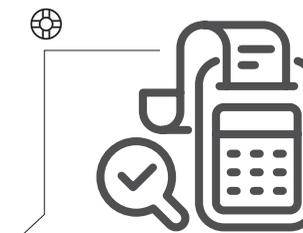
² IFRS 16 is identical to SFRS(I) 16 *Leases* and FRS 116 *Leases*

³ Technical Bites, Knowledge Centre, ISCA website

⁴ Practical Guidances, Knowledge Centre, ISCA website



Central Business District, Singapore



IFRS 9¹ and IFRS 16²; these insights aided the profession to be better prepared for regulatory inspections as they included updates on areas of review focus and common pitfalls to avoid in financial reporting. The Conference also featured the issuance of:

- + the ISCA Financial Reporting Codification Framework for technical contents on financial reporting;
- + Financial Reporting Guidance (FRG) 1 “Real Property Valuation for Financial Reporting – Best practices when engaging valuers: Considerations for Scope of Work and Valuation Report”, which sets out best practices when engaging valuers for financial reporting, and
- + Exposure Draft ED FRG 2 “Accounting for Cryptoassets: From a Holder’s Perspective”, which sets out considerations in the accounting of cryptoassets from a holder’s perspective.

Below are some of the more interesting salient matters discussed at the Conference.

MESSAGE FROM FRC CHAIRMAN

One of FRC's broad initiatives is the issuance of guidance to provide technical support to members and the profession. The guidance includes Technical Bites³, guidance publications⁴ and articles in the *IS Chartered Accountant Journal*.

With the aim of formalising the various ISCA financial reporting technical contents, the ISCA Financial Reporting Codification Framework (Framework) was developed and issued. The Framework establishes formalised categorisations, degrees of authority and a due process for future issuance of ISCA's technical content. It provides credence to ISCA's technical content, promulgates ISCA's views on the application of accounting standards as well as promotes quality, consistency and best practices in financial reporting.

The Framework organises technical content into three categories:

- (i) Financial Reporting Practice (FRP);
- (ii) Financial Reporting Guidance (FRG);
- (iii) Financial Reporting Bulletin (FRB).



▲ ISCA President Kon Yin Tong (3rd from left) with speakers (from left) Kok Moi Lre, Prof Chua Kim Chiu, Reinhard Klemmer, Chan Yen San and Lie Kok Keong

With the Framework in place, members of the public will have the opportunity to provide comments and feedback when exposure drafts (EDs) of technical content for FRPs and FRGs are issued. This due process would facilitate the consideration of comments from the public which will in turn result in better adoption and application of the guidance by the financial reporting ecosystem.

FRG 1 and ED FRG 2 were issued under the new Framework. Mr Klemmer shone the spotlight on ED FRG 2⁵, which is intended to fill the gap in accounting for cryptoassets as such assets are currently not explicitly within the scope of any IFRS Standard. Guidance on accounting for cryptoassets from the issuer’s perspective would be the subject of a separate FRG expected to be issued

⁵ FRG 2 was finalised and issued in March 2020
⁶ How The IFRS Interpretations Committee Helps Implementation, IFRS website

⁷ The Singapore-specific application challenges were deliberated on by the SFRS(I) 9 Working Group that was formed under the FRC. The deliberations are shared in a series of five Technical Bites issued by ISCA in February 2019; they can be found at Technical Bites, Knowledge Centre, ISCA website.

at a later date.

The latest financial reporting developments, including Interest Rate Benchmark (IBOR) Reform and IBOR developments in Singapore, and recent agenda decisions published by IFRIC, were shared with the participants. Agenda decisions⁶ were highlighted as they contain useful explanatory materials on how to apply certain principles and requirements in the IFRS Standards to the question/issue that was submitted to IFRIC. The objective of including explanatory material in agenda decisions is to improve consistency in the application of IFRS Standards.

GRASPING THE PRINCIPLES OF SPPI TEST IN IFRS 9

IFRS 9 *Financial Instruments* fundamentally rewrites the accounting rules for financial instruments. One key change is the introduction of a new concept in the classification of financial assets – the Solely Payments of Principal and Interest on the principal amount outstanding (SPPI) test.

Chua Kim Chiu, a member of FRC Core Sub-Committee and SFRS(I) 9 Working Group, immediate-past Chairman of FRC, and Professor (Practice) at NUS Business School, explained the principles to consider when performing the SPPI test (Figure 1) and highlighted the implications of “passing” or “failing” the SPPI test.

Prof Chua also expounded several Singapore-specific challenges⁷ arising from the application of the SPPI test. One such application challenge is whether debt instruments with interest rates that are referenced to the Singapore Interbank Offered Rate (SIBOR) or Swap Offer Rate (SOR) would pass the SPPI test. For a SIBOR-based financial asset, it is clear that it is consistent with a basic lending arrangement and meets the SPPI test. For a SOR-based financial asset, the SFRS(I) 9 Financial Instruments Working Group had deliberated over the nature of SOR and concluded that a SOR-based financial asset is consistent with a basic lending arrangement and meets the SPPI test.

Prof Chua ended his presentation by reiterating the two key considerations in assessing whether a financial asset meets SPPI:

- + Is the reference interest rate (the time value of money element) of the financial asset’s interest rate “modified”?
- + Is there any embedded contractual term that could change the timing or amount of contractual cash flows such that they are no longer SPPI?

INSIGHTS INTO REAL PROPERTY VALUATION FOR FINANCIAL REPORTING

As real estate assets such as land and buildings are often significant assets of companies, it would be beneficial for all involved parties (that is, the valuer, the preparer company and the auditor) to have a clear understanding of the valuation process of these

real estate assets and the requirements of the relevant accounting standards. This would help to bridge the expectation gap and facilitate a smooth valuation process. Therefore, FRG 1 was issued to facilitate the valuation process for real property valuation that is intended to be used for financial reporting under SFRS(I)s or Singapore Financial Reporting Standards.

Lie Kok Keong, a member of FRC, Chairman of FRC Valuation Sub-Committee, and Partner at PricewaterhouseCoopers Ltd, shared on practical issues and pain points typically encountered by the parties involved in the valuation process when reporting real property interests at their fair value. He then walked the audience through FRG 1 and communicated how these issues were addressed by the FRG.

One of the practical issues is the use of valuation reports which are not fit for financial reporting purposes. For instance, the valuation report was not prepared using “fair value” as the basis of value (example, market value). The use of such basis does not meet the

requirements of SFRS(I) 13. To address this, timely agreement of the scope of work is key.

FRG 1 highlights best practices for preparers when engaging the valuers, which include setting out a recommended workflow of the engagement process with the valuer and the auditor; stipulating matters to be considered in the scope of work and valuation report, and recommending that known limitations and contentious issues should be discussed upfront. Most importantly, FRG 1 emphasises that the basis used in valuation reports that are being used for financial reporting can only be fair value as required under SFRS (I) 13.

THE NEW LEASES STANDARD IS UPON US; ARE YOU READY FOR IT?

IFRS 16 *Leases* is effective from 1 January 2019 and almost all “operating leases” are now required to be recognised as lease liabilities and right-of-use assets on the balance sheet. The concept of recognising leases on balance sheet is not new as lessees are already required

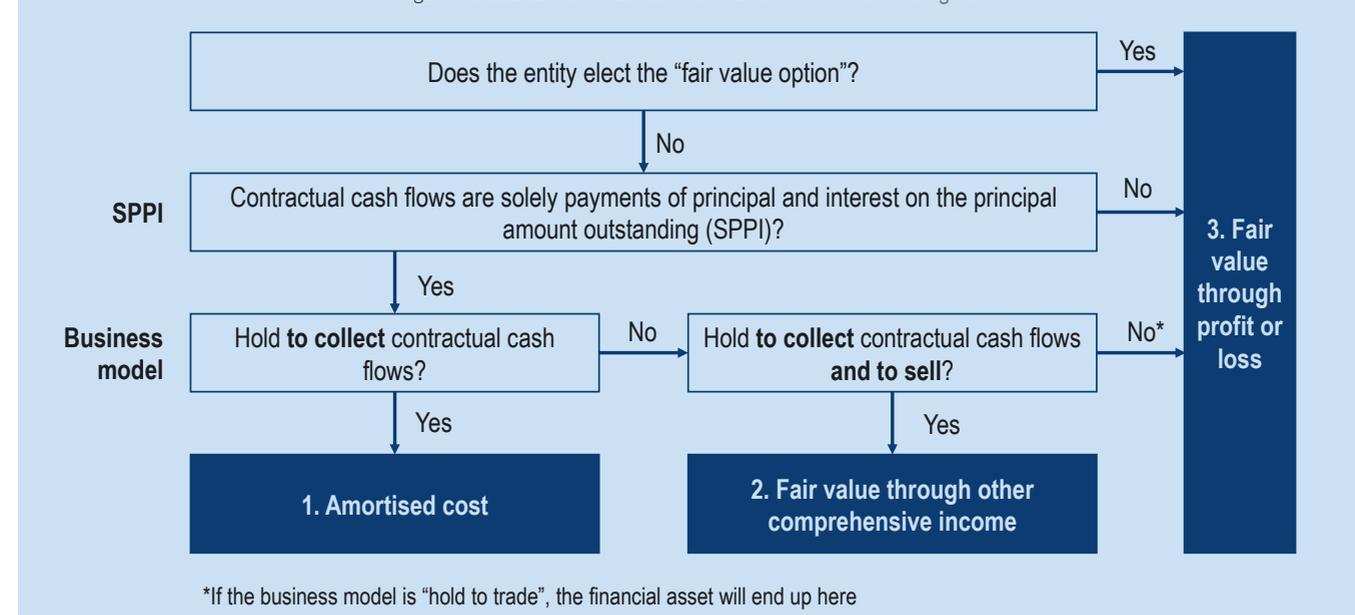
to recognise “finance leases” on balance sheet under IAS 17 *Leases*. However, a magnitude of challenges arises on the application of IFRS 16. Chan Yen San, a member of FRC and FRC Core Sub-Committee, and Partner at KPMG Singapore, expounded on several pressing common application issues faced by entities and provided practical tips to aid entities in addressing them.

The application issues highlighted were:

- + What is a lease?
- + What is the lease term?
- + How are variable rent leases with JTC Corporation accounted for under IFRS 16?
- + How to determine the appropriate discount rate?
- + Does a right-of-use asset need to be assessed for impairment?
- + Are there deferred tax implications arising from IFRS 16?

In addressing the above issues, Ms Chan shared on (i) past ISCA

Figure 1 Classification of financial assets under IFRS 9 – three categories





Leases Roadmap

Figure 2

Roadblock 1: Is there an identified asset? If NO, the journey ends. If YES, proceed to **Roadblock 1A**.
Roadblock 1A: Does the supplier have substantive asset substitution rights? If YES, the journey ends. If NO, proceed to **Roadblock 2**.
Roadblock 2: Does the customer have the right to control the use of the identified asset? If YES, the contract contains a lease.
Roadblock 2A: Does the customer have the right to obtain "substantially all" of the economic benefits from the use of the identified asset? If NO, the journey ends. If YES, proceed to **Roadblock 2B**.
Roadblock 2B: Does the customer have the right to direct the use of the identified asset? If NO, the journey ends. If YES, the contract contains a lease.
Roadblock 2B(i): Does the customer have the right to direct how and for what purpose the asset is used throughout the period of use? If YES, the contract contains a lease. If NO, consider **Roadblock 2B(ii)**.
Roadblock 2B(ii): Are the relevant decisions about how and for what purpose the asset is used predetermined? If YES, (i) does the customer have the right to operate the identified asset throughout the period of use without the supplier having the right to change those operating instructions, or (ii) did the customer design the asset in a way that predetermines how and for what purpose the asset will be used throughout the period of use? If YES to either (i) or (ii), the customer can still direct the use of the asset and hence, the contract contains a lease.

guidances that were issued such as the Leases Roadmap (Figure 2) which provides instructions to negotiate the roadblocks in the journey to determine whether there exists a lease at the end of the road; (ii) relevant agenda decisions published by IFRIC, and (iii) key considerations that entities should take note of.

KNOWING THE AREAS OF REVIEW FOCUS AND AVOIDING COMMON PITFALLS IN FINANCIAL REPORTING

Kok Moi Lre, Chairperson of ISCA Financial Statements Review Committee (FSRC), a member of FRC Core Sub-Committee, and Partner at PricewaterhouseCoopers LLP, introduced FSRC and its collaboration with the Accounting and Corporate Regulatory Authority (ACRA) on ACRA's Financial Reporting Surveillance Programme (FRSP). The FRSP aims to enhance the quality of financial reporting in Singapore through the review of financial statements, which are conducted through FSRC which comprises 12 experienced senior practitioners from the accountancy sector. FSRC would share its observations on potential non-

compliances in the financial statements with ACRA, which would then deliberate and take enforcement actions under the Companies Act if necessary.

To aid directors in their review of financial statements through highlighting areas of possible reporting misstatements, areas of review focus have been regularly published by ACRA.⁸ For FY2019 financial statements, the areas of review focus are:

1. Accounting standards that took effect recently
 - + **SFRS(I) 16/FRS 116 Leases** – specific areas include whether a contract contains a lease, lease term, amount of lease liability to be recorded, variable rents payable to JTC Corporation, and presentation and disclosure;
 - + **SFRS (I) INT 23 Uncertainty over Income Tax Treatments (2019)** – more guidance provided on when and how to provide for uncertain tax provisions;
 - + **SFRS(I) 15/FRS 115 Revenue from Contracts with Customers (2018)** – specific areas include variable consideration, significant financing component, borrowing costs for uncompleted properties and disclosure of aggregated revenue;
 - + **SFRS(I) 9/FRS 109 Financial Instruments** – specific areas include fair valuation of unquoted equities and new impairment loss model;

2. Impairment assessment – common challenges in estimating future cash flows;
3. Business acquisitions – separating intangible assets from goodwill.

Ms Kok walked the participants through some of the above areas of review focus with the use of simple examples to illustrate the principles and requirements of the respective financial reporting standards. As the above areas are highly judgemental, the appropriate accounting of each transaction would depend heavily on the facts and circumstances of the entity. Directors should be prepared to ask relevant questions so as to ensure appropriateness of the accounting and related disclosures in the financial statements.

Q&A SESSION

During the ensuing Q&A session, Mr Klemmer, Mr Lie, Ms Chan and Ms Kok fielded questions from the floor including:

- + How relevant are the issues discussed this morning to the other countries in the region?
- + In determining the discount rates for leases, what are some possible online sources of information which could be used?
- + What are the key differences between market value and fair value?
- + Are entities expected to state compliance with the FRGs in their financial statements?

CONCLUDING REMARKS

The old adage rings true: the only constant is change. The accountancy profession must continually rise to the challenges brought about by changes to the financial reporting landscape. ISCA will continue to address these challenges through the issuance of technical content and outreach. ISCA

Lim Ju May is Deputy Director, Technical, ISCA; Felicia Tay, Donaphan Boey and Marcus Chan are from Financial & Corporate Reporting, Technical, ISCA.



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⁸ Financial Reporting Practice Guidance No.2 of 2019 (issued on 21 November 2019)