



Wolters Kluwer



A Practical Guide to Financial Reporting Standards (Singapore)

6th Edition

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LIST OF ABBREVIATIONS

A/D.....	Accumulated depreciation
ACRA	Accounting and Corporate Regulatory Authority
AFS	Available-for-sale
ASC.....	Accounting Standards Council
BRP.....	Beginning retained profit
B/S.....	Balance sheet
C&CE.....	Cash and cash equivalents
CCDG	Council on Corporate Disclosure and Guidance
<i>c/f</i>	Carried forward
CBS.....	Consolidated balance sheet
CF.....	Cash flow
CFH.....	Cash flow hedge
CGU	Cash generating unit
CIP	Construction in progress
CJE.....	Consolidation journal entry
CLS	Convertible loan stock
COGS.....	Cost of goods sold
CPF	Central Provident Fund
CPL	Consolidated profit and loss account
CPS	Convertible preference shares
CSCI.....	Consolidated statement of comprehensive income
DCF.....	Discounted cash flow
DTL.....	Deferred tax liability
ED	Exposure Draft
EIR	Effective interest rate
EPS.....	Earnings per share
ERP	Ending retained profit
ESOP.....	Employee stock ownership plan
FASB.....	Financial Accounting Standards Board
FC.....	Forward contract/Futures contract
FEC.....	Forward exchange contract
FIFO.....	First-in, first-out
FRS	Financial Reporting Standard
FV	Fair value
FVH.....	Fair value hedge
FVTOCI.....	Fair value through other comprehensive income
FVTPL	Fair value through profit or loss
GAAP.....	Generally accepted accounting principles
GPP	General purchasing power
GPPA	General purchasing power accounting
HC.....	Historical cost
HTM.....	Held-to-maturity

IAS	International Accounting Standard
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standard
INTFRS	Interpretations of Financial Reporting Standard
IRAS	Inland Revenue Authority of Singapore
IRR	Internal rate of return
ISCA	Institute of Singapore Chartered Accountants
JCE	Jointly-controlled entity
JE	Journal entry
LIFO	Last-in, first-out
NCI	Non-controlling interest
NRV	Net realisable value
OCI	Other comprehensive income
P&L	Profit and loss
P/L	Profit or loss
pa	Per annum
PAT	Profit after tax
PBT	Profit before tax
PPE	Property, plant and equipment
PPP	Public-private-partnership/ public-to-private/build-operate-transfer
PV	Present value
RP	Retained profit
SAS	Statements of accounting standard
SCE	Statement of charges in equity
SCI	Statement of comprehensive income
SGX	Singapore Exchange
SIBOR	Singapore Interbank Offered Rate
SIC	Standing Interpretations Committee
SPE	Special purpose entity
SPPI	Solely payments of principal and interest
TCI	Total comprehensive income
WIP	Work in progress

TABLE OF CONTENTS

	Page
<i>About Wolters Kluwer</i>	iii
<i>About the Authors</i>	v
<i>Dedications</i>	vii
<i>Preface</i>	ix
<i>List of Abbreviations</i>	xi
Introduction	1
FRS 1 Presentation of Financial Statements	15
FRS 2 Inventories	49
FRS 7 Statement of Cash Flows	65
FRS 8 Accounting Policies, Changes in Accounting Estimates and Errors	119
FRS 10 Events After the Reporting Period	149
FRS 11 Construction Contracts	157
FRS 12 Income Taxes	185
FRS 16 Property, Plant and Equipment	233
FRS 17 Leases	263
FRS 18 Revenue	327
FRS 19 Employee Benefits	347
FRS 20 Accounting for Government Grants and Disclosure of Government Assistance	357
FRS 21 The Effects of Changes in Foreign Exchange Rates	363
FRS 23 Borrowing Costs	413
FRS 24 Related Party Disclosures	419
FRS 26 Accounting and Reporting by Retirement Benefit Plans	425
FRS 27 Separate Financial Statements	429
FRS 28 Investments in Associates and Joint Ventures	433
FRS 29 Financial Reporting in Hyperinflationary Economies	483
FRS 32 Financial Instruments: Presentation	493
FRS 33 Earnings per Share	505
FRS 34 Interim Financial Reporting	553
FRS 36 Impairment of Assets	563
FRS 37 Provisions, Contingent Liabilities and Contingent Assets	577
FRS 38 Intangible Assets	589
FRS 39 Financial Instruments: Recognition and Measurement	603
FRS 40 Investment Property	679
FRS 41 Agriculture	691

	Page
FRS 101 First-time Adoption of Financial Reporting Standards	699
FRS 102 Share-based Payment	709
FRS 103 Business Combinations	741
FRS 104 Insurance Contracts	777
FRS 105 Non-current Assets Held for Sale and Discontinued Operations	781
FRS 106 Exploration for and Evaluation of Mineral Resources	791
FRS 107 Financial Instruments: Disclosures	795
FRS 108 Operating Segments	815
FRS 109 Financial Instruments	823
FRS 110 Consolidated Financial Statements	901
FRS 111 Joint Arrangements	999
FRS 112 Disclosure of Interests in Other Entities	1,015
FRS 113 Fair Value Measurement	1,021
FRS 114 Regulatory Deferral Accounts	1,031
FRS 115 Revenue from Contracts with Customers	1,035
FRS 116 Leases	1,083
Appendix: INT FRS	1,171
Index	1,237

INTRODUCTION

Introduction	¶100
Accounting standards setting in Singapore	¶200
Accounting standards in Singapore	¶300
Preface to Financial Reporting Standards	¶310
Financial Reporting Standards	¶320
Preface to Interpretations of Financial Reporting Standards	¶330
Interpretations of Financial Reporting Standards	¶340
Conceptual Framework	¶350
Appendix A	¶400
Appendix B	¶500
Appendix C	¶600

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Notes to the financial statements	¶1-360
Disclosure of accounting policies	¶1-361
Capital disclosures	¶1-362
Other disclosures	¶1-363
Comparison with IASB standard	¶1-400
Appendix A: Consolidated financial statements	¶1-500

¶1-100 Introduction

FRS 1 (2009) *Presentation of Financial Statements* prescribes the basis for the presentation of general purpose financial statements. Specifically, it sets out the:

- overall requirements for the presentation of financial statements
- guidelines for the structure of the financial statements, and
- minimum requirements for the content of the financial statements (para 1).

FRS 1 is applicable to all general purpose financial statements prepared and presented in accordance with Financial Reporting Standards (FRSs) (para 2).

FRS 1 is therefore applicable to the financial statements of all business entities (either individual or group) presented in annual reports and other public documents such as prospectus, but not to condensed interim financial information prepared in accordance with FRS 34 *Interim Financial Reporting* (para 4).

FRS 1 was issued by the Council on Corporate Disclosures and Governance (CCDG) (which has been replaced by the Accounting Standards Council (ASC)) on 20 July 2007 to supersede FRS 1 (2005) *Presentation of Financial Statements*.

FRS 1 should be applied for annual periods beginning on or after 1 January 2009. Early application is encouraged. An entity that applies FRS 1 for a period beginning before 1 January 2009 should disclose that fact.

FINANCIAL STATEMENTS

¶1-200 Financial statements

General purpose financial statements (hereafter referred to as “financial statements”) are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs (para 7).

¶1-210 Purpose of financial statements

The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions (para 9).

¶1-220 Complete set of financial statements

To achieve the above-mentioned objective of financial statements, FRS 1 provides that a complete set of financial statements should include the following components (para 10):

- a statement of financial position
- a statement of profit or loss and other comprehensive income
- a statement of changes in equity
- a statement of cash flows, and

- notes comprising a summary of significant accounting policies and other explanatory information.

FRS 1 allows an entity to use titles for the statements other than those used in the standard (para 10). For example, an entity may use the title "statement of comprehensive income" instead of "statement of profit or loss and other comprehensive income". The latter title is introduced by the Amendments to FRS 1 issued in September 2011 (hereafter referred to as the "2011 Amendments to FRS 1"), which apply to annual periods beginning on or after 1 July 2012.

FRS 1 requires an entity to present with equal prominence all of the financial statements in a complete set of financial statements (para 11).

FRS 1 also encourages an entity to present, outside the financial statements, a financial review by management which describes and explains the main features of the entity's financial performance and financial position, and the principal uncertainties it faces (para 13). An entity is also encouraged to present, outside the financial statements, additional statements such as environmental reports and value added statements if management believes they will assist users in making economic decisions (para 14). It should be noted that these additional reports and statements are to be presented outside the financial statements and they are outside the scope of FRSs.

¶1-230 General features

FRS 1 sets out the general features for the presentation of financial statements. Specifically, FRS 1 deals with the following:

- Fair presentation and compliance with FRSs
- Going concern
- Accrual basis of accounting
- Materiality, aggregation and offsetting
- Consistency of presentation
- Comparative information, and
- Frequency of reporting.

¶1-231 Fair presentation and compliance with FRSs

FRS 1 requires financial statements to present fairly the financial position, financial performance and the cash flows of an entity (para 15).

Fair presentation requires faithful representation of the effects of transactions, other events and conditions in accordance with the definition and recognition criteria of assets, liabilities, income and expenses set out in the Framework (para 15).

The application of FRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation (para 15).

In 2015, FRS 1 is amended under the "Disclosure initiative" project, which became effective for annual periods beginning on or after 1 January 2016. Under the Disclosure initiative amendment, an entity may aggregate or disaggregate line items specified in FRS so as to disclose material and relevant information. Specifically, an entity is no longer required to provide the specific disclosures required by any FRS, if the information resulting from that disclosure is not material, even if the FRS contains a list of specific disclosure requirements or describes them as minimum requirements (para 31).

A fair presentation also requires an entity to (para 17):

- select and apply accounting policies in accordance with FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- present information in a manner that provides relevant, reliable, comparable and understandable information, and
- provide additional disclosures when compliance with FRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

FRS 1 requires an entity whose financial statements comply with FRSs to make an explicit and unreserved statement of such compliance (para 16). FRS 1 further provides that financial statements should not be described as complying with FRSs unless they comply with all the requirements of FRSs (para 16). Note that the term "Financial Reporting Standards" is defined in para 7 as comprising both Financial Reporting Standards and Interpretations of Financial Reporting Standards developed by the ASC.

In the extremely rare circumstance in which management concludes that compliance with a requirement in a FRS would be so misleading that it would conflict with the objective of financial statements set out in the Framework, FRS 1 requires the entity to depart from the requirement, if such departure is not prohibited by relevant regulatory framework (para 19). As mentioned here, the *Companies Act* has also provided for "true and fair view" override.

When the above-mentioned occurs, FRS 1 provides that the entity should disclose the following (para 20):

- That management has concluded that the financial statements present fairly the entity's financial position, financial performance and cash flows
- That it has complied with all applicable FRSs except that it has departed from a particular requirement to achieve a fair presentation
- The title of the FRS from which the entity has departed, the nature of the departure (including the treatment that the FRS would require), the reason for the departure (including why the treatment in the FRS would conflict with the objective of financial statements set out in the Framework) and the treatment adopted, and

- The financial impact of the departure on each item in the financial statements for each period presented.

When an entity has departed from a requirement of a FRS in a prior period, and that departure affects the amounts recognised in the financial statements for the current period, FRS 1 requires the entity to disclose the third and the fourth disclosures from the previous paragraph (para 21).

FRS 1 further provides that inappropriate accounting treatments are not, and cannot be, rectified either by disclosure of the accounting policies used or by notes or explanatory material (para 18).

It should be noted that the financial statements of Singapore-incorporated companies are also required by the *Companies Act* to comply with the accounting standards issued by ASC (s 201(3)). The *Companies Act* has, however, also provided for "true and fair view" override (s 201(14A)). Thus, in extremely rare circumstances where management concludes that compliance with a requirement in a FRS would be misleading, the entity should not comply with the requirement to the extent necessary to achieve a true and fair view.

¶1-232 Going concern

FRS 1 provides that management should make an assessment of an entity's ability to continue as a going concern when preparing financial statements (para 25). In assessing whether the going concern assumption is appropriate, management should take into account all available information for the foreseeable future, which should be at least, but not limited to, 12 months from the balance sheet date (para 26).

FRS 1 further provides that the financial statements should be prepared on a going concern basis, unless management either intends to liquidate the entity or to cease operation, or has no realistic alternative but to do so (para 25).

When management is aware of material uncertainties related to events or conditions which may cast significant doubt upon the entity's ability to continue as a going concern, however, FRS 1 requires those uncertainties to be disclosed (para 25).

When the financial statements are not prepared on a going concern basis, FRS 1 requires that fact and the reason thereof to be disclosed, together with the basis on which the financial statements have been prepared (para 25).

¶1-233 Accrual basis of accounting

FRS 1 requires an entity to prepare its financial statements, except for cash flow information, using the accrual basis of accounting (para 27).

¶1-234 Materiality, aggregation and offsetting

FRS 1 provides that each material item should be presented separately in the financial statements (para 29).

A piece of information is material if its omission or misstatement could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

FRS 1 also provides that immaterial items should be aggregated with amounts of similar nature and need not be presented separately (para 29).

The application of the materiality concept also means that specific disclosure requirement of an FRS need not be met if the resulting information is not material (para 31).

FRS 1 further provides that assets and liabilities, and income and expense, should not be offset except when offsetting is required or permitted by another FRS (para 32). (In this context, it may be noted that FRS 32 *Financial Instruments: Presentation* provides that a financial asset may be set off against a financial liability if, and only if, there is legal right and intention to offset.)

It is important that assets and liabilities, and income and expenses, are reported separately. Offsetting in the income statement or the balance sheet, except when offsetting reflects the substance of the transaction, detracts from the ability of users to understand the financial statements. In this context, it may be noted that the reporting of an asset net of its valuation allowance (for eg trade debtor less allowance for doubtful debt) is not offsetting (para 33).

¶1-235 Consistency of presentation

FRS 1 provides that the presentation and classification of items in the financial statements should be consistent from one period to the next (para 45).

FRS 1 allows the presentation and classification to be changed when the change (para 45):

- will result in a more appropriate presentation, or
- is required by an FRS or INT FRS.

A significant change in the nature of the operation of an entity might suggest that the previous presentation and classification of items in the financial statements may no longer be appropriate, and should therefore be changed so as to result in a more appropriate presentation. FRS 1, however, cautions that a change in the presentation and classification under such circumstance should be made only if the revised structure is likely to continue (para 46).

Similarly, a review of the financial statements may suggest that presentation and classification of items in the financial statements should be changed so as to result in a more appropriate presentation. Again, FRS 1 cautions that a change in the presentation and classification under such circumstance should be made only if the benefit of the alternative presentation is clear (para 46).

When the presentation or classification of items in the financial statements is amended, FRS 1 provides that comparative amounts should also similarly be reclassified to ensure comparability with the current year, unless it is impracticable to do so (para 41).

Further, FRS 1 requires disclosure of the nature, amount and reason for the reclassification (para 41) including as at the beginning of the preceding period, per the Improvements to FRS 1 (August 2012).

When it is impracticable to reclassify comparative amounts (eg data may not have been collected in the previous period in a way which allows reclassification), FRS 1 requires the entity to disclose the reason for not reclassifying and the nature of the change that would have been made if amounts were reclassified (para 42).

¶1-236 Comparative information

FRS 1 provides that comparative information should be presented in respect of the preceding period for all numerical information reported in the current period's financial statements unless another FRS permits or requires otherwise (para 38).

FRS 1 further provides that comparative information should be included in narrative and descriptive information if it is relevant to understanding the current period's financial statements (para 38).

Improvements to FRS 1 (August 2012) (effective for annual periods beginning on or after 1 January 2013) further require an entity to present, as a minimum, two statements of financial position, two statements of profit or loss and other comprehensive income, two separate statements of profit or loss (P/L) (if presented), two statements of cash flows and two statements of changes in equity, and related notes.

In the presentation of the comparative information, the provision of para 41 and 42 of FRS 1, as previously discussed, should also be followed, when relevant.

When there is a change in the presentation of the financial statements, the comparative figures are generally adjusted or reclassified to conform to the current year's presentation. The fact is also generally disclosed in the notes to the accounts.

It may be noted that generally, comparative information is provided for the immediately preceding year. However, FRS 1 also requires presentation of a statement of financial position (balance sheet) as at the beginning of the earliest comparative period under certain circumstances (see ¶1-324).

¶1-237 Timeliness and frequency of reporting

The usefulness of financial statements is diminished if they are not made available to users on a timely basis.

In this respect, FRS 1 requires financial statements to be presented at least annually (para 36).

It may be noted that under the *Companies Act*, listed companies are required to make their financial statements available within four months of the balance sheet date, and non-listed companies within six months. It may also be noted that the *SGX Listing Manual* requires listed companies to announce their full year results within 60 days from the end of the company's accounting year end.

When the entity's balance sheet date changes and the financial statements are presented for a period longer or shorter than a year (eg an entity is acquired by another), FRS 1 requires the entity to disclose the following (para 36):

- The reason for using a period which is a longer or shorter period, and
- The fact that amounts presented in the financial statements are not entirely comparable.

STRUCTURE AND CONTENT OF FINANCIAL STATEMENTS

¶1-300 Structure and content of financial statements

As previously mentioned, FRS 1 requires the presentation of the following financial statements:

- A statement of financial position
- A statement of profit or loss and other comprehensive income
- A statement of changes in equity
- A statement of cash flows, and
- Notes comprising a summary of significant accounting policies and explanatory notes.

¶1-310 Identification of financial statements

FRS 1 requires that financial statements be clearly identified and distinguished from other information in the same documents (para 49).

FRS 1 also provides that each component of the financial statements should be clearly identified (para 51).

In addition, FRS 1 requires the following information to be prominently displayed and repeated when it is necessary for a proper understanding of the information presented (para 51):

- (a) The name of the entity
- (b) Whether the financial statements cover the individual entity or a group of entities
- (c) The balance sheet date or the period covered by the financial statements; whichever is appropriate to the related component of the financial statements

- (d) The presentation currency, and
- (e) The level of rounding used in the presentation of figures in the financial statements.

For requirement (e), a common rounding level used by Singapore companies is thousands of Singapore Dollars (\$'000).

¶1-320 Statement of financial position

For the statement of financial position (balance sheet), FRS 1 contains provisions in relation to:

- current/non-current distinction
- information to be presented on the face of the statement
- information to be presented either on the face of the statement or in the notes, and
- a statement as at the beginning of the earliest comparative period.

¶1-321 Current/non-current distinction

FRS 1 requires an entity to present current and non-current assets, and current and non-current liabilities, as separate classifications on the face of its balance sheet, except when a presentation based on liquidity provides information that is more reliable and is more relevant (para 60).

For each asset and liability item that combines amounts expected to be recovered or settled both before and after 12 months from the balance sheet date, FRS 1 requires disclosure of the amount expected to be recovered or settled after more than 12 months (para 61). It may be noted that FRS 1 does not require a further breakdown of the amount. However, note that FRS 17 *Leases* requires the lessor/lessee to further disclose leases receivable/payable after 12 months under a finance lease into three time bands of "less than one year", "one to five years" and "more than five years". Further, FRS 107 *Financial Instruments: Disclosures* requires aging analysis of some of the financial assets and maturity analysis of the financial liabilities.

Current and non-current assets

For an entity that presents current and non-current assets as separate classifications on the face of the balance sheet, FRS 1 provides guidance on the proper classification.

Specifically, para 66 of FRS 1 provides that an asset should be classified as a current asset when it is:

- expected to be realised in, or is intended for sale or consumption in, the entity's normal operating cycle
- held primarily for the purpose of being traded
- expected to be realised within 12 months of the balance sheet date, or
- a cash or a cash equivalent asset that is not restricted in its use.

All other assets should be classified as non-current assets.

Thus, asset items are generally included in current assets on the basis that they are expected to be realised within one year or within the normal operating cycle of the entity, whichever is the longer. (An operating cycle is the average time period from the date inventory is acquired to the date the inventory is converted back to cash.)

It may, therefore, be noted that trading inventories and trade receivables are classified as current assets, even though they may be realised after the 12-month period, because they are, by definition, expected to be realised within one operating cycle.

Current and non-current liabilities

For an entity that presents current and non-current liabilities as separate classifications on the face of the balance sheet, FRS 1 provides guidance on the proper classification.

Specifically, para 69 of FRS 1 provides that a liability should be classified as a current liability when:

- it is expected to be settled in the entity's normal operating cycle
- it is held primarily for purpose of being traded
- it is due to be settled within 12 months of the balance sheet date, or
- the entity does not have an unconditional right to defer settlement for at least 12 months after the balance sheet date.

All other liabilities should be classified as non-current liabilities.

Thus, operating items such as trade creditors and accruals for operating expenses (which, by definition, are settled within one operating cycle) are classified as current liabilities even if they are due to be settled after more than 12 months from the balance sheet date.

If part of a long-term liability is due to be settled within 12 months of the balance sheet date, that part of the long-term liability should be reclassified as a current liability. FRS 1 para 72 further clarifies that this portion continues to be classified as a current liability even if an agreement to refinance or to reschedule payments on a long-term basis is completed after the balance sheet date but before the date financial statements are authorised for issue. This is because, at the balance sheet date, the entity does not have an unconditional right to defer the settlement for at least 12 months after that date.

Also, when an entity breaches a provision of a long-term loan arrangement before the balance sheet date, with the effect that the liability becomes payable on demand, FRS 1 requires the liabilities to be reclassified as current, even if after the balance sheet date the lender agrees not to demand payment as a consequence of the breach (para 74). Again, this is because, at the balance sheet date, the entity does not have an unconditional right to defer the settlement for at least 12 months after that date.

If, in the above-mentioned case, the lender agrees before the balance sheet date to provide a grace period ending at least 12 months after the balance sheet date within which the entity can rectify the breach and the lender cannot demand immediate payment, then FRS 1 requires the liability to be classified as non-current (para 75). This is because, in this case, the entity has an unconditional right to defer the settlement for at least 12 months after the balance sheet date.

On the other hand, FRS 1 requires an entity to classify its short-term loan obligation as non-current if it expects and has the discretion to refinance or roll over an obligation for at least 12 months after the balance sheet date (para 73). However, when the refinancing or roll over of the obligation is not at the discretion of the entity, it should classify the short-term loan obligation as current.

FRS 1 also specifically provides that deferred tax assets and liabilities should not be classified as current assets and liabilities (para 56). Therefore, in the Singapore context, all deferred tax assets and liabilities should be presented as non-current.

¶1-322 Information to be presented on the face of the statement of financial position

FRS 1 provides that the face of the statement of financial position should include line items which present the following amounts (para 54):

- Fixed assets (property, plant and equipment (PPE))
- Intangible assets
- Financial assets
- Investment properties
- Investments
- Biological assets
- Inventories
- Trade and other receivables
- Cash and cash equivalents (C&CE)
- Assets held for sale
- Trade and other payables
- Provisions
- Other financial liabilities
- Tax liabilities and tax assets
- Deferred tax liabilities and deferred tax assets
- Liabilities included in discontinued operation
- Non-controlling interests (NCI)
- Issued share capital and reserves.

FRS 1 further provides that additional line items, headings and subtotals should be presented on the face of the balance sheet if such presentation is relevant to understanding the entity's financial position (para 55).

¶1-323 Information to be presented either on the face of the statement of financial position or in the notes

FRS 1 provides that an entity should disclose, either on the face of the statement of financial position or in the notes, further subclassifications of the line items presented, classified in a manner appropriate to the entity's operations (para 77).

FRS 1 specifically requires disclosure of the following for each class of share capital, either on the face of the balance sheet or in the notes (para 79):

- The number of shares authorised (note that this is no longer applicable in Singapore since 30 January 2006)
- The number of shares issued and fully paid, and issued but not fully paid
- Par value per share (note that this is no longer applicable in Singapore since 30 January 2006), or that the shares have no par value
- A reconciliation of the number of shares outstanding at the beginning and at the end of the year
- The rights, preferences and restrictions attaching to the class including restrictions on the distribution of dividends and repayment of capital
- Shares in the entity held by the entity itself or by subsidiaries or associates of the entity, and
- Shares reserved for issuance under options and sales contracts, including the terms and amounts.

FRS 1 also requires disclosure of a description of the nature and purpose of each reserve within equity, either on the face of the balance sheet or in the notes (para 79).

¶1-324 A third column

As previously mentioned, generally, comparative information is provided for the immediately preceding year. However, FRS 1 also requires presentation of a statement of financial position (balance sheet) as at the beginning of the earliest comparative period under certain circumstances.

FRS 1 requires an entity to present a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements (para 10). Improvements to FRS 1 (August 2012) (effective for annual periods beginning on or after 1 January 2013) added that the third statement of financial position is required if the retrospective application, retrospective restatement or

the reclassification has a material effect on the information in the statement of financial position at the beginning of the preceding period.

Illustration 1

ABC Ltd presented its statements of financial position (balance sheets) in its 20x8 annual report as follows (simplified for illustrative purposes):

	31 December 20x8	31 December 20x7
	\$'000	\$'000
Land	50,000	50,000
Building	5,000	5,000
Net current assets	3,000	1,000
Shareholders' equity	58,000	56,000

In 20x9, ABC Ltd discovered that the building, which was acquired in January 20x1, has not been depreciated. ABC Ltd's accounting policy is to depreciate the cost of the building over 50 years on a straight line basis. The correction of error is to be accounted retrospectively in accordance with FRS 8.

When ABC Ltd presents its 20x9 statement of financial position (balance sheet), it has to present three columns (as required by FRS 1), as shown:

	31 December 20x9	31 December 20x8	1 January 20x8
	\$'000	\$'000	\$'000
Land	50,000	50,000	50,000
Building	4,100	4,200	4,300
Net current assets	4,000	3,000	1,000
Shareholders' equity	58,100	57,200	55,300

¶1-330 Statement of profit or loss and other comprehensive income

FRS 1 requires an entity to present a "statement of profit or loss and other comprehensive income", to replace the traditional "profit and loss (P&L) account" (or the income statement). The statement of profit or loss and other comprehensive income may be presented using the one-statement format or the two-statement format.

Specifically, the 2011 Amendments to FRS 1 require the statement of profit or loss and other comprehensive income to present: (i) P/L, (ii) other comprehensive income (OCI), and (iii) comprehensive income being the total of P/L and OCI (para 81A). For both P/L and comprehensive income, an entity is to present the respective amounts attributable to: (i) NCIs, and (ii) owners of the parents. If an entity presents P/L in a separate statement, it is to present the breakdown in that statement (para 81B).

Under the Disclosure initiative amendment (effective 1 January 2016), besides presenting an entity's own OCI under two categories of:

- items of OCI that will not be classified subsequently to profit or loss, and
- items of OCI that will be classified subsequently to profit or loss when specific conditions are met,

an entity is required to present its share of associate's OCI under the two categories of items of OCI that will or will not be classified subsequently to profit or loss (para 82A).

¶1-331 One-statement format

Under the one-statement format, all items of income and expense recognised in a period are presented in one single statement. Items that were traditionally presented in the P&L account will be presented in the top portion of the statement ending with the line item titled "profit for the year". OCI items (such as revaluation surplus/deficit of fixed assets under FRS 16, translation gains/losses under FRS 21 and mark-to-market gains/losses on available-for-sale (AFS) securities under FRS 39) are presented at the bottom portion of the statement, ending with the line item titled "total comprehensive income for the year".

An illustration is provided in the Guidance on implementation accompanying FRS 1 as follows (it is slightly modified here for illustration purposes):

XYZ Ltd Statement of comprehensive income for the year ended 31 December 20x7		
	20x7	20x6
	\$'000	\$'000
Revenue	390,000	355,000
Cost of sales	<u>(245,000)</u>	<u>(230,000)</u>
Gross profit	145,000	125,000
Other income	20,667	11,300
Distribution costs	(9,000)	(8,700)
Administrative expenses	(20,000)	(21,000)
Other expenses	(2,100)	(1,200)
Finance costs	(8,000)	(7,500)
Share of profit of associates	<u>35,100</u>	<u>30,100</u>
Profit before tax	161,667	128,000
Income tax expense	<u>(40,417)</u>	<u>(32,000)</u>
Profit from continuing operations	121,250	96,000
Loss from discontinued operations	<u>—</u>	<u>(30,500)</u>
PROFIT FOR THE YEAR	<u>121,250</u>	<u>65,500</u>

Other comprehensive income (net of tax):		
Items that will not be reclassified to profit or loss:		
Gains on property revaluation	500	3,000
Items that may be reclassified subsequently to profit or loss:		
Translation differences	4,000	8,000
Available-for-sale financial assets	(18,000)	20,000
Cash flow hedges	(500)	(3,000)
Other comprehensive income for the year	(14,000)	28,000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	107,250	93,500
Profit attributable to:		
Owners of the parent	97,000	52,400
Non-controlling interests	24,250	13,100
	<u>121,250</u>	<u>65,500</u>
Total comprehensive income attributable to:		
Owners of the parent	85,800	74,800
Non-controlling interests	21,450	18,700
	<u>107,250</u>	<u>93,500</u>

¶1-332 Two-statement format

Under the two-statement format, the statement of comprehensive income is presented in two separate statements:

- statement of profit or loss, and
- statement of profit or loss and other comprehensive income.

Items that were traditionally presented in the P&L account will be presented in the first statement (income statement) ending with the line item titled "profit for the year". The second statement (ie statement of profit or loss and other comprehensive income) will commence with "profit for the year" brought forward from the income statement, with OCI items (such as revaluation surplus/deficit of fixed assets under FRS 16, translation gains/losses under FRS 21 and mark-to-market gains/losses on AFS securities under FRS 39) presented in the body of the statement, and end with the line item titled "total comprehensive income for the year". Thus, when an entity presents P/L in a separate statement, it does not need to present the P/L section in the statement presenting comprehensive income (para 81A in the 2011 Amendments to FRS 1).

An illustration is provided in the Guidance on implementation accompanying FRS 1 as follows (it is slightly modified here for illustration purposes):

XYZ Ltd Income statement for the year ended 31 December 20x7		
	20x7	20x6
	\$'000	\$'000
Revenue	390,000	355,000
Other income	20,667	11,300
Changes in inventories of finished goods and work in progress	(115,100)	(107,900)
Work performed by the entity and capitalised	16,000	15,000
Raw material and consumables used	(96,000)	(92,000)
Employee benefits expense	(45,000)	(43,000)
Depreciation and amortisation expense	(19,000)	(17,000)
Impairment of property, plant and equipment	(4,000)	—
Other expenses	(6,000)	(5,500)
Finance costs	(15,000)	(18,000)
Share of profit of associates	<u>35,100</u>	<u>30,100</u>
Profit before tax	161,667	128,000
Income tax expense	<u>(40,417)</u>	<u>(32,000)</u>
Profit from continuing operations	121,250	96,000
Loss from discontinued operations	—	<u>(30,500)</u>
PROFIT FOR THE YEAR	<u>121,250</u>	<u>65,500</u>
Profit attributable to:		
Owners of the parent	97,000	52,400
Non-controlling interests	<u>24,250</u>	<u>13,100</u>
	<u>121,250</u>	<u>65,500</u>

XYZ Ltd Statement of comprehensive income for the year ended 31 December 20x7		
	20x7	20x6
	\$'000	\$'000
Profit for the year	121,250	65,500
Other comprehensive income (net of tax):		
Items that will not be reclassified to profit or loss:		
Gains on property revaluation	500	3,000

Items that may be reclassified subsequently to profit or loss:		
Translation differences	4,000	8,000
Available-for-sale financial assets	(18,000)	20,000
Cash flow hedges	(500)	(3,000)
Other comprehensive income for the year	(14,000)	28,000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	107,250	93,500
Total comprehensive income attributable to:		
Owners of the parent	85,800	74,800
Non-controlling-interests	21,450	18,700
	<u>107,250</u>	<u>93,500</u>

¶1-333 Information to be presented on the face of the statement profit or loss and other comprehensive income

In addition to items required by other FRSs, FRS 1 provides that the following line items should be presented in the P/L section or the statement of P/L (para 82):

- Revenue
- Finance costs
- Share of profit/(loss) of associates and joint ventures
- Tax expense
- A single amount for the total of discontinued operations.

FRS 1 further provides that the following items should be presented in the statement as allocation of P/L for the period (para 83):

- P/L for the period attributable to: (i) NCIs, and (ii) owners of the parent, and
- TCI for the period attributable to: (i) NCIs, and (ii) owners of the parent.

FRS 1 also provides that, additional line items, headings and subtotals should be presented in the statement(s) presenting P/L and OCI when such presentation is relevant to an understanding of the entity's financial performance (para 85 in the 2011 Amendments to FRS 1).

It should be noted that FRS 1 does not allow the presentation of any items of income and expense as an extraordinary item in the statement(s) presenting P/L and OCI or in the notes (para 87 in the 2011 Amendments to FRS 1).

FRS 1, however, requires separate disclosure of the nature and amount of items of income and expense that are material (para 97). These items are normally referred to as "abnormal items".

In its normal usage, the term "abnormal items" refers to items of income and expense which are of such a size, nature or incidence that their disclosure is required to explain the performance of the entity for the relevant accounting period.

FRS 1 lists the following as examples of abnormal items (para 98):

- Write-downs of inventories to net realisable value (NRV), or of fixed assets to recoverable amount, as well as the reversal of such write-downs
- Costs of business restructuring
- Gains or losses on disposals of fixed assets
- Gains or losses on disposals of long-term investments
- Gains or losses arising from discontinued operations
- Gains or losses upon litigation settlements, and
- Other reversals of provisions.

Illustration 2

To illustrate, assume that ABC Ltd's P&L account for the year 20x8 shows a turnover of \$5,000,000 and a PBT of \$1,000,000, whereas the comparative figures for 20x7 turnover and profit for 20x7 are \$4,000,000 and \$1,500,000, respectively. Assume also that the reason why the 20x8 pre-tax profit is lower than the pre-tax profit for 20x7 (when the turnover for 20x8 is higher than the 20x7 turnover) is an extra amount of \$600,000 was paid for wages in 20x8 under a new union agreement. In this case, the extra amount of wages should be disclosed to explain the changes in pre-tax profits, as required by FRS 1. The extra wages of \$600,000 should either be disclosed under a separate heading "abnormal item" on the face of the income statement, or disclosed in the notes to the accounts.

¶1-334 Information to be presented either on the face of the statement of profit or loss and other comprehensive income or in the notes

FRS 1 requires an entity to present two pieces of information either on the face of the statement(s) of profit or loss and other comprehensive income or in the notes to the accounts, namely: (i) an analysis of expenses (para 99), and (ii) an analysis of the items of OCI (para 90).

(i) An analysis of expenses

FRS 1 requires an entity to present an analysis of expenses in the statement(s) presenting P/L and OCI (para 100 in the 2011 Amendments to FRS 1).

FRS 1 further provides that the expenses should be subclassified based on either the nature or the function of the expenses, whichever provides more reliable and relevant information (para 99).

Under the "nature of expense" method, the expenses are classified according to their nature (for eg depreciation, transportation and wages). An illustration is

provided in FRS 1 (para 102) as follows (it is slightly modified here for illustration purposes):

	\$'000
Revenue	390,000
Other income	20,667
Purchases	80,000
Changes in inventories	115,000
Employee benefits costs	45,000
Depreciation and amortisation expenses	19,000
Impairment loss	4,000
Finance costs	15,000
Other expenses	6,000
Share of profit of associates	<u>35,100</u>
Profit before tax	<u>161,667</u>

Under the "function of expense" (or "cost of sales") method, expenses are classified according to their function (eg cost of sales, distribution expenses, administrative expenses, etc). An illustration is provided in FRS 1 (para 103) as follows (it is slightly modified here for illustration purposes):

	\$'000
Sales	390,000
Cost of sales	<u>245,000</u>
Gross profit	145,000
Other income	20,667
Distribution expenses	9,000
Administrative expenses	20,000
Finance costs	8,000
Other expenses	2,100
Share of profit of associates	<u>35,100</u>
Profit before tax	<u>161,667</u>

Under the "function of expense" method, FRS 1 also requires disclosure of additional information on the nature of expenses, including depreciation and amortisation expenses and employee benefits costs (para 104).

It is generally believed that the "function of expense" method will provide more useful information (eg the gross margin). However, the "function of expense" method will be more difficult to implement because a more detailed categorisation of expenses will be required (eg under the "nature of expense" method, depreciation expense will be disclosed as a line item, whereas under the

"function of expense" method, depreciation of factory machinery will be categorised as cost of sales, depreciation of office equipment categorised as administrative expense and depreciation of a delivery van categorised as distribution expense).

(II) An analysis of items of other comprehensive income

FRS 1 requires disclosure of the following either in the statement of profit or loss and other comprehensive income or in the notes to accounts:

- Income tax amount relating to each item of OCI, and
- reclassification adjustments (para 90 in the 2011 Amendments to FRS 1).

An illustration of the above-mentioned disclosures is provided in the Guidance on implementation accompanying FRS 1 as follows (it is slightly modified here for illustration purposes):

Disclosure of components of other comprehensive income year ended 31 December 20x9		
	20x9 \$'000	20x8 \$'000
Exchange differences on translating foreign operations		
Gains arising during the year	5,334	10,667
Tax	<u>1,334</u>	<u>2,667</u>
	<u>4,000</u>	<u>8,000</u>
Available-for-sale financial assets:		
Gains arising during the year	1,333	30,667
Reclassification adjustments for gains included in profit or loss	(25,333)	(4,000)
Tax	<u>6,000</u>	<u>6,667</u>
	<u>(18,000)</u>	<u>20,000</u>
Cash flow hedges:		
Gains (losses) arising during the year	(4,667)	(4,000)
Reclassification adjustments for gains (losses) included in profit or loss	3,333	—
Adjustments for amounts transferred to initial carrying amount of hedged items	667	—
Tax	<u>167</u>	<u>1,000</u>
	<u>(500)</u>	<u>(3,000)</u>
Property revaluation:		
Surplus for the year	500	3,000
Tax	<u>—</u>	<u>—</u>
	<u>500</u>	<u>3,000</u>
Other comprehensive income for the year, net of tax	<u>(14,000)</u>	<u>28,000</u>

¶17-100 Introduction

NOTE: FRS 17 will be superseded by FRS 116 *Leases* (see chapter on FRS 116) effective for annual periods beginning on or after 1 January 2019.

A lease is an agreement whereby the lessor conveys to the lessee the right to use an asset for an agreed period of time in return for rent.

In economic substance, a lease may range from a case where it is nothing more than a mere rental agreement (eg the lessee leases an exhibition hall from the lessor for one month) to a case where it amounts to a purchase with financing facilities (eg the lessee acquires the right to use a photocopying machine for its entire useful life, but pays for the use through periodic lease payments).

In conformity with the principle of "substance over form", each lease should be examined to determine its economic substance and accorded proper accounting treatment.

In Singapore, the accounting standard that prescribes accounting treatments for leases is FRS 17 *Leases*. Two other standards related to leases are INT FRS 27 and INT FRS 104. Where there is a lease, both legally and in substance, FRS 17 should be applied; where there is legally a lease, but not a lease in substance, INT FRS 27 should be applied; and where there is legally no lease, but there is a lease in substance, INT FRS 104 should be applied.

FRS 17 should be applied for annual periods beginning on or after 1 January 2005.

FRS 17 is applicable to all leases except the following (para 2):

- Lease agreement for exploration of natural resources, and
- Lease agreement for such items as motion picture films, plays, and copyrights.

FRS 17 is also not applicable to the measurement of the following (para 2):

- Lease agreement for investment property (which is covered under FRS 40 *Investment Property*), and
- Lease agreement for biological assets (which is covered under FRS 41 *Agriculture*).

CLASSIFICATION OF LEASES

¶17-200 Classification of leases

FRS 17 classifies all leases, for accounting purposes, into two broad categories (para 8):

- Operating leases, and
- Finance leases.

The criterion used in the classification is the extent to which risks and rewards incidental to the ownership of a leased asset lie with the lessor or the lessee (para 7).

Risks incidental to ownership include the possibility of losses from idle capacity or technological obsolescence and that of variations in return due to changing economic conditions. Rewards incidental to ownership may be represented by the expectation of profitable operation over the asset's useful life and that of gain from appreciation in value.

Under FRS 17, a lease is classified as a finance lease if, regardless of its legal form, it transfers substantially all the risks and rewards incidental to ownership from the lessor to the lessee (para 8).

A lease that does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the lessee is classified as an operating lease (para 8).

FRS 17 does not operationalise the concept of "transfer of substantially all risks and rewards incidental to ownership". However, it does provide, in para 10, examples of situations where a lease would normally be classified as a finance lease, as follows:

- The lease transfers ownership of the asset to the lessee by the end of the lease term
- The lease contains a bargain purchase option
- The lease term is for the major part of the useful life of the asset
- The present value (PV) of the minimum lease payments (excluding executory costs) is greater than or equal to substantially all of the fair value (FV) of the asset, and
- The leased assets are of a specialised nature such that only the lessee can use them without major modification being made.

FRS 17 further lists indicators of situations which individually or in combination could lead to a lease being classified as a finance lease, as follows (para 11):

- If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee
- Gains or losses from the fluctuation in the FV of the residual value fall to the lessee, and
- The lessee has the ability to continue the lease for a secondary period at a rent which is substantially lower than market rent.

The US accounting standard, FASB Statement No 13 *Accounting for Leases*, is more specific in its provisions. It spells out the capitalisation criteria, using the first four tests in para 10 with specific quantitative cut-offs.

Each of these four criteria (tests) will be examined in more detail in the following sections.

¶17-210 Transfer of ownership test

If the lease transfers ownership of the asset to the lessee, it is a finance lease. The rationale for this test is that if the ownership of the leased asset is transferred to the lessee, then it is obvious that the risks and rewards incidental to ownership of the leased asset would be transferred to the lessee.

¶17-220 Bargain purchase option test

If a lease contains a bargain purchase option, it is a finance lease. A bargain purchase option is a provision in the lease agreement which gives the lessee an option to purchase the asset at a price which is expected to be sufficiently lower than the FV at the date the option becomes exercisable. Moreover, at the inception of the lease, it is reasonably certain that the option will be exercised.

The rationale for classifying a lease with a bargain purchase option as a finance lease is that under the lease, the lessee will ultimately buy over the leased asset. Therefore, the lessee effectively assumes the risks and enjoys the rewards incidental to the ownership of the leased asset.

¶17-230 Economic life test

If the lease term is for the major part of the useful life of the asset, it follows that substantially all the risks and rewards incidental to ownership are transferred to the lessee. Capitalisation is therefore appropriate.

The three variables in this test (lease term, useful life, and "major part") are explained below.

Lease term

The "lease term", as defined in FRS 17, is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option (para 4).

For example, if a lease contract provides for a non-cancellable period of five years (with or without a normal renewal option), the lease term is five years. However, if a lease contract provides for a non-cancellable period of five years and a bargain renewal option of another three years, then the lease term is eight years. Also, if a lease contract provides for a non-cancellable period of five years and a bargain purchase option at the end of a normal renewal option of four years, then the lease term will be nine years.

Useful life

The estimation of the useful life of the asset, though difficult and subjective, is part and parcel of contemporary accounting. The issues involved in estimating the useful lives of depreciable assets for the purposes of depreciation accounting discussed under FRS 16 *Property, Plant and Equipment* are equally relevant here.

"Major part"

The phrase "major part" is not defined in FRS 17.

FASB Statement No 13, on the other hand, provides for a quantified cut off point. It provides that if the lease period equals or exceeds 75% of the asset's economic life, the asset should be capitalised.

For example, if an asset with a useful life of five years is leased for four years, then the lease is classified as a finance lease because the lease term in this case is more than 75% ($4/5 = 80\%$) of the useful life of the leased asset.

¶17-240 Recovery of investment test

If the PV of the minimum lease payments is greater than or equal to substantially all of the FV of the leased asset, then the lease is a finance lease. The rationale for this test is that if the asset is leased such that the PV of the lease payments is substantially equal to the asset's market value, then the asset is, in substance, sold by the lessor to the lessee.

There are a few variables that have to be defined and quantified before this test can be objectively implemented.

Firstly, what constitutes "minimum lease payments"? Secondly, what rate is to be used to discount the minimum lease payments to arrive at its PV? Thirdly, what is meant by "substantially equal"?

Minimum lease payments

The minimum lease payments generally consist of the rental payments (excluding the executory costs such as insurance, repair and maintenance) which the lessee is or can be required to make during the lease term.

From the lessee's viewpoint, the minimum lease payments also include the amount of the residual value guaranteed by the lessee or a party related to the lessee (eg its holding company).

From the lessor's viewpoint, the minimum lease payments include the initial direct costs, any residual value guaranteed by the lessee, or a party related to the lessee, or an independent third party.

If there is a bargain purchase option, however, the minimum lease payments (for both the lessor and the lessee) comprise the rentals payable over the lease term and the payment required to exercise the purchase option.

Discount rate

In calculating the PV of the minimum lease payments, FRS 17 provides that the discount factor is the interest rate implicit in the lease (para 20). However, if it is not practicable to determine the implicit rate, the lessee's incremental borrowing rate is used as the discount factor (para 20).

In practice, therefore, the lessor will use the implicit rate as the discount factor. As for the lessee, if the implicit rate is made known to him/her, he/she will use the implicit rate; otherwise, he/she will use his incremental borrowing rate as the discount factor.

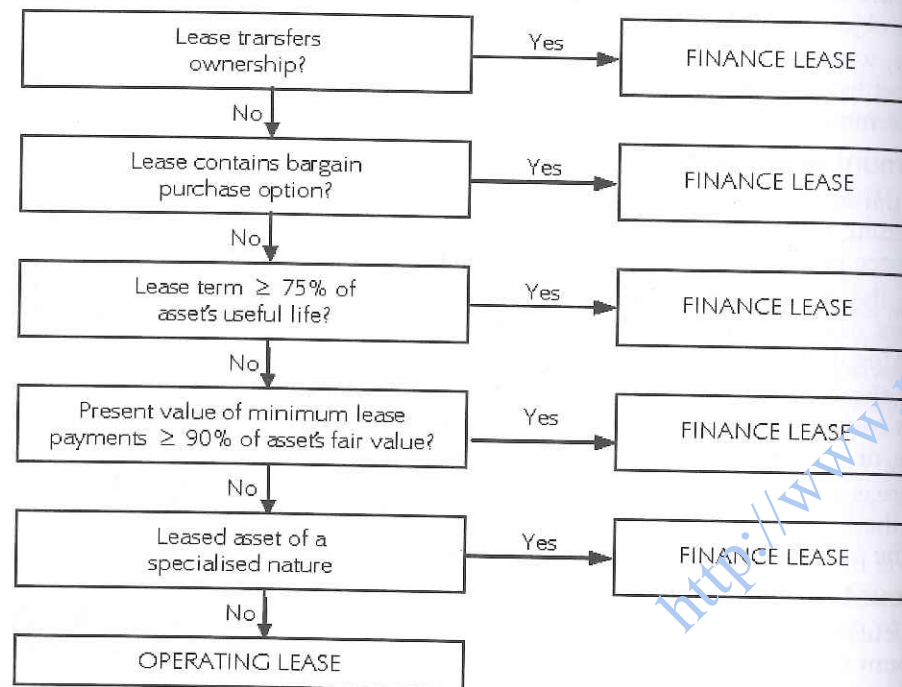
"Substantially equal"

The phrase "substantially equal" is not quantified in FRS 17. FASB Statement No 13, on the other hand, uses 90% as the cut-off point. It provides that if the PV of the minimum lease payments equals or exceeds 90% of the FV of the leased asset, the leased asset should be capitalised.

If the fair market value of a leased computer at the inception of the lease is, for example, \$10,000, the lease will therefore be classified as a finance lease if the PV of the minimum lease payments is equal to or more than \$9,000.

¶17-250 Summary of the tests

Applying the provisions of FRS 17, together with the quantitative criteria of the FASB Statement No 13, the classification process may be presented as a flowchart (not necessarily in the same sequence):



It should be noted that all the above-mentioned tests are to be performed at the inception of the lease. The inception of the lease is the earlier of the date of the lease agreement or the date of a commitment by the parties to the principal provisions of the lease. If subsequent to the inception of the lease the lessee and the lessor agree to change the provisions of the lease, FRS 17 provides that the revised agreement is to be considered as a new agreement over its term (para 13). However, changes in estimates (eg a change in the estimate of the useful life) or changes in circumstances (eg default by the lessee) do not give rise to a new classification of a lease (para 13).

It should also be noted that, so long as one of the tests is satisfied, the lease would be classified as a finance lease. This is because lease accounting standards were designed to prevent unjustifiable off-statement of financial position accounting.

Since the transaction between the lessor and lessee is based on a lease agreement common to both parties, the two parties will normally classify the lease in the same way.

There are, nevertheless, two circumstances where the application of the tests may result in the same lease being classified differently by the lessor and lessee, as follows:

- Where the lessor and lessee use different rates to discount the minimum lease payments, the investment recovery test may be satisfied by one party and not by the other, and
- Where the residual value is guaranteed by an independent third party, the minimum lease payments will be different for the lessor and the lessee (because in this case, the residual value is considered unguaranteed from the lessee's perspective and, therefore, will be excluded from the computation of the lessee's minimum lease payments; however, from the lessor's perspective, the residual value is considered guaranteed and, therefore, will be included in the computation of the lessor's minimum lease payments). Therefore, the investment recovery test may again yield different results.

FRS 17 provides that the land and building elements of a lease of land and building should be considered separately for the purposes of lease classification (para 15A). For this purpose, the minimum lease payments (including any lump sum upfront payments) are allocated between the land and the building elements in proportion to the relative FVs of their leasehold interests at the inception of the lease (para 16).

It should be noted that it is possible for a lessee to account for a property interest held under an operating lease as an investment property under FRS 40 *Investment Property*.

OPERATING LEASES

¶17-300 Operating leases

An operating lease will be accounted for as if it is a rental agreement. Thus, the leased asset will continue to be accounted for in the lessor's books, and the periodic lease payments will be recorded as income by the lessor and as expenses by the lessee.

¶17-310 Accounting by lessees

In the lessee's books, FRS 17 requires the lease payments to be charged to the profit and loss (P&L) account as rental expenses (para 33).

Illustration 1

Assume that A Ltd leases a car for three months from 1 November 20x1 to 31 January 20x2 at a monthly rental of \$2,000.

Quite obviously, this lease will be classified as an operating lease (it is difficult to imagine that this lease could transfer substantially all the risks and rewards incidental to the ownership of the car to the lessee).

Given that the lease is an operating lease, what is required to be accounted for in the books of A Ltd (lessee) are the periodic lease payments. Assuming A Ltd's accounting year end is 31 December, rental expenses of \$4,000 will be charged to the 20x1 P&L account and rental expense of \$2,000 charged to the 20x2 P&L account.

FRS 17 further requires the charge to the P&L account to be recognised on a straight line basis over the lease term unless another systematic basis is representative of the time pattern of the user's benefit (para 33). Thus, the amount recognised may not be equal to the amount paid for each accounting period. This is to ensure proper matching.

Illustration 2

Assume that B Ltd leases an office space for 15 months commencing 1 October 20x1 (it is obvious that this lease will be classified as an operating lease). According to the terms of the lease agreement, no rental is payable for the first three months, but a monthly rental of \$5,000 will be payable for each of the remaining 12 months.

Assuming 31 December is the accounting year end, it will not be appropriate for B Ltd to charge no rental expenses to the 20x1 P&L account, and to charge \$60,000 of lease payments paid in 20x2 to the 20x2 P&L account.

Since B Ltd has paid a total of \$60,000 ($\$5,000 \times 12$) of lease payments for the use of the office space for 15 months, it will be more appropriate to charge a lease expense of \$4,000 ($\$60,000/15$) per month. This will be more representative of the time pattern of the user's benefit.

Thus, for proper matching, the amount of rental expenses that should be charged to the P&L accounts for 20x1 and 20x2 should respectively be \$12,000 ($\$4,000 \times 3$) and \$48,000 ($\$4,000 \times 12$).

¶17-320 Accounting by lessors

For lessors, assets held under operating leases should be retained in their books as fixed assets. Accordingly, these assets should be accounted for in accordance with FRS 16, and under the same accounting policies (eg depreciation method) as those applicable to other fixed assets with similar characteristics.

Illustration 3

If C Ltd is the lessor of the car leased to A Ltd in Illustration 1, the car will be reported as a fixed asset in C Ltd's statement of financial position. The car should be accounted for in the books of C Ltd according to the same accounting policies in respect of valuation basis, frequency of revaluation, method of depreciation and rate of depreciation as those applicable to other motor vehicles held by C Ltd.

The lease payments received should be accounted for as rental income in the P&L account. FRS 17 requires that the rental income be recognised on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished (para 50).

Illustration 4

If D Ltd is the lessor of the office space leased to B Ltd in Illustration 2, the amounts of rental income that D Ltd should recognise for 20x1 and 20x2 are \$12,000 and \$48,000, respectively (assuming that the year end is 31 December and that the straight line basis is most representative of the time pattern of the earnings process).

For initial direct costs incurred by lessors in negotiating and arranging an operating lease, FRS 17 requires that they should be added to the carrying amount of the leased asset and recognised as an expense over the lease term on the same basis as the lease income (para 52).

FINANCE LEASES

¶17-400 Finance leases

Under a finance lease, the accounting procedure will be as follows:

- The leased asset will be accounted for as if it has been sold to the lessee. The leased asset will therefore be recorded as a fixed asset in the lessee's books
- The related financing facility will be recorded as a liability (lease payable) in the lessee's books and as an asset (lease receivable) in the lessor's books, and
- The periodic lease payments are computed to cover both finance charges/income and repayment of the principal sum. Therefore, the periodic lease payments, when paid or payable by the lessee, or received or receivable by the lessor, will have to be apportioned into interest and principal portions and recorded accordingly in the books of both the lessee and the lessor.

¶17-410 Accounting by lessees

FRS 17 requires the asset under a finance lease to be recorded as a fixed asset in the lessee's books.

The capitalised amount is the lower of the FV of the asset at the inception of the lease or the PV of the minimum lease payments (para 20).

In calculating the PV of the minimum lease payments, the discount factor is the interest rate implicit in the lease. However, if the implicit rate is not practical to determine, the lessee's incremental borrowing rate is used as the discount factor (para 20).

The leased asset under the finance lease recorded as a fixed asset in the lessee's books should be accounted for in accordance with FRS 16 and with the same accounting policies as those adopted by the lessee to account for other fixed assets with similar characteristics.

The leased asset should be depreciated over its useful life if the lessee is to obtain ownership of the asset by the end of the lease term (that is, either test 1 (transfer of title) or test 2 (bargain purchase option) is met). Otherwise, the leased asset should be depreciated over the shorter of the lease term or its useful life (para 27).

FRS 17 also requires the lessee to record the obligation arising from the finance lease at the same amount as the leased asset (para 27).

As for the periodic lease payments, FRS 17 requires them to be apportioned between the finance charge (interest expense) and the reduction of the outstanding liability (para 25).

Generally, the interest expense should be allocated using the "effective interest rate method" so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period during the lease term (para 25). In practice, some form of approximation (eg "sum-of-digit method" or "straight line method") may also be used (para 26).

Thus, for a finance lease, the lessee will record the leased asset and the related liability as if the asset were purchased with financing facility. Periodic lease payments should be accounted for as payments for the principal amount under the lease liability as well as payments for interest expense. It may be noted that, under a finance lease, the lessee will record two expense elements relating to the finance lease: interest expense and depreciation expense.

Illustration 5

On 1 January 20x1, ABC Trading Ltd entered into a lease agreement to lease a piece of equipment from DEF Leasing Ltd.

The terms of the agreement included a:

- non-cancellable lease term of four years, with no renewal or purchase option, and
- lease rental of \$10,000 per year to be paid by ABC Trading Ltd on 31 December of each of the four years, commencing 31 December 20x1.

The lease rental was calculated and mutually agreed upon based on a 5% rate of return to DEF Leasing Ltd.

The equipment was new on 1 January 20x1, had a fair market value of \$42,000 and was expected to have an estimated useful life of five years.

At the end of the lease term, the equipment was to be returned to DEF Leasing Ltd. There was no mention of the residual value.

As part of its accounting policies, ABC Trading Ltd used the "straight line" method to depreciate all its fixed assets (assuming no salvage value unless stated otherwise), and the "effective interest" method to allocate the finance charge.

In this case, the lease would be classified as a finance lease because the lease term of four years was for the major part (more than 75%) of the useful life of five years of the equipment.

ABC Trading Ltd (the lessee) would have to capitalise the leased asset, record the related liability, provide depreciation and allocate the interest expense over the lease term. Thus, three initial calculations would have to be performed: (i) PV of the minimum lease payments, (ii) depreciation charge, and (iii) amortisation schedule for interest expense.

- Calculation of the PV of the minimum lease payments:
Minimum lease payments: Ordinary annuity of \$10,000 for four periods = \$40,000
Discount rate: 5%
PV: $\$10,000 \times 3.5459 = \$35,459$
Since the PV of the minimum lease payments was less than the FV of the equipment, the leased equipment would be capitalised and the related liability recorded in ABC Trading Ltd's books at \$35,459.
- The depreciation charge on the leased equipment would be \$8,865 ($\$35,459 \div$ four years) for each of the four years from 20x1 to 20x4.
- Amortisation schedule for finance charges of \$4,541 ($\$40,000 - \$35,459$):

Date	Lease payment	Interest (5%)	Principal	Lease liability
	\$	\$	\$	\$
1 January 20x1				35,459
31 December 20x1	10,000	1,773	8,227	27,232
31 December 20x2	10,000	1,362	8,638	18,594

Date	Lease payment	Interest (5%)	Principal	Lease liability
	\$	\$	\$	\$
31 December 20x3	10,000	930	9,070	9,524
31 December 20x4	<u>10,000</u>	<u>476</u>	<u>9,524</u>	Nil
Total	<u>40,000</u>	<u>4,541</u>	<u>35,459</u>	

The journal entries to record the lease for each of the four years (assuming 31 December year ends) would be as follows:

1 January 20x1

Dr Leased equipment	35,459	
Cr Lease payable (to record the finance lease)		35,459

31 December 20x1

Dr Lease payable	8,227	
Dr Interest expense	1,773	
Cr Cash (to record lease payment)		10,000
Dr Depreciation expense	8,865	
Cr Accumulated depreciation (to record depreciation expense)		8,865

31 December 20x2

Dr Lease payable	8,638	
Dr Interest expense	1,362	
Cr Cash (to record lease payment)		10,000
Dr Depreciation expense	8,865	
Cr Accumulated depreciation (to record depreciation expense)		8,865

31 December 20x3

Dr Lease payable	9,070	
Dr Interest expense	930	
Cr Cash (to record lease payment)		10,000
Dr Depreciation expense	8,865	
Cr Accumulated depreciation (to record depreciation expense)		8,865

31 December 20x4

Dr Lease payable	9,524	
Dr Interest expense	476	
Cr Cash (to record lease payment)		10,000
Dr Depreciation expense	8,865	
Cr Accumulated depreciation (to record depreciation expense)		8,865

It should be noted that by the end of the lease on 31 December 20x4, all the accounts relating to the lease would have been written off, the lease liability fully settled and the leased asset fully depreciated.

In the following discussion, the technicality of the provisions of FRS 17 will be demonstrated using the finance lease between ABC Trading Ltd and DEF Leasing Ltd in Illustration 5. Modifications are made to the lease to include the bargain purchase option, bargain renewal option and residual value, and to assume that the implicit interest rate is not known to the lessee. In addition, a case where the lease payments are in the form of an annuity due instead of an ordinary annuity is illustrated. Each of the cases is to be considered independently. For the sake of simplicity, it is assumed that the implicit rate remains at 5% in each of the following cases, despite the fact the some of the above-mentioned changes would affect the rate of return to the lessor.

Bargain purchase option

The effects of the existence of a bargain purchase option are:

- the lease will be classified as a finance lease
- the minimum lease payments will be increased by the exercise price, and
- the useful life, instead of the lease term, will be used as the basis over which the depreciable amount for the leased asset is allocated to determine the annual depreciation charge for the leased asset.

Illustration 6

Assume that the lease agreement between ABC Trading Ltd and DEF Leasing Ltd in Illustration 5 included a provision to give ABC Trading Ltd an option to buy over the equipment at the end of the four-year lease term for \$1,000, and that at the inception of the lease on 1 January 20x1, it was estimated that the fair market value of the equipment would be about \$5,000 after four years' usage.

Given the bargain purchase option, the lease would be classified as a finance lease (the lease would also qualify as a finance lease under the economic life test). The minimum lease payments would be increased by the exercise price to \$41,000. Also, the leased equipment would be depreciated over five years instead of four years.

The related calculations would be as shown as follows:

- (i) Calculation of the PV of the minimum lease payments:

Minimum lease payments: Ordinary annuity of \$10,000 for four periods plus \$1,000 at the end of the fourth period = \$41,000

Discount rate: 5%

PV: $\$10,000 \times 3.5459 + \$1,000 \times 0.8227 = \$36,282$.

The leased equipment would be capitalised and the related liability recorded in ABC Trading Ltd's books at \$36,282 (the PV of minimum lease payments of \$36,282 being lower than the FV of \$42,000).

- (ii) The depreciation charge for the leased equipment would be \$7,256.40 ($\$36,282 \div$ five years) for each of the five years from 20x1 to 20x5.
 (iii) Amortisation schedule for finance charges of \$4,718 ($\$41,000 - \$36,282$):

Date	Lease payment	Interest (5%)	Principal	Lease liability
	\$	\$	\$	\$
1 January 20x1				36,282
31 December 20x1	10,000	1,814	8,186	28,096
31 December 20x2	10,000	1,405	8,595	19,501
31 December 20x3	10,000	975	9,025	10,476
31 December 20x4	10,000	524	9,476	1,000

The journal entries to record the lease would be the same as those under the original lease in Illustration 5, except for changes in the figures.

In addition, it is noted that in the amortisation schedule, there would be a balance of \$1,000 in the lease liability account at the end of the lease. This is the amount the lessee would have to pay to exercise the purchase option. The journal entry to record the exercise of the purchase option on 31 December 20x4 would be as follows:

Dr Lease payable	1,000	
Cr Cash		1,000
(to record exercise of purchase option)		

In this case, at the end of the lease on 31 December 20x4, while the lease liability would be fully settled, the leased asset would still carry a balance because it would be depreciated over five years. Also, on this date, the leased asset should preferably be transferred to an ordinary fixed asset account.

Bargain renewal option

The effects of the existence of a bargain renewal option are:

- the lease term is increased by the renewal period, and
- the minimum lease payments are increased by the lease payments during the renewal period.

The increase in the lease term and the minimum lease payments may affect the classification decision of the lease under the economic life test and the recovery of investment test. Also, the increase in lease term extends the period over which the leased asset is to be depreciated.

Illustration 7

Assume that the lease agreement between ABC Trading Ltd and DEF Leasing Ltd in Illustration 5 included a provision to give ABC Trading Ltd an option to renew the lease for two additional years at the end of the four-year lease term for an additional sum of \$1,000 per year to be paid on 31 December 20x5 and 20x6, and that at the inception of the lease on 1 January 20x1, it was estimated that the fair market rental rate of a similar equipment in its fifth and sixth year of use would be about \$5,000 per year. Assume also that the leased equipment had a useful life of seven (instead of five) years.

In this case, the lease would be classified as a finance lease because the lease term (six years) was for the major part (more than 75%) of the useful life (seven years). The minimum lease payments would be increased by the lease payments in the renewal period to \$42,000. Also, the leased equipment would be depreciated over the lease term of six years. The related calculations would be as shown as follows:

- (i) Calculation of the PV of the minimum lease payments:

Minimum lease payments: Ordinary annuity of \$10,000 for four periods plus \$1,000 for the next two periods = \$42,000

Discount rate: 5%

PV: $(\$10,000 \times 3.54595) + (\$1,000 \times 0.783531) + (\$1,000 \times 0.74622) = \$36,988$.

The leased equipment would be capitalised and the related liability recorded in ABC Trading Ltd's books at \$36,988 (the PV of minimum lease payments of \$36,988 being lower than the FV of \$42,000).

- (ii) The depreciation charge for the leased equipment would be \$6,164.67 ($\$36,988 \div$ six years) for each of the six years from 20x1 to 20x6.

(iii) Amortisation schedule for finance charges of \$5,012 (\$42,000 – \$36,988):

Date	Lease payment	Interest (5%)	Principal	Lease liability
	\$	\$	\$	\$
1 January 20x1				36,988
31 December 20x1	10,000	1,849	8,151	28,837
31 December 20x2	10,000	1,442	8,558	20,279
31 December 20x3	10,000	1,014	8,986	11,293
31 December 20x4	10,000	565	9,435	1,858
31 December 20x5	1,000	93	907	951
31 December 20x6	1,000	49	951	Nil

The journal entries to record the lease would be the same as those under the original lease in Illustration 5 except for changes in the accounting period and the changes in the figures.

By the end of the lease on 31 December 20x6, all the accounts relating to the lease would have been written off: the lease liability fully settled and the leased asset fully depreciated.

Residual value

As for the residual value of the leased asset, there may be three possible scenarios as far as the lessee is concerned: firstly, the lessee may be required to guarantee the residual value of the leased asset at the end of the lease; secondly, the lessee may enjoy wholly or share with the lessor the sale proceeds of the leased asset when it is disposed of at the end of the lease; and thirdly, the lessee may have nothing to do with the residual value.

Guaranteed residual value

If the lease agreement requires the lessee (or any party related to the lessee, eg its parent company) to guarantee the residual value of the leased asset, the following points should be noted:

- The guaranteed residual value will form part of the minimum lease payments
- The depreciable amount of the leased asset will be equal to the capitalised amount less the guaranteed residual value (as in the case for any depreciable assets under FRS 16)

- The lease liability will also have a balance equal to the amount of the guaranteed residual value at the end of the lease, and
- A gain or loss will arise due to the difference between the guaranteed residual value and the FV of the leased asset at the end of the lease.

Illustration 8

Assume that in the lease transaction between ABC Trading Ltd and DEF Leasing Ltd in Illustration 5, ABC Trading Ltd guaranteed DEF Leasing Ltd that the leased asset would have a residual value of \$5,000 when the leased asset was reverted to the lessor at the end of the lease on 31 December 20x4.

The above-mentioned lease would be classified as a finance lease because the lease term (four years) was for the major part (more than 75%) of the useful life (five years).

In this case, the minimum lease payments would be increased by the guaranteed residual value of \$5,000 to \$45,000. The depreciable amount of the leased equipment would be reduced by the guaranteed residual value. The related calculations would be as shown as follows:

(i) Calculation of the PV of the minimum lease payments:

Minimum lease payments: Ordinary annuity of \$10,000 for four periods plus \$5,000 at the end of the 4th period = \$45,000

Discount rate: 5%

PV: $(\$10,000 \times 3.54595) + (\$5,000 \times 0.8227) = \$39,572$.

The leased equipment would be capitalised and the related liability recorded in ABC Trading Ltd's books at \$39,572 (the PV of minimum lease payments of \$39,572 being lower than the FV of \$42,000).

- (ii) The depreciable amount of the leased equipment would be \$34,572 (\$39,572 – \$5,000). The depreciation for the leased equipment would therefore be \$8,643 ($\$34,572 \div$ four years) for each of the four years from 20x1 to 20x4.
- (iii) Amortisation schedule for finance charges of \$5,428 (\$45,000 – \$39,572):

Date	Lease payment	Interest (5%)	Principal	Lease liability
	\$	\$	\$	\$
1 January 20x1				39,572
31 December 20x1	10,000	1,979	8,021	31,551
31 December 20x2	10,000	1,578	8,422	23,129
31 December 20x3	10,000	1,157	8,843	14,286
31 December 20x4	10,000	714	9,286	5,000

The journal entries to record the lease would be the same as those under the original lease in Illustration 5 except for changes in the figures.

In addition, it may be noted that in the amortisation schedule there would be a balance of \$5,000 in the lease liability account at the end of the lease. This is the amount the lessee had guaranteed to pay on the residual value of the leased asset. The leased equipment account would also be carried at a book value of \$5,000 (capitalised amount of \$39,572 less A/D of \$34,572 (\$8,643 × four years)). Assuming that the FV of the equipment as at 31 December 20x4 was \$5,000, the journal entry to close the accounts relating to the lease would simply be as follows:

Dr Lease payable	5,000	
Dr Accumulated depreciation	34,572	
Cr Leased equipment (to close the lease accounts)		39,572

If the FV of the leased equipment was less than the guaranteed amount when it was returned to the lessor, however, the lessee would have to pay to the lessor the difference. This additional payment would be recorded as a loss in the lessee's books.

For example, assuming that the leased equipment had an FV of \$3,000 at the end of the lease on 31 December 20x4, the lessee would have to pay to the lessor the difference of \$2,000. The closing entry and the journal entries to record the loss would be as follows:

Dr Lease payable	5,000	
Dr Accumulated depreciation	34,572	
Cr Leased equipment (to close the lease accounts)		39,572
Dr Loss on finance lease	2,000	
Cr Cash (to record loss on guarantee)		2,000

On the other hand, if the FV of the leased equipment was more than the guaranteed value when it was returned to the lessor, the lessee might or might not enjoy the surplus (or part thereof), depending on the terms of the lease agreement. If the lease agreement merely required the lessee to guarantee a certain minimum amount of residual value, then the lessee might not be entitled to any surplus. However, the lease agreement could, of course, provide expressly that any surplus of FV over the guaranteed amount would accrue wholly to the lessee or to the lessor, or shared between the lessee and the lessor. In the latter case, any amount received by the lessee would be recorded as a gain.

Sharing of sales proceeds

Where the lease agreement provides for the lessee to enjoy wholly or share with the lessor the sale proceeds of the leased asset when it is disposed of at the end of the lease, the amount of the sales proceeds accruing to the lessee represents a cash inflow (as opposed to cash outflow in the case of a guaranteed residual value).

Thus, the minimum lease payments will not be affected. Moreover, the capitalised amount and the amortisation schedule for finance charges will not be affected by the existence of the lessee's right to share in the realised amount of the residual value.

As in the case of a guaranteed residual value, however, the depreciable amount of the leased asset will be reduced by the amount of the expected residual value accruing to the lessee. Therefore, the annual depreciation charge each year will correspondingly be reduced.

Illustration 9

Assume that the lease agreement between ABC Trading Ltd and DEF Leasing Ltd in Illustration 5 provided that ABC Trading Ltd and DEF Leasing Ltd were to share the sales proceeds of the leased equipment at the end of the lease at the ratio of 2:3. Assume also that the leased asset was expected to have a residual value of \$5,000 as at 31 December 20x4.

In this case, the lease would be classified as a finance lease because the lease term (four years) was for the major part (more than 75%) of the useful life (five years).

The PV of the minimum lease payments and the amortisation schedule for the interest expense would be the same as those in the original case as follows:

(i) Calculation of the PV of the minimum lease payments (same as that shown in the original case in Illustration 5):

Minimum lease payments: Ordinary annuity of \$10,000 for four periods = \$40,000

Discount rate: 5%

PV: \$10,000 × 3.54595 = \$35,459.

(ii) Amortisation schedule for finance charges of \$4,541 (\$40,000 – \$35,459) (same as that shown in the original case in Illustration 5).

The depreciation charge for each accounting period, however, would be different from that in the original case in Illustration 5. In this case, the depreciable amount of the leased equipment would be reduced by the expected residual value accruing to the lessee of \$2,000 ($2/5 \times \$5,000$), and would therefore be \$33,459 (\$35,459 – \$2,000). Consequently, the annual depreciation charge would be \$8,364.75 ($\$33,459 \div$ four years) for each of the years 20x1 to 20x4.

The journal entries to record the lease would be same as those under the original lease in Illustration 5 except for changes in the depreciation figures.

It is noted that the leased liability account would be fully closed at the end of the lease on 31 December 20x4, as in the original case.

At the end of the lease on 31 December 20x4, however, the leased equipment would be carried at an amount equal to the estimated residual value of \$2,000 accruing to the lessee (\$35,459 - (\$8,364.76 × 4)). If the equipment were subsequently sold in January 20x5 for \$5,000 and ABC Trading Ltd received its share of \$2,000, the accounts would be closed as follows:

31 December 20x4

Dr Receivable from lessor	2,000	
Dr Accumulated depreciation	33,459	
Cr Leased equipment		35,459

January 20x5

Dr Cash	2,000	
Cr Receivable from lessor		2,000

If the leased asset were subsequently disposed of at an amount more than or less than \$5,000, the lessee would record the surplus as a gain and the deficit as a loss, as the case may be.

Unguaranteed residual value

If the lessee (or a party related to it) does not guarantee the residual value, nor is the lessee entitled to the sale proceeds of the leased asset at the end of the lease, then the residual value of the leased asset is of no relevance to the lessee and should therefore be ignored.

Use of lessee's incremental borrowing rate

In practice, the lessor may not always disclose the implicit rate to the lessee because the lessor may deem the implicit rate used in the lease agreement as part of its trade secrets.

In cases where the lessee has no knowledge of the lessor's implicit rate, FRS 17 requires that the lessee use its own incremental borrowing rate to compute the PV of the minimum lease payments.

Illustration 10

Assume that in the original case of the lease between ABC Trading Ltd and DEF Leasing Ltd in Illustration 5, ABC Trading Ltd had no knowledge of the implicit rate used in the lease and that its incremental borrowing rate was 6% pa.

In this case, the lease would still be classified as a finance lease (because the lease term of four years was more than 75% of the useful life of the leased equipment).

However, in the computation of the minimum lease payments, the lessee's incremental borrowing rate of 6% would be used (instead of the implicit rate of 5%).

(i) Calculation of the PV of the minimum lease payments:

Minimum lease payments: Ordinary annuity of \$10,000 for four periods = \$40,000

Discount rate: 6%

PV: \$10,000 × 3.46511 = \$34,651.

Since the PV of the minimum lease payments was less than the FV of the equipment, the leased asset would be capitalised and the related liability recorded in ABC Trading Ltd's books at \$34,651.

(ii) The depreciation charge for the leased equipment would be \$8,662.75 (\$34,651 ÷ four years) for each of the four years from 20x1 to 20x4.

(iii) Amortisation schedule for finance charges of \$5,349 (\$40,000 - \$34,651):

Date	Lease payment	Interest (6%)	Principal	Lease liability
	\$	\$	\$	\$
1 January 20x1				34,651
31 December 20x1	10,000	2,079	7,921	26,730
31 December 20x2	10,000	1,604	8,396	18,334
31 December 20x3	10,000	1,100	8,900	9,434
31 December 20x4	10,000	566	9,434	Nil

The journal entries to record the lease would be the same as those under the original lease in Illustration 5 except for changes in the figures.

By the end of the lease on 31 December 20x4, all the accounts relating to the lease would have been written off: the lease liability fully settled and the leased asset fully depreciated.

Annuity due

In practice, it is common for the lease agreement to provide for the first periodic lease payment to be made at the beginning of the period (annuity due) rather than at the end of the period (ordinary annuity).

Financially, the difference between an annuity due and an ordinary annuity is that in the former case the lessee is taking less financing from the lessor and, therefore, the finance charge should correspondingly be reduced.

¶38-100 Introduction

FRS 38 *Intangible Assets* prescribes the accounting and disclosure for intangible assets that are not specifically dealt with in other FRSs.

FRS 38 applies to all intangible assets except:

- intangible assets that are within the scope of another standard (eg goodwill acquired in a business combination (which is dealt with in FRS 103 *Business Combinations*))
- financial assets as defined in FRS 32 *Financial Instruments: Presentation*
- exploration and evaluation assets, and
- expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources.

FRS 38 is operative for annual periods beginning on or after 1 July 2004.

RECOGNITION

¶38-200 Recognition

FRS 38 provides that the recognition of an item as an intangible asset requires an entity to demonstrate that the item meets (para 18):

- the definition of an intangible asset, and
- the recognition criteria.

An "intangible asset" is defined in para 8 of FRS 38 as an identifiable non-monetary asset without physical substance.

Thus, to meet the definition of an intangible asset, an item must fulfil three criteria, namely:

- identifiability
- control over a resource, and
- existence of future economic benefits.

FRS 38 provides that an asset meets the identifiability criteria when it:

- is separable from the entity (ie can be sold, transferred, licensed, rented or exchanged individually or together with a related contract, asset or liability), or
- arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity (para 12).

The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way.

The future economic benefits flowing from an intangible asset may include revenue from the sale of product or service, cost savings or other benefits resulting from its use by the entity.

The recognition criteria are stated in FRS 38 as follows (para 21):

- It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise, and
- The cost of the asset can be measured reliably.

Expenditure that meets the definition of intangible asset and satisfies the recognition criteria previously discussed should be recognised as an intangible asset.

If an intangible item does not meet both the definition and the recognition criteria of an intangible asset, FRS 38 requires the expenditure on this item to be recognised as an expense when it is incurred (para 68).

If the item is acquired in a business combination, however, this expenditure (included in the cost of acquisition) should form part of the amount attributed to goodwill (negative goodwill) at the date of acquisition (para 68).

Further, FRS 38 provides that expenditure on an intangible item that was initially recognised as an expense should not be recognised as part of the cost of an intangible asset at a later date (para 71).

¶38-210 Internally generated intangible assets

Many internal expenditure that are expected to result in future economic benefits are not recognised as intangible assets because either:

- they are not separately identifiable as an asset, or
- the enterprise has insufficient control.

For example, internally generated goodwill, brands and items similar in substance cannot be distinguished from the cost of developing the business as a whole and are therefore not recognised as intangible assets. Also, an enterprise may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits from training, however, usually, an enterprise has insufficient control over the staff to recognise these as intangible assets. An enterprise has control of an asset if it has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits (para 13).

Thus, FRS 38 specifically provides that internally generated goodwill, brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as assets (para 48 and 63).

Examples of other expenditure that will not give rise to an intangible asset to be recognised in the financial statements are as follows (para 69):

- Expenditure on starting up an operation or a business (start-up costs)
- Expenditure on training

- Expenditure on advertising and promotion, and
- Expenditure on relocating or reorganising part or all of an enterprise.

Generally, to assess whether an internally generated intangible asset meets the criteria for recognition, FRS 38 requires an entity to classify the generation of the asset into: (i) a research phase, and (ii) a development phase (para 52).

FRS 38 provides that all expenditure on research or during the research phase of an internal project should be written off as an expense when incurred, and no intangible asset should be recognised (para 54).

As for expenditure on development or during the development phase of an internal project, FRS 38 provides that it should be capitalised as an intangible asset if, and only if, the enterprise can demonstrate all of the following (para 57):

- Technical feasibility of completion
- Intention to complete
- Ability to use or sell the asset
- Generation of probable future economic benefits
- Availability of adequate resources to complete and to use or sell, and
- Development expenditure attributable to the asset can be measured reliably.

¶38-220 Separately-acquired intangible assets

For separately-acquired intangible assets, FRS 38 provides that the probability criterion is always considered to be satisfied (para 25), and that the cost can be usually be measured reliably (para 26).

Normally, the price an enterprise pays to acquire an intangible asset reflects expectations about the probability that the expected future economic benefits embodied in the asset will flow to the enterprise.

Further, since there is a transaction, the measurement issue will also be overcome.

Thus, most of the acquired intangible assets will be recognised as intangible assets under FRS 38.

¶38-230 Intangible assets acquired in a business combination

For intangible assets acquired in a business combination, FRS 38 provides that the probability criterion is always considered to be satisfied (para 33). However, measurement for individual intangible assets may be an issue.

Thus, FRS 38 provides that an entity should recognise an intangible asset acquired in a business combination separately from goodwill if the asset's FV can be measured reliably, irrespective of whether the asset had been recognised by the acquiree before the business combination (para 34).

FRS 38 further provides that the FV of intangible assets acquired in business combinations can normally be measured with sufficient reliability to be recognised separately from goodwill, especially if the acquired intangible assets have finite useful lives (para 35).

FRS 38 specifically provides that an in-process research and development (R&D) project of the acquiree should be recognised as an intangible asset separately from the goodwill if the project meets the definition of an intangible asset and its FV can be measured reliably (para 34).

INITIAL MEASUREMENT

¶38-300 Initial measurement

FRS 38 provides that an intangible asset should be measured initially at cost (para 24).

¶38-310 Internally generated intangible assets

FRS 38 provides that the cost of an internally generated intangible asset is the amount of expenditure incurred from the date when the intangible asset first meets the recognition criteria (para 65).

Further, as previously mentioned, FRS 38 para 71 prohibits expenditure that has been initially recognised as an expense in previous annual financial statements or interim financial reports to be recognised as part of the cost of an intangible asset at a later date.

Illustration 1

ABC Ltd is developing a new production process. For the year ended 31 December 20x5, expenditure incurred was \$100,000, of which \$70,000 was incurred during the first three quarters of 20x5 and \$30,000 was incurred during the last quarter of 20x5. The company presents quarterly reports, and for the first three quarters, it was able to demonstrate that the production process met the criteria for recognition as an intangible asset only as at 1 October 20x5. The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be \$50,000.

In this case, the production process is recognised as an intangible asset in the 20x5 balance sheet at a cost of \$30,000. The \$70,000 expenditure incurred during the first three quarters has been written off as expense because the recognition criteria were not met, and this expenditure cannot be reversed to form part of the cost of the production process recognised in the balance sheet.

The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce and prepare the asset to be capable of operating in the manner intended by management. Examples of these directly attributable costs are costs of materials, costs of employee benefits and amortisation of patents and licences consumed in generating the intangible asset and legal fees to register a legal right (para 66). However, selling, administrative

and other general overhead expenditure (unless this expenditure can be directly attributable to preparing the asset for its intended use), identified inefficiencies and initial operating losses incurred before the asset achieves planned performance and expenditure to train staff to operate the asset are not part of the cost of an internally generated intangible asset (para 67).

¶38-320 Separately-acquired intangible assets

For a separately-acquired intangible asset, FRS 38 provides that the cost comprises its purchase price and any directly attributable expenditure on preparing the asset for its intended use (para 27).

Examples of directly attributable costs are costs of employee benefits and professional fees arising directly from bringing the asset to its working condition, and costs of testing whether the asset is functioning properly (para 28).

¶38-330 Intangible assets acquired in a business combination

For an intangible asset acquired in a business combination, FRS 38 provides that the cost of the asset is its FV at the acquisition date (para 33). For annual periods beginning on or after 1 January 2013, the measurement and disclosure of FV should follow FRS 113 *Fair Value Measurement*.

SUBSEQUENT MEASUREMENT

¶38-400 Subsequent measurement

After initial recognition, FRS 38 allows an intangible asset to be measured using either the cost model or the revaluation model (para 72).

Under the cost model, an intangible asset should be carried, after initial recognition, at its cost less any accumulated amortisation and any accumulated impairment losses (para 74).

Under the revaluation model, an intangible asset should be carried, after initial recognition, at a revalued amount less any subsequent accumulated amortisation and any subsequent accumulated impairment losses (para 75).

FRS 38 specifies that the revaluation model is permitted if, and only if, FV can be determined by reference to an active market for the intangible asset (para 75). In addition, once an entity elects this model, FRS 38 requires revaluation to be made with sufficient regularity such that the carrying amount of the intangible asset does not differ materially from that which would be determined using FV at the balance sheet date (para 75), and all the intangible assets in the same class should be revalued unless there is no active market for any asset in the class (para 72 and 81). The accounting treatments for revaluation increase and decrease as provided for in para 85 and 86 are similar to that provided in FRS 16 *Property, Plant and Equipment*.

Illustration 2

Scenario A

Assume that on 1 January 20x1, ABC Ltd (with 31 December accounting year ends) capitalised an intangible asset with indefinite life at a cost of \$10 million. Assume further that, on 31 December 20x3, the company revalued its intangible asset to market value of \$13 million, but revalued it downwards to \$11 million on 31 December 20x5 and to \$9 million on 31 December 20x7.

In this case, the revaluation surplus of \$3 million in 20x3 should be credited to a non-distributable reserve, "revaluation reserve", the deficit on revaluation of \$2 million in 20x5 should be charged against the revaluation reserve, and of the revaluation deficit of \$2 million in 20x7, \$1 million should be charged to the revaluation reserve and the other \$1 million charged to the 20x7 income statement.

Scenario B

Assume that on 1 January 20x2, XYZ Ltd (with 31 December accounting year ends) capitalised an intangible asset with indefinite life at a cost of \$20 million. Assume further that, on 31 December 20x4, XYZ Ltd revalued its intangible asset downwards to its market value of \$18 million, and on 31 December 20x6, revalued it upwards to its market value of \$21 million.

In this case, the deficit on revaluation of \$2 million in 20x4 should be charged to the 20x4 income statement. Of the revaluation surplus of \$3 million in 20x6, \$2 million should be credited to the 20x6 income statement and the remaining \$1 million credited to a non-distributable reserve, "revaluation reserve".

Note that FRS 36 *Impairment of Assets* (para 124) prohibits the reversal of impairment loss recognised for goodwill in a subsequent period. This is because any subsequent increase in recoverable amount of goodwill after an impairment is likely to be an increase in internally generated goodwill (FRS 36 para 125).

Depending on whether the useful life of an intangible asset is finite or indefinite, the subsequent accounting treatment will defer.

Specifically, an intangible asset with finite life will be subjected to amortisation and the impairment test, while an intangible asset with indefinite useful life will not be subjected to amortisation but will be subjected to a more vigorous impairment test. An enterprise applies FRS 36 to determine when to recognise or reverse an impairment loss on an intangible asset and how to measure the impairment loss (para 111).

Thus, it is important, as required by para 88 of FRS 38, that an entity should assess whether the useful life of an intangible asset is finite or indefinite.

It may be noted that FRS 38 requires an intangible asset to be regarded as having an indefinite useful life when, based on the analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for an entity (para 88).

FRS 38 further provides that the useful life of an intangible asset that has been assessed to be indefinite (and hence, not amortised) should be reviewed each period to determine whether events and circumstances continue to support an

indefinite useful life assessment of that asset. If they do not, the change in the useful life assessment from indefinite to finite life should be accounted for as a change in accounting estimate in accordance with FRS 8 (para 109). FRS 38 para 110 further requires that, in this case, the entity test the intangible asset for impairment in accordance with FRS 36.

¶38-410 Amortisation

FRS 38 provides that intangible assets with indefinite useful lives should not be amortised (para 107).

For intangible assets with finite useful lives, however, FRS 38 provides that its depreciable amount (ie cost or revalued amount less residual value) should be amortised on a systematic basis over its useful life (para 97).

Thus, the discussion here is only applicable to intangible assets with finite useful lives (whether carried at cost or at revalued amount), and not applicable to intangible assets with indefinite useful lives.

Amortisation should commence when the asset is available for use and cease when the asset is derecognised or when the asset is classified as held for sale, if earlier (para 97).

FRS 38 also requires that the amortisation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight line method should be adopted (para 97).

In the *Amendment to FRS 16 and FRS 38* (2014), which is effective for annual periods beginning on or after 1 January 2016, FRS 38 is amended to provide that amortisation method based on "revenue" is not appropriate, unless the useful life of the underlying intangible asset is limited by revenue (para 98A).

The amortisation charge should be recognised as an expense unless another FRS permits or requires it to be included in the carrying amount of another asset (para 97).

For the purposes of determining the depreciable amount, FRS 38 specifies that the residual value of an intangible asset is assumed to be zero unless there is either a commitment by a third party to purchase the asset at the end of its useful life or an active market by which its residual value can be determined and it is probable that this market will exist at the end of the asset's useful life (para 100).

FRS 38 requires the amortisation period and the amortisation method to be reviewed at least at each financial year end (para 104). Any change to the amortisation period and amortisation method should be accounted for as change in accounting estimate in accordance with FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

The following example illustrates the provisions of FRS 38 in relation to amortisation of intangible assets:

Illustration 3

Assume that DEF Ltd has capitalised \$12 million of development costs as at 31 December 20x1. DEF Ltd expects the net profit from the sale of the newly developed product to be approximately \$15 million, of which 50% will be earned in 20x2, 30% in 20x3 and 20% in 20x4.

In this case, the development costs should be amortised in a manner such that \$6 million will be charged to the 20x2 profit and loss (P&L) account, \$3.6 million to the 20x3 P&L account and \$2.4 million to the 20x4 P&L account.

¶38-420 Impairment

FRS 38 requires all intangible assets (whether with finite or indefinite useful lives, and whether carried at cost or at revalued amount) to be subjected to the impairment test.

Intangible assets with finite useful lives, however, are subjected to the impairment test only whenever there is indication that the asset may be impaired, whereas intangible assets with indefinite useful lives should be subjected to the impairment test at least annually and whenever there is indication that the asset may be impaired (para 108).

To assess whether an intangible asset may be impaired, an enterprise applies FRS 36 *Impairment of Assets*.

FRS 36 also requires the reversal of impairment loss for all intangible assets other than goodwill accounted for under FRS 38.

The following examples illustrate the provisions of FRS 36 in relation to impairment of intangible assets:

Illustration 4

In August 20x4, ABC Ltd pays \$15,000,000 to acquire the business of another company. Assume that, the net identifiable assets acquired include an intangible asset (Brand) which has an FV of \$3,000,000 at the date of acquisition.

Assume that, In 20x6, because of adverse press reports, the Brand is deemed to have a recoverable amount of only \$1,000,000.

In this case, the Brand is deemed to be impaired and an impairment loss of \$2,000,000 has to be written off and charged against ABC's 20x6 income statement.

Assume further that the press reports are subsequently found to be untrue and the recoverable amount of the Brand increases to \$2,500,000 in 20x8.

In this case, there is a reversal of impairment in 20x8 and a gain of \$1,500,000 will be credited to ABC's 20x8 income statement.

Illustration 5

Assume that LMN Ltd has capitalised \$15,000,000 of development costs as at 31 December 20x1. LMN Ltd expects the recoverable amount from the sale of the new product to be approximately \$20,000,000, and the amount is to be earned evenly from 20x2 to 20x6. Assume further that as at 1 January 20x3 (after the amortisation charge of \$3,000,000 for 20x2 and when the unamortised amount, therefore, stands at \$12,000,000), it is expected that, due to changes in the market conditions, the recoverable amount in the future will only be \$10,000,000 (to be earned evenly from 20x3 to 20x6).

In this case, a write-down of \$2,000,000 (\$12,000,000 – \$10,000,000) is necessary. This impairment loss should be charged to the 20x3 income statement. Note that the amortisation charge for 20x3 will be \$2,500,000 (\$10,000,000 ÷ 4), whilst the amortisation charge for 20x2 was \$3,000,000 (\$15,000,000 ÷ 5).

The journal entry for the impairment loss in 20x3 is as follows:

Dr Impairment loss	2,000,000	
Cr Accumulated impairment		2,000,000

Illustration 6

Refer to the case of LMN Ltd in Illustration 5.

Assume that as at 1 January 20x5, (when the unamortised amount stands at \$5,000,000), it is expected that, due to changes in the market conditions, the original forecasted recoverable amount of \$20,000,000 is attainable, and that \$4,000,000 is expected to be recovered in each of the years 20x5 and 20x6.

In this case, the write-down of \$2,000,000 in 20x3 should be reinstated. However, the amortisations for 20x3 and 20x4 have each been reduced by \$500,000 (\$3,000,000 – \$2,500,000) due to the write-down in 20x3. Thus, the write-back in this case, which should be credited to the 20x5 income statement, would be \$1,000,000 (\$2,000,000 – \$500,000 × 2). After the reinstatement, the amortisation charges for 20x5 and 20x6 would each be \$3,000,000 ((\$5,000,000 + \$1,000,000) ÷ 2), the same amount as that before the write-down.

The journal entry to record the reinstatement of impairment in 20x5 is as follows:

Dr Accumulated impairment	2,000,000	
Cr Accumulated amortisation		1,000,000
Cr Write-back of impairment loss		1,000,000

¶38-500 Retirements and disposals

FRS 38 provides that an intangible asset should be derecognised on disposal or when no future economic benefits are expected from its use and subsequent disposal (para 112).

Gains and losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised in income statement (para 113).

¶38-600 Disclosures

FRS 38 requires the following disclosure for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets (para 118):

- Whether the useful lives are finite or indefinite, and if finite, the useful lives or the amortisation rates used
- The amortisation methods used for intangible assets with finite useful lives
- The gross carrying amount and the accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period
- The line item(s) of the income statement in which the amortisation of intangible assets is included, and
- A reconciliation of the carrying amount at the beginning and end of the period showing—
 - additions, indicating separately those from internal development, those acquired separately and those acquired through business combinations
 - assets classified as held for sale and other disposals
 - increases or decreases during the period resulting from revaluations and from impairment losses recognised or reversed directly in equity
 - impairment losses recognised in the income statement during the period under FRS 36
 - impairment losses reversed in the income statement during the period under FRS 36
 - any amortisation recognised during the period
 - net exchange differences arising on the translation of the financial statements of a foreign entity, and
 - other changes in the carrying amount during the period.

A class of intangible assets is a grouping of assets of a similar nature and used in an enterprise's operations. Examples of separate classes may include: brand names; mastheads and publishing titles; computer software; licences and franchises; copyrights, patents and other industrial property rights, service and operating rights; recipes, formulae, models, designs and prototypes; and intangible assets under development (para 119).

FRS 38 further requires the financial statements to disclose (para 122):

- for an intangible asset assessed as having an indefinite useful life, the carrying amount of that asset and the reasons supporting the assessment of an indefinite useful life

- a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the entity's financial statements
- for intangible assets acquired by way of a government grant and initially recognised at FV—
 - the FV initially recognised for these assets
 - their carrying amounts, and
 - whether they are measured using the cost model or the revaluation model.
- the existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities, and
- the amount of contractual commitments for the acquisition of intangible assets.

For intangible assets that are carried at revalued amounts, FRS 38 requires the following additional disclosures (para 124):

- By class of intangible assets—
 - the effective date of the revaluation
 - the carrying amount of revalued intangible assets, and
 - the carrying amount that would have been included in the financial statements had the revalued intangible assets been measured using the cost model.
- The amount of the revaluation surplus that relates to intangible assets at the beginning and end of the period, indicating the changes during the period and any restrictions on the distribution of the balance to shareholders, and
- The methods and significant assumptions applied in estimating the assets' FVs.

For R&D expenditure, FRS 38 requires the financial statements to disclose the aggregate amount of R&D expenditure recognised as an expense during the period (para 126).

¶38-700 Transitional provisions

FRS 38 is operative for annual periods beginning on or after 1 July 2004.

FRS 38 should be applied prospectively (para 129). Thus, on the first day FRS 38 is adopted, an entity should not adjust the carrying amount of its recognised intangible assets.

Further, on the first day FRS 38 is adopted, an entity should reassess the useful lives of its recognised intangible assets. If, as the result of the reassessment, the

entity changes its assessment of the useful life of an asset, that change should be accounted for as a change in accounting estimate in accordance with FRS 8 (para 129).

¶38-800 Comparison with IASB standard

FRS 38 is based on IAS 38 *Intangible Assets*. There are no significant differences between FRS 38 and IAS 38. Compliance with FRS 38 will ensure compliance with IAS 38.

¶38-900 Appendix A: INT FRS 32

The Accounting Standards Council (ASC) issued INT FRS 32 *Intangible Assets — Web Site Costs*, which was operative on 1 February 2003.

INT FRS 32 addresses the accounting issues relating to internal expenditure on the development and operation of an entity's own website for internal or external access: (i) whether the website is an internally generated intangible asset under FRS 38, and (ii) the appropriate accounting treatment of such expenditure.

An enterprise may incur internal expenditure on the development and operation of its own website for internal or external access. A web site designed for external access may be used for various purposes such as to promote and advertise an enterprise's own products and services, provide electronic services and sell products and services. A website designed for internal access may be used to store company policies and customer details and search relevant information. The stages of a website's development comprise: planning, application and infrastructure development, graphical design development and content development.

INT FRS 32 provides that an enterprise's own website that arises from development and is for internal or external access is an internally generated intangible asset that is subject to the requirements of FRS 38.

INT FRS 32 further provides that a website arising from development shall be recognised as an intangible asset if, and only if, in addition to complying with the general recognition requirements described in FRS 38 para 21, an enterprise can satisfy the requirements in FRS 38 para 57.

For example, expenditure on the planning stage of a website development, which is similar to the research phase in FRS 38 para 54 to 56, should be expensed when incurred.

On the other hand, expenditure on the application and infrastructure development stage, the graphical design stage and the content development stage, other than for advertisement and promotion purposes, should be recognised as an intangible asset when the expenditure can be directly attributed and is necessary to create, produce or prepare the website for it to be capable of operating in the manner intended by management.

¶39-100 Introduction

NOTE: FRS 39 will be superseded by FRS 109 *Financial Instruments* (see chapter on FRS 109) effective for annual periods beginning on or after 1 January 2018.

The International Accounting Standards Board (IASB) has issued four accounting standards on financial instruments:

- IAS 32 *Financial Instruments: Disclosure and Presentation*, issued in March 1995 and operative on 1 January 1996, deals with the disclosure and presentation issues relating to financial instruments (since 1 January 2007, IAS 32 no longer deals with disclosure issues which are dealt with in IFRS 7)
- IAS 39 *Financial Instruments: Recognition and Measurement*, issued in January 1999 and operative on 1 January 2001, deals with the recognition and measurement issues relating to financial instruments
- IFRS 7 *Financial Instruments: Disclosures*, issued in August 2005 and operative on 1 January 2007, deals with the disclosure issues relating to financial instruments (superseding the provisions of IAS 32 on disclosure issues), and
- IFRS 9 *Financial Instruments*, issued in July 2014, will replace IAS 39 effective for annual periods beginning on or after 1 January 2019.

In Singapore, IAS 32 was issued by the Council on Corporate Disclosure and Governance (Singapore) (CCDG) as FRS 32 *Financial Instruments: Disclosure and Presentation* in January 2003 and was operative for financial statements covering periods beginning on or after 1 October 2000. IAS 39 was issued as FRS 39 *Financial Instruments: Recognition and Measurement* in May 2003 and was operative for financial statements covering periods beginning on or after 1 January 2005. IFRS 7 *Financial Instruments: Disclosures* was issued as FRS 107 *Financial Instruments: Disclosures* in January 2006 to supersede those provisions of FRS 32 dealing with disclosure issues and is effective on 1 January 2007 for listed companies and on 1 January 2008 for non-listed companies. (The title of FRS 32 was thereafter renamed *Financial Instruments: Presentation*.)

Thus, commencing from 1 January 2007 for listed companies and 1 January 2008 for non-listed companies, there are three FRSs dealing with financial instruments in Singapore, namely:

- FRS 32 *Financial Instruments: Presentation*
- FRS 39 *Financial Instruments: Recognition and Measurement*, and
- FRS 107 *Financial Instruments: Disclosures*.

FRS 39 establishes the principles for recognition and measurement of financial instruments in the financial statements.

A “financial instrument” is defined in FRS 39 as any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.

Thus, financial instruments comprise:

- primary instruments like cash, account receivable, account payable, loans and investments, and
- derivative instruments like forward, future, options and swaps.

FRS 39 should be applied by all entities to all financial instruments except:

- those interests in subsidiaries, associates and joint ventures that are accounted for under FRS 27 *Consolidated and Separate Financial Statements*, FRS 28 *Investments in Associates* and FRS 31 *Interests in Joint Ventures*, respectively
- rights and obligations under leases accounted for under FRS 17 *Leases*
- employer’s assets and liabilities under employee benefit plans accounted for under FRS 19 *Employee Benefits*
- financial instruments under FRS 102 *Share-based Payment*
- contracts for contingent consideration in a business combination under FRS 103 *Business Combinations*
- rights and obligations under insurance contracts as defined in FRS 104 *Insurance Contracts*
- equity instruments issued by the reporting entity including options, warrants and other financial instruments that are classified as shareholders’ equity of the reporting entity, and
- commodity contracts that were entered into and continue to meet the entity’s expected purchase, sales or usage requirement, and were designated for that purpose at their inception and are expected to be settled by delivery.

¶39-200 Recognition

FRS 39 provides that an entity should recognise a financial asset or financial liability on its statement of financial position when, and only when, it becomes a party to the contractual provisions of the instrument (para 14).

Some examples of applying the principle in para 14 are as follows:

- Trade receivables and payables are recognised as assets and liabilities when the entity becomes a party to the sales or purchase contract (with immediate delivery of goods) and, as a consequence, has a legal right to receive, or a legal obligation to pay money
- No receivable or payable is recognised as a result of a firm commitment to purchase or sell goods until at least one of the parties has performed under the agreement such that it either is entitled to receive an asset or is obligated to disburse an asset

- A forward contract (FC) is, however, recognised as an asset or a liability on the commitment date, rather than waiting until the closing date on which the exchange actually takes place
- Financial options are recognised as assets or liabilities when the holder or writer becomes a party to the contract
- Planned future transactions, no matter how likely, are not recognised as assets or liabilities of an entity since the entity has not become a party to a contract requiring future receipt or delivery of assets arising out of the future transactions, and
- All contractual rights or obligations under derivatives are recognised as assets or liabilities in the statement of financial position.

It may be noted that as far as recognition of primary instruments is concerned, there is no change under FRS 39. Before FRS 39, even though there had not been many guidelines in accounting standards, primary instruments have been recognised in practice on a basis consistent with the recognition criteria of FRS 39.

Recognition of derivative instruments, however, will be greatly affected by the recognition requirements of FRS 39. Before FRS 39, derivative instruments were mainly off the statement of financial position until the day they matured. FRS 39 now requires the derivative instruments to be "recognise(d) ... when it (the entity) becomes a party to the contractual provisions of the instrument" (para 14). Thus, FRS 39 requires all derivative instruments to be on the statement of financial position from day one. FRS 39 specifically requires an entity to recognise all of its contractual rights and obligations under derivatives in its statement of financial position as assets or liabilities (para AG34).

Illustration 1

On 30 November 20x1, when the shares of XYZ Ltd are listed at \$6.00 per share, ABC Ltd (with 31 December accounting year ends) pays \$500 to buy a call option for 1,000 shares of XYZ Ltd with a strike price of \$6.00 per share. The option expires on 30 January 20x2.

In this case, ABC Ltd has to record the option (a derivative) on 30 November 20x1 as follows:

Dr Investment in call option	500	
Cr Cash		500

As will be discussed, the investment in call option has to be marked to market at the statement of financial position date. (The fair value (FV) of the option may be estimated using option-pricing models, such as the Black-Scholes model. It may also be simply calculated as equal to its intrinsic value (the difference between the market price and the strike price of the underlying at any point in time) plus its time value (based on, inter alia, the expected changes in market price of the underlying during the option period).)

Assume that on 31 December 20x1, the shares of XYZ Ltd are traded at \$7.50 (thus resulting in the option having an intrinsic value of \$1,500), and the time value of the call option is \$200. In this case, the FV of the call option on 31 December 20x1 is \$1,700, and ABC Ltd has to carry its investment account at \$1,700 in its 20x1 statement of financial position. The journal entry required at 31 December 20x1 will be as follows:

Dr Investment in call option	1,200	
Cr Fair value gain		1,200

Illustration 2

ABC Ltd (with 31 December accounting year end) enters into a forward exchange contract (FEC) on 1 January 20x1 to buy US\$10 million from the exchange dealer on 1 January 20x3.

The exchange rate between US\$ and S\$ at the relevant dates are as follows:

At 1 January 20x1		
Spot rate	US\$1.00 = S\$1.50	
24-month future rate	US\$1.00 = S\$1.52	
At 31 December 20x1		
Spot rate	US\$1.00 = S\$1.55	
12-month future rate	US\$1.00 = S\$1.58	
At 31 December 20x2		
Spot rate	US\$1.00 = S\$1.68	

Using the forward rate as the basis of measurement, the journal entries to record the above-mentioned transactions will be as follows:

1 January 20x1

No journal entry required. Only a memorandum entry to record the fact that a forward exchange contract has been entered into.

31 December 20x1

Dr Other debtors	600,000	
Cr Fair value gain		600,000
(year-end fair value adjustment for contract receivable)		

31 December 20x2

Dr Other debtors	1,000,000	
Cr Fair value gain		1,000,000
(year-end fair value adjustment for contract receivable)		

1 January 20x3

Dr Cash	1,600,000	
Cr Other debtors		1,600,000
(receipt from exchange dealer)		

Alternatively, the spot rate may be used, and the journal entries to record the above-mentioned transactions will be as follows:

1 January 20x1			
Dr Contract receivable	15,000,000		
Dr Deferred premium	200,000		
Cr Contract payable			15,200,000
(to record forward exchange contract)			

Note: The contract receivable and contract payable may be offset and only the net amount of \$200,000 is recorded.

31 December 20x1			
Dr Contract receivable (FC)	500,000		
Cr Fair value gain			500,000
(year-end fair value adjustment for contract receivable)			

31 December 20x2			
Dr Contract receivable (FC)	1,300,000		
Cr Fair value gain			1,300,000
(year-end fair value adjustment for contract receivable)			

1 January 20x3			
Dr Contract payable	15,200,000		
Cr Cash			15,200,000
(payment to exchange dealer)			
Dr Cash	16,800,000		
Cr Contract receivable (FC)			16,800,000
(receipt from exchange dealer)			

Note: Prior to FRS 39, the forward exchange contract would be, in most cases, off the statement of financial position until its maturity date on 1 January 20x3, when the following is recorded.

Dr Cash	1,600,000		
Cr Gain on FEC			1,600,000

Besides the stand-alone derivatives (as illustrated), FRS 39 also requires embedded derivatives to be separately recognised from the host contract if all the following conditions are met (para 11):

- The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract
- A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and
- The hybrid instrument is not measured at FV with changes in FV recognised in profit or loss (P/L).

The tests for the above-mentioned conditions should be done only on the date of initial recognition; subsequent tests are not allowed unless there is a significant change in the terms of the host contract or there is a reclassification out of fair value through profit or loss (FVTPL).

Illustration 3

ABC Ltd (with 31 December accounting year end) buys a convertible loan stock of XYZ Ltd for \$1.5 million on 1 July 20x1. ABC Ltd has the intention to hold the loan stock for the longer term (the loan stock is therefore to be accounted for as an available-for-sale (AFS) financial instrument¹, as will be discussed).

In this case, the equity conversion feature is an embedded derivative. It may be noted that the economic characteristics and risks of the embedded derivative are not closely related to those of the host (the value of the loan stock (host contract) is largely affected by changes in market interest rates, while the value of the conversion feature (embedded derivative) is dependent on the market price of the underlying shares).

Thus, under para 11, the conversion option should be recognised separately from the loan stock.

In order to avoid "first day gain/loss", FRS 39 further requires the embedded derivative to be first measured at its FV, and the balance of the costs assigned to the host contract.

Assuming the FV of the conversion option to be \$300,000, the cost of \$1.5 million is to be allocated as \$1.2 million for the loan stock and \$300,000 for the equity conversion feature (the FV of the embedded derivative should be first determined, and the balance of the cost allocated to the host), the journal entry required on 1 July 20x1 will be as follows:

Dr Investment in loan stock	1,200,000		
Dr Investment in derivative	300,000		
Cr Cash			1,500,000

As will be discussed, the investment in derivative has to be marked to market at the statement of financial position date. Assuming that the equity conversion right has an FV of \$400,000 on 31 December 20x1, the journal entry required at 31 December 20x1 is as follows:

Dr Investment in derivative	100,000		
Cr Fair value gain			100,000

It may be noted that applying the recognition criteria in FRS 39 strictly would mean that when an entity places an order to buy shares on day one and receives the shares on day three, it will have to first recognise a financial asset (forward derivative) on day one and later recognise another financial asset (shares) on day three. In order not to make it unnecessarily cumbersome, FRS 39 provides for two shortcut methods on recognition for such transactions.

Specifically, FRS 39 provides that a "regular way" purchase or sale of financial assets should be recognised using either "trade date accounting" or "settlement date accounting" (para 38).

FRS 39 further requires that the method used should be applied consistently for all purchases and sales of financial assets that belong to the same category of financial assets. (FRS 32 requires disclosure of the accounting policy.)

A "regular way" contract is one for the purchase or sale of financial assets that requires delivery of the assets within the time frame generally established by regulation or convention in the market place concerned.

The trade date is the date that an entity commits to purchase or sell an asset. Under "trade date accounting":

- the asset to be received and the liability to pay for it are recognised on the trade date, and
- the asset that is sold is derecognised and the receivable from the buyer for payment is recognised on the trade date.

The settlement date is the date that an asset is delivered to or by an entity. Under "settlement date accounting":

- the asset is recognised on the day it is transferred to the entity, and
- the asset is derecognised on the day it is transferred by the entity.

When settlement date accounting is applied, any change in the FV of the asset during the period between the trade date and the settlement date should be accounted for. How the change in FV is accounted for depends on the category to which the asset belongs.

Illustration 4

On 29 June 20x1, ABC Ltd commits to purchase 1,000,000 shares for \$2 million. On 1 July 20x1 (settlement date), the FV of the shares is \$2.1 million. The shares are classified as "held for trading". ABC Ltd has a 31 December accounting year end. Under "trade date accounting":

29 June 20x1			
Dr Investment in shares	2,000,000		
Cr Account payable		2,000,000	
1 July 20x1			
Dr Account payable	2,000,000		2,000,000
Cr Cash		2,000,000	
Dr Investment in shares			2,000,000
Cr Fair value gain	100,000		100,000

Under "settlement date accounting":

29 June 20x1			
No entry			
1 July 20x1			
Dr Investment in shares	2,100,000		
Cr Cash		2,000,000	
Cr Fair value gain			100,000

Illustration 5

Refer to Illustration 4. Assume that ABC Ltd's accounting year end is 30 June (instead of 31 December), and the FV of the shares is \$2.07 million as at 30 June 20x1. In this case the journal entries will be as follows:

Under "trade date accounting":

29 June 20x1			
Dr Investment in shares	2,000,000		
Cr Account payable		2,000,000	
30 June 20x1			
Dr Investment in shares	70,000		70,000
Cr Fair value gain			70,000
1 July 20x1			
Dr Account payable	2,000,000		2,000,000
Cr Cash		2,000,000	
Dr Investment in shares		30,000	
Cr Fair value gain			30,000

Under "settlement date accounting":

29 June 20x1			
No entry			
30 June 20x1			
Dr Other debtors	70,000		70,000
Cr Fair value gain			70,000
1 July 20x1			
Dr Investment in shares	2,100,000		2,000,000
Cr Cash		2,000,000	
Cr Other debtors		70,000	
Cr Fair value gain			30,000

In the two above-mentioned illustrations, because investment in shares qualifies as a "regular way" transaction, the shortcut methods are used. It may be noted that under the shortcut methods (either trade date accounting or settlement date accounting), only one financial asset (investment in shares) is recognised. Applying the recognition requirements of FRS 39 strictly will require two financial assets (investment in derivative and investment in shares) to be recognised.

Footnotes:

- 1 FRS 39 requires that if the embedded derivative cannot be separately recognised and measured, the entire hybrid instrument should be designated as a "FVTPL" financial instrument (para 12).

Once the rule is tainted, all HTM investments have to be reclassified as AFS investments and the entity is not allowed to classify any investment as HTM for the next two accounting periods, both at the company level as well as at the group level (para 9).

For the purpose of measurement, FRS 39 classifies financial liabilities in two categories:

- Financial liabilities at FVTPL (which comprises: (i) "held-for-trading" liabilities, and (ii) "designated" liabilities), and
- Others.

Financial liabilities held for trading are financial liabilities that were incurred principally for the purpose of generating profit from short-term fluctuations in price or dealer's margin. For example, an entity that borrows shares from the Singapore Exchange (SGX) to cover its short position will have to classify the liability as "held for trading". Further, derivative financial liabilities are always deemed held for trading unless they are designated as effective hedging instruments.

Financial liabilities designated as liabilities at fair value through profit or loss are those liabilities that are designated, when initially recognised as financial liabilities by the entity, as FVTPL. Before 1 January 2006, FRS 39 permitted any financial liability to be designated as FVTPL, except for those whose FV cannot be reliably measured. However, after the "FV option" amendment effective 1 January 2006, there are only four circumstances under which the designation may be employed (see "Financial assets designated as assets at fair value through profit or loss").

¶39-310 Initial measurement

FRS 39 provides that a financial asset or liability should be measured at its FV upon initial recognition (para 43). However, a financial asset/liability not at FVTPL should be measured at its FV plus the directly attributable transaction costs, eg fees and commissions paid to agents, advisors, brokers, and dealers; levies by regulatory agencies and securities exchanges; and transfer taxes and duties (para 43).

It may be noted that as an exception to para 43, FRS 39 requires certain hedging gains and losses to be included as part of the initial measurement of the cost of the related hedged asset (see ¶39-500).

¶39-320 Subsequent measurement

For financial assets, FRS 39 provides that after initial recognition:

- financial assets at FVTPL and AFS financial assets should be measured at their FV (without deduction for expected disposal costs), unless the financial asset does not have a quoted market price in an active market and whose FV cannot be reliably measured (para 46)

- those financial assets that are excluded from fair valuation under para 46 and have a fixed maturity should be measured at amortised cost, using the effective interest rate method (para 46), and
- those financial assets that are excluded from fair valuation under para 46 and do not have a fixed maturity should be measured at cost (para 46).

If a reliable measure becomes available for a financial asset for which such a measure previously was not available, the asset should be remeasured at FV and the difference between its carrying amount and FV should be accounted for in accordance with para 55, to be discussed in this section (para 53).

Similarly, if due to a change of intent or ability, it is no longer appropriate to classify an investment as HTM, it should be reclassified as AFS and remeasured at FV. The difference between its carrying amount and FV should be accounted for in accordance with para 55(b), to be discussed in this section (para 51).

On the other hand, if due to a change of intent or ability or a reliable measure of FV is no longer available, it becomes appropriate to carry a financial asset at amortised cost rather than at FV, the carrying amount (FV) of the financial asset on that date becomes its new amortised cost. Any previous gain or loss on that asset that had been recognised directly in equity should be accounted for as follows:

- In the case of a financial asset with fixed maturity, the gain or loss should be amortised over the remaining life of the HTM investment, and
- In the case of a financial asset that does not have a fixed maturity, the gain or loss should be left in equity until the financial asset is derecognised at which time it should be included in the net P/L for the period (para 54).

For financial liabilities, FRS 39 provides that after initial recognition (para 47):

- liabilities at FVTPL should be measured at FV
- derivatives that are liabilities should be measured at FV (except those that are linked to and must be settled by delivery of an unquoted equity instrument whose FV cannot be reliably measured, which should be measured at cost)
- financial liabilities that are designated as hedged items are subject to measurement under the hedge accounting provisions, and
- all other financial liabilities should be measured at amortised cost.

For financial assets and financial liabilities that are remeasured to FV, FRS 39 provides that the gain or loss arising therefrom should be accounted for as follows (para 55):

- Gain or loss on financial asset or liability classified as at FVTPL should be included in the net P/L for the period in which it arises, and
- Gain or loss on an AFS financial asset should be recognised directly in equity, until the financial asset is derecognised or impaired, at which time the cumulative gain or loss previously recognised in equity should be included in the net P/L for the period.

For financial assets and financial liabilities carried at amortised cost, gain or loss is recognised in the net P/L when the financial asset or liability is derecognised or impaired, as well as through the amortisation process (para 56).

The following illustrates a case of "held-for-trading" investment measured at FV (mark-to-market) as required under para 46 and 55 of FRS 39. Note that this illustration is also equally applicable to any financial asset classified as FVTPL.

Illustration 6

ABC Ltd acquires the following shares in the SGX on 15 November 20x1, which it intends to sell in early 20x2 to take advantage of the expected changes in the share prices, as follows:

- 100,000 ordinary shares of LMN Ltd at \$2.00 per share plus transaction costs of \$3,000, and
- 200,000 ordinary shares of XYZ Ltd at \$3.00 per share plus transaction costs of \$5,000.

At its accounting year end on 31 December 20x1, the shares are quoted at the SGX at the following prices:

- Ordinary shares of LMN Ltd: \$1.80 per share, and
- Ordinary shares of XYZ Ltd: \$4.00 per share.

In this case, the shares will be classified as "held-for-trading", and the accounting treatment required under FRS 39 will be as follows:

15 November 20x1			
Dr Investment in trading securities		\$800,000	
Dr Expense		\$8,000	
Cr Cash			\$808,000
31 December 20x1			
Dr Investment in trading securities		\$180,000	
Cr Fair value gain			\$180,000

	Cost \$'000	Fair value \$'000	Gain/(loss) \$'000
LMN Ltd	200	180	(20)
XYZ Ltd	<u>600</u>	<u>800</u>	<u>200</u>
Total	<u>800</u>	<u>980</u>	<u>180</u>

In the statement of financial position as at 31 December 20x1, the investment in trading securities will be presented at its FV of \$980,000.

In the statement of profit or loss and other comprehensive income for the year ended 31 December 20x1, the FV gain on trading securities of \$180,000 and the expense of \$8,000 will be included as part of the net P/L for the year.

The following illustrates a case of AFS investment measured at FV (mark-to-market), as required under para 46 and 55 of FRS 39.

Illustration 7

Refer to the Illustration 6. Assume that the shares were acquired as long-term investments, and, therefore, are classified as AFS securities.

Assume further that at its accounting year end on 31 December 20x2, the shares are quoted at the SGX at the following prices:

- Ordinary shares of LMN Ltd: \$1.70 per share, and
- Ordinary shares of XYZ Ltd: \$3.10 per share.

In this case, the accounting treatment will be as follows:

15 November 20x1			
Dr Investment in available-for-sale securities		\$808,000	
Cr Cash			\$808,000
31 December 20x1			
Dr Investment in available-for-sale securities		\$172,000	
Cr Fair value reserve			\$172,000

	Cost \$'000	Fair value \$'000	Gain/(loss) \$'000
LMN Ltd	203	180	(23)
XYZ Ltd	<u>605</u>	<u>800</u>	<u>195</u>
Total	<u>808</u>	<u>980</u>	<u>172</u>

31 December 20x1			
Dr Fair value reserve		\$190,000	
Cr Investment in available-for-sale securities			\$190,000

	Cost \$'000	Fair value \$'000	Gain/(loss) \$'000
LMN Ltd	203	170	(33)
XYZ Ltd	<u>605</u>	<u>620</u>	<u>15</u>
Total	<u>808</u>	<u>790</u>	<u>(18)</u>
Fair value adjustment carried forward			<u>172</u>
Adjustment for the year			<u>(190)</u>

Notes

- (1) The FV loss of \$190,000 for 20x2 may also be computed by simply comparing the FV at the end of 20x2 of \$790,000 with that at the end of 20x1 of \$980,000.

Note that, as required under para 43, "loans and receivables", like all other financial assets, have to be initially recognised at FV. In most arm's length transactions, cost and FV are of the same amount at the date of transaction. However, where the cost and the FV are materially different, the FV should be used.

Illustration 9

Case A

On 30 December 20x1, ABC Ltd sells goods invoiced at \$100,000 to XYZ Ltd on terms 30-day credit. Assume that XYZ Ltd's incremental cost of borrowing is 6% pa. In this case, there is no material difference between the cost (\$100,000) and the FV (present value of \$100,000 discounted at 6% pa for 30 days). The trade debtor (and, correspondingly, the sales) will be initially recognised at \$100,000, as follows:

30 December 20x1		
Dr Trade debtor		100,000
Cr Sales		100,000

Assuming that there is no collectibility problem as at ABC Ltd's accounting year end on 31 December 20x1, the trade debtor will be carried in the statement of financial position as at 31 December 20x1 at \$100,000.

Case B

On 30 December 20x1, DEF Ltd sells goods invoiced at \$100,000 to LMN Ltd. It is agreed that the amount will be payable only after two years on 30 December 20x3 with no interest. Assume LMN Ltd's incremental cost of borrowing is 6% pa. Assume also that there is no collectibility problem.

In this case, there is a material difference between the cost of \$100,000 and the FV of \$89,000 (\$100,000 discounted at 6% for two periods). Therefore, the trade debtor (and, correspondingly, the sales) should be initially recognised at \$89,000, as follows:

30 December 20x1		
Dr Trade debtor		89,000
Cr Sales		89,000

In subsequent years, the trade debtor amount will be increased due to the unwinding of the discount period (until it reaches the amount of \$100,000 on 30 December 20x3). The other journal entry will be interest income. The relevant journal entries are as follows:

31 December 20x2		
Dr Trade debtor		5,340
Cr Interest income (6% × 89,000)		5,340

30 December 20x3		
Dr Trade debtor	5,660	
Cr Interest income (6% × (89,000 + 5,340))		5,660
Dr Cash	100,000	
Cr Trade debtor		100,000

Note that in Case B, DEF Ltd is, in substance, making a sale of \$89,000 and extending a loan to LMN Ltd. The \$100,000 that DEF Ltd receives comprises sale proceeds of \$89,000 and interest income of \$11,000.

In accounting for "loan and receivables" there are two basic principles in FRS 39 that must be adhered to, namely:

- "loan and receivables", like all other financial assets must be initially recognised at their FV, and
- the interest income must be computed based on the fair market interest rate.

This where "loans and receivables" do not carry the market interest rate, the accounting becomes slightly more complicated. This is because, in these cases, the FV of the "loans and receivables" will not be equal to their costs, and the interest income will not be equal to interest received.

The various cases in Illustration 10 illustrate and explain the issues involved.

Illustration 10

Case A (at fair interest rate and repayable at a determinable future date)

Where intercompany loans are granted at market interest rate and are repayable at a determinable future date, there will be minimal problems with valuation (and accounting).

Assume that on 1 January 20x1, P Ltd grants a \$100,000 loan to its subsidiary S Ltd at the market interest rate of 6% pa, to be repayable on 31 December 20x3.

P Ltd

1 January 20x1		
Dr Loan due from subsidiary	100,000	
Cr Cash		100,000
31 December 20x1		
Dr Cash	6,000	
Cr Interest income		6,000

S Ltd

1 January 20x1		
Dr Cash	100,000	
Cr Loan due to parent		100,000

Additionally, for this type of loan (often referred to as an "equity loan"), there is an additional accounting issue for the borrower. As provided for in FRS 32, a borrower has to present this loan as equity, instead of liability.

Assume that on 1 January 20x5, P Ltd grants a \$1 million loan to its subsidiary B Ltd which is in financial difficulty. The loan does not bear any interest rate, and no repayment is stipulated. The mutual understanding is that the loan is to be turned into investment when B Ltd turns around in the future.

P Ltd

1 January 20x1			
Dr Loan due from subsidiary	1,000,000		
Cr Cash			1,000,000
31 December 20x1			
No entry			

B Ltd

1 January 20x1			
Dr Cash	1,000,000		
Cr Equity loan ¹			1,000,000
31 December 20x1			
No entry			

Case E (interest-free loan to employees)

When a company grants a loan to its employee at zero interest rate or below market interest rate, there will be three accounting issues to consider (as discussed under Case B):

- valuation of loan
- accounting for the "initial difference", and
- accounting for interest income.

Assume that on 1 January 20x1, A Ltd grants a three-year interest-free \$100,000 loan to its CEO (assume the fair interest rate for the CEO is 6% pa).

A Ltd

1 January 20x1			
Dr Loan due from employee	84,000		
Dr Deferred staff cost	16,000*		
Cr Cash			100,000

*The deferred staff cost should be charged to the profit and loss (P&L) account for the periods which benefit from the CEO's service. If the loan is granted without any conditions attached, the deferred staff cost should be charged to the 20x1 P&L account. If the loan is granted on the condition that the CEO must serve the

company for the next five years, then the deferred staff cost should be amortised and charged to the P&L accounts for the years 20x1 to 20x5. If the service period is contracted to be three years, then the deferred staff cost should be amortised and charged to the P&L account for the years 20x1 to 20x3 and the journal entry for 31 December 20x1 will be as follows:

31 December 20x1			
Dr Loan due from employee	5,040		
Cr Interest income (6% × 84,000)			5,040
Dr Staff cost (1/3 × 16,000)	5,333		
Cr Deferred staff cost			5,333

Footnotes:

¹ FRS 39 requires that if the embedded derivative cannot be separately recognised and measured, the entire hybrid instrument should be designated as a "FVTPL" financial instrument (para 12).

¹ To be presented as part of shareholders' equity in B Ltd's statement of financial position.

¶39-330 Impairment of financial assets

FRS 39 provides that all financial assets, except those measured at FVTPL, are subject to the impairment test (para 46).

Specifically, FRS 39 requires an entity to assess at each statement of financial position date whether there is any objective evidence that a financial asset or group of assets may be impaired. Further, FRS 39 provides that a financial asset is impaired and impairment loss is incurred if, and only if, one or more events has occurred (loss event) and the loss event has an impact on the estimated future cash flows of the assets that can be measured reliably. If such evidence exists, the entity should estimate the recoverable amount of that asset or group of assets and recognise the impairment loss (para 59).

The recoverable amounts of the various categories of financial assets are determined as follows:

- For a financial asset carried at amortised cost, its recoverable amount is the PV of expected future cash flows discounted at the financial instrument's original effective interest rate (para 63)
- For an unquoted equity security that is not carried at FV, its recoverable amount is the PV of expected future cash flows discounted at the current market rate of interest for a similar financial asset (para 66), and
- For an equity instrument carried at FV, its recoverable amount is its current FV (para 67).