



Revised FRS 23: Borrowing costs Revised FRS 108: Operating Segments Introducing Corporate Advisory Services (CAS)

In this bulletin, we discuss the key changes in FRS 23- *Borrowing costs* and FRS 108- *Operating Segments*. Both standards are effective for financial periods beginning on or after 1 January 2009.

We also introduce our new division – Corporate Advisory Services

Revised FRS 23: Borrowing costs

1. The Revised FRS 23 Borrowing Costs, effective for financial periods beginning on or after 1 January 2009, allows borrowing costs that are directly attributable to acquisition, construction or production of a qualifying asset that form part of the cost of the asset to be capitalised. This treatment was the alternative allowed before revision to the Standard, while the benchmark treatment was to expense off all borrowing cost regardless of how the borrowings were applied. There is no alternative treatment allowed under the revised FRS 23; borrowing costs must be capitalised if all the conditions for capitalisation are met.
2. **Qualifying asset**

A qualifying asset is one that takes a substantial amount of time to get ready for its intended use or sale. Examples are inventories, plants, facilities, intangible assets and investment properties. Inventories, that are manufactured or produced over a short period of time are not qualifying assets.
3. Capitalisation of borrowing costs commences when the entity meets **ALL** the following conditions:
 - (a) expenditure for the asset is incurred; and
 - (b) borrowing costs are incurred; and
 - (c) activities to prepare the asset for its intended use or sale has started



4. Suspending the capitalisation of borrowing costs

An entity should suspend the capitalisation of borrowing costs when it suspends the active development of a qualifying asset. This depends on the circumstances and we have to evaluate the reasons behind the suspension. Sometimes suspension of activities may be necessary or normal in the development of certain assets. For example, in building a bridge over a river, water levels could be raised and the development has to be suspended until the water level subsides. In this case, if the raising of the water levels is a normal process in building a bridge over rivers, the suspension is considered temporary and normal. Therefore, capitalisation of borrowing costs continues during the suspension.

5. Cessation of capitalisation

When all the activities to get the asset ready for its intended use or sale has been completed, an entity should cease capitalising borrowing cost.

6. Disclosure

An entity needs to disclose the borrowing cost capitalised in the financial period and the capitalisation rate used to compute the amount of borrowing costs that are eligible for capitalisation.



Revised FRS 108: Operating Segments

Operating segments which supersedes FRS 14 Segment Reporting is effective from financial year commencing 1 January 2009. This bulletin will highlight the key changes are as follows:

1. Identification of segments

- 1.1 FRS 108 takes a management approach to the identification of a reporting segment as compared to FRS 14 which was more prescriptive. FRS 14 specifically stated that there are two viable segments, namely, the business and geographical segments while FRS 108 identifies an operating segment in reference to the reports the chief decision maker (refers to a function and not an individual) allocates resources and accesses the performance of the various components of an entity. This is because such reports are normally structured along operating components which are the various 'profit and loss centers'.
- 1.2 Under FRS 108, as to how to report and what to report depends primarily on what the chief decision maker reviews and reports and , uses to decide resource allocation and assess performance of each operating unit.
- 1.3 The term chief decision maker refers to the "function" to allocate resources and assess performance and not an individual. Therefore the term can mean a managing director or the board of directors or any other functionary.
- 1.4 Under FRS 14, there were various factors under both the 'business segment' and 'geographical segment' which provided guidance on how to identify either segment. Under FRS 108, there are only 3 main characteristics which preparers now use as a guide to identify an operating segment.

The 3 characteristics of an operating segment are that the operating segment:

- engages in business activities that generate revenue and incur expenses from both internal and external sources;
- operating results are regularly reviewed and used to perform the resources allocation and performance assessment function by the chief decision maker; and
- has discrete and detailed financial information that is available.



The key characteristic that identifies an operating segment is one whose operating results are regularly reviewed by the chief decision maker to allocate resources and assess performance.

- 1.5 Under FRS 108 a reportable segment includes one that sells primarily and exclusively to another segment or other operating segments of the entity. FRS 14 identified a reportable segment as one that earned a majority of its revenue from external customers. There was therefore no requirement under FRS 14 to identify vertically integrated operations as a separate segment.
-



2. Measurement of segment information

2.1 The amount reported for each item under each segment is the amount as in the report used by the chief decision maker to allocate resources and assets and liabilities are allocated into each reporting segment in the form and amount that is used by the chief decision maker. This is likely to vary from entity to entity. FRS 14 had required in the past, segmental information to be prepared in conformity with the accounting policies adopted for preparing and presenting the consolidated or entity level financial statements.

2.2 FRS 14 had defined what are segment revenue, segment expenses, segment results, segment assets and segment liabilities. FRS 108 does not define these terms but requires an explanation on the measurement of segment profit or loss, segment assets and segment liabilities for each segment. There are 6 basic disclosures that are required under this Standard:

- Basis of accounting for inter segment transactions;
- Reconciliation between the operating segment total profit and entity's profit;
- Reconciliation between the operating segment assets and entity's assets;
- Reconciliation between the operating segment liabilities and entity's liabilities;
- Nature of changes from prior periods in terms of measurement methods used to measure the segment profit and loss; and
- Nature of asymmetrical allocations to segments. For example, allocating a property, plant and equipment item to the segment balance, but not depreciation.



3. Disclosure

3.1 FRS 108 requires an entity to disclose the factors used to identify the reportable segment derives its revenue from. These factors should again be based on how the chief decision maker views the business.

3.2 FRS 108 requires the specific amounts of revenues, expenses, assets and liabilities to be disclosed for each reportable segment if they are included in the reports used or regularly reviewed by the chief decision maker. FRS 14 required specific items on an entity's primary segment to be disclosed.

3.3 FRS 108 requires interest revenue to be reported separately from interest expense for each reportable segment unless the chief decision maker uses net revenue to allocate resources and assess performance of that segment.

3.4 FRS 108 requires entity-wide disclosure on an entity's:

(i) Products and Services

Revenues from external customers by significant products and services or group of similar products and services.

(ii) Geographical areas

- Need to disclose the revenues from external customers attributable to the entity's country of domicile and revenues attributable to individual foreign countries if material; and
- Non-current assets located in the entity's country of domicile and those located in foreign countries if material.

(iii) Major customer

An entity needs to disclose its extent of reliance on major customers. If a customer forms 10% or more of an entity revenue, the entity shall disclose the total revenue from that customer and the segment generating the revenue. There is no need to disclose the identity of the customer.

These requirements apply even if an entity is a single reporting segment and if the information has not been included as part of the disclosures about segments.



Contact Us

For further information on this bulletin, please contact:

LTC LLP

Certified Public Accountants
1 Raffles Place
#20-02 OUB Centre
Singapore 048616

Tel: +65 62260080
Fax: +65 62263345

Alex Chai
Partner



Tel: +65 62260080

alexchai@ltc-cpa.com

This publication has been issued to inform clients of technical and other developments that may be important to our client. This bulletin has been prepared using information believed by the author to be reliable and accurate but LTC LLP ("LTC") makes no warranty as to accuracy or completeness. While we take care to ensure that the information given is correct and accurate, the nature of the document is such that details may be omitted which may be relevant to a particular situation or entity. The information contained in this bulletin is not a substitute for advice or relied upon as a basis for formulating business decisions. Materials published may only be reproduced with the consent of LTC LLP.

Permit no.: MICA (P) 284/07/2009



Introduction to Corporate Advisory Services (CAS)

In line with the firm's vision to continuously expand our service provision to cater for our clients' needs, we now have a new division - **The Corporate Advisory Services**. The division provides the following professional services to assist our clients in their business initiatives and objectives.

Corporate Advisory

You may be facing challenges in your business and want to move your business forward or you may feel that your business has the potential to reach greater heights. We are here to help.

We believe that we are the right business partners to help you improve your profitability, margins, cash flows, productivity and maximize your resources.

Our services include:

- Identifying factors that may be stemming profitability;
- Proposing business processes that increase efficiency and productivity;
- Analyzing and fine-tuning organization goals and strategies; and
- Consultation in the implementation of organizational goals and strategies.

Valuation Services

Whether you are buying a business or thinking of selling your business, it is always important to know how much the business is worth.

You may also need to value your employee stock options to comply with the Financial Reporting Standards.

Whatever your needs are, we provide the following independent valuation services:

- Valuation of businesses and enterprise;
- Valuation of employee stock options;
- Valuation for litigation and disputes; and
- Valuation for compliance with the relevant Financial Reporting Standards.

We believe that valuation is not just the application of formulas and equations. It is an active application of our business expertise in conjunction with a clear understanding of your business objectives to help you arrive at a reliable valuation to best serve your needs.



Merger and Acquisition Support

If you are considering acquiring a business or merging with another business, we have the right people to ensure that the process is efficiently, effectively and expeditiously managed. We guide and advise you on potential pitfalls of transactional processes to enable you to reap the benefits of the whole transaction.

Ever wondered why companies like Enron reported profits but fell under without any warning?

Our professional partners affiliated to Corporate Advisory Services allow us to be a one-stop shop in assessing and advising on financial, tax and legal due diligences and their implications. The advisory team has the necessary commercial and business expertise to guide you through the whole process, both “pre” and “post” acquisition/merger.

The completion of an acquisition/merger is just the beginning of the journey which requires continuous assessment and management of internal processes to make the acquisition/merger a success. We can advise on post-merger reviews to ensure that the merged or acquired entities yield the kind of benefits you had expected.

We provide the following services:

- Structuring of the initial memorandum of understanding;
- Financial, tax and legal due diligence to ensure that “what you see is what you get and avoid hidden surprises”;
- Price negotiations;
- Structuring of the Sale and Purchase agreement;
- Completing the acquisition/merger process; and
- Consultation on the post implementation process of integrating the acquired/merged business.

Management Buy-Out (MBO)

Your current employer may be looking to sell his or their business and you may be interested in taking over the business. This opens up the perfect opportunity for you but can also be a challenging process if not managed correctly.

We advise and consult on the MBO process. We provide the following services:

- Advising on the MBO process;
- Structuring the memorandum of understanding;
- Financial, legal and tax due diligence to ensure that “you know what you need to know to make an informed decision”;
- Consulting on the whole process from initiation to completion; and
- Availing to you post completion management expertise to ensure that you get the necessary support as the new owner.



Economic Value Added (EVA)

Ever wondered whether the income statement is a good guide to business decision making or whether all the cost have been reflected in your income statement?

With profits reported under the Financial Reporting Standards getting complex to understand and to interpret, how does one measure performance and what would be a comprehensive measurement tool. EVA is a financial performance tool that helps corporations or business owners, like yourselves, to calculate what your fully costed or valued economic profit is. The method takes into consideration the opportunity cost of capital employed and owners/ shareholders get a positive return or value only when return from the capital employed in the business operations is greater than the cost of the corresponding and relevant capital utilized.

EVA is generally used as a management tool to:

- Set organization goals;
- Set bonuses;
- Use as a performance indicator;
- Communicate with shareholders and investors;
- Motivating managers; and
- Capital budgeting.

We provide consultation in implementing EVA in your organization.

Incentive Schemes and Tax Incentives

You may be starting out on your business or your business may be growing. There is assistance available from the Government and Statutory Boards. We can advise and assist you on such Incentives or Grants.

We can assist by:

- Identifying the various financial support or incentive schemes that are available to your organization;
- Identifying the various tax schemes you may be eligible for; and
- Preparing information memorandum and business proposals for your applications to the relevant authorities.