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MANAGING PARTNER'S MESSAGE

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As we head into the second quarter of the year, we are looking forward to our annual BDO's budget seminar on 13 April 2016 at Mandarin Orchard. The budget announcement unveiled by our Finance Minister Mr Heng Swee Keat on 24 March 2016 gives us much to look forward to amidst Singapore's continuous efforts in restructuring our economy and the global economic uncertainties.

With the looming economy on the horizon, businesses should take advantage of the enhancement and introduction of numerous incentive programs to invest and improve productivity on all fronts. It is also critical for entrepreneurs and business leaders to be open in adopting new strategies to attain higher productivity yields.

It has also been a busy quarter here at BDO that saw us at numerous events. These include outreach programs to schools like SMU, NTU and Ngee Ann Poly, to beneficial seminars for our clients like the Japanese Real Estate Investment Seminar and the Construction Industry Seminar. These events were well received and will go a long way to get our brand name more recognised in the Singapore market.

As we approach the next quarter, I hope everyone has had the opportunity to read about and appreciate the implications of Budget 2016 on the rest of the fiscal year. Moving on, we should be nimble and innovative in adapting to the changes brought about, and look forward to tackling the challenges facing us in the year ahead.

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Fundamental Changes to Lease Accounting Introduced with IFRS 16 Leases

On 13 January 2016, the International Accounting Standards Board (IASB) issued IFRS 16 Leases, which supersedes IAS 17 Leases and related interpretations, and introduces a new lease accounting model applicable for all leases effective for annual periods beginning on or after 1 January 2019.

IFRS 16 is the result of a long-running and extensively debated IASB project intended to increase transparency and comparability, and to address off-balance sheet financing through leasing arrangements. Essentially, IFRS 16 eliminates the current distinction between operating leases and finance leases for entities that lease assets (lessees) by requiring all leases to be capitalised on the balance sheet, subject to limited exceptions.

In Singapore, the ASC is currently working on local adoption of IFRS 16 as part of Singapore Financial Reporting Standards, and we anticipate SFRS 116 to be issued relatively soon and with the same effective date of 1 January 2019 as the international version.

Lessee Accounting

At the commencement of a lease, lessees record a right-of-use asset and a lease liability. The lease liability is measured at the present value of the lease payments, discounted at the interest rate implicit in the lease, or the lessee's incremental borrowing rate. The right-of-use asset is recognised at cost which comprises the lease liability, any lease payments already made, any direct costs, lease incentives and estimated costs of dismantling and restoration at the end of the lease.

Subsequently, the right-of-use asset is accounted for in the same manner as owned property, plant and equipment or investment property, applying either the depreciated cost or revaluation model. The lease liability is measured at amortised cost using the effective interest method.

This means that the current straight-line operating lease expense will typically be replaced by a depreciation charge on the lease asset and an interest expense on the lease liability. The interest expense will be recorded as part of finance costs. Under the effective interest method the finance cost is likely to be higher at the beginning of the lease, and the amount decreases as the lease payments are made.

The Exceptions

Lessees can choose not to apply IFRS 16 requirements in respect of:

- Short term leases (leases of 12 months or less, including extension options)
- Leases of low-value assets (e.g. personal computers)

Such leases can continue to be accounted for in a manner similar to operating leases under IAS 17.

Lessor Accounting

Lessor accounting under IFRS 16 remains substantially unchanged from IAS 17. Lessors will continue to classify leases as operating or finance leases, depending on whether or not substantially all risks and rewards incidental to ownership of an asset are retained or transferred, and will continue to account for these two types of leases differently.

Other Aspects of IFRS 16

IFRS 16 includes detailed guidance on a number of other aspects, including:

- Definition of a lease and the identification of leases as distinct from service contracts
- The lease term - assessment of options to extend and reassessing the lease term
- Variable lease payments and contingent lease payments
- Sale-and-leaseback transactions
- Enhanced disclosures by both lessees and lessors
- Transition

Impact

Since IFRS 16 will result in an increase in recorded assets and corresponding liabilities, for entities with significant leasing arrangements as lessees, it is likely to have a significant impact on certain key financial ratios such as gearing ratios. Businesses should consider the potential impact of IFRS 16 on borrowing covenants, remuneration arrangements, and some entities may have to even consider the potential changes to systems (asset registers and lease liability amortisation schedules) to enable proper tracking and recording of information required for accounting purposes.

Industries likely to be most affected include retail, transportation (airlines, shipping), mining and other industries that lease major equipment or have large fleets of leased motor vehicles. Although the effective date of the new standard, 1 January 2019 is some time away, we recommend that businesses with significant leasing arrangements start to consider the potential impact to their financial statements and prepare for the changes as soon as possible.

For more information:

For further information on IFRS 16, refer to BDO's [BDO IFR Bulletin 2016/01 IFRS 16 Leases and BDO IFRS at a Glance on IFRS 16] and look out for more analysis and publications from BDO coming out soon.

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Amendments to IAS 7 Disclosure Initiative

As part of the Disclosure Initiative project to improve disclosures in financial statements, the International Accounting Standards Board (IASB) issued on 29 January 2016 Amendments to IAS 7 Statements of Cash Flows, requiring additional disclosures about changes in an entity's financing liabilities arising from both cash flow and non-cash flow items. The amendments are effective for annual periods beginning on or after 1 January 2017. Early adoption is permitted and no comparatives are required when the amendments are first applied.

In Singapore, the ASC adopted these as Amendments to FRS 7 on 11 March 2016 with the same effective date.

These changes were introduced in response to calls from investors for more information to help them better understand changes in an entity's net debt.

Amendments to IAS 12 Recognition of Deferred Tax Assets for Unrealised Losses

On 19 January 2016, the International Accounting Standards Board (IASB) issued Amendments to IAS 12 Income Taxes, to clarify the requirements for the recognition of deferred tax assets for unrealised losses, particularly those relating to debt instruments measured at fair value. The amendments are effective for annual periods beginning on or after 1 January 2017 and are to be applied retrospectively in accordance with the transitional provisions. Early adoption is permitted.

In Singapore, the ASC adopted these as Amendments to FRS 12 on 11 March 2016 with the same effective date.

The objective of these amendments is to clarify the accounting for deferred tax assets when an entity:

- has deductible temporary differences relating to unrealised losses on debt instruments that are classified as available-for-sale financials assets and measured at fair value;
- is not allowed to deduct unrealised losses for tax purposes;
- has the ability and intention to hold the debt instruments until the unrealised loss reverses; and
- has insufficient taxable temporary differences and no other probable taxable profits against which the entity can utilise those deductible temporary differences.

ACRA's Financial Reporting Surveillance Programme (FRSP) and Areas of Review Focus for FY 2015 Financial Statements

As the national regulator of companies in Singapore and administrator of the Companies Act, ACRA has established the FRSP to enforce directors' duties under the Companies Act to prepare financial statements in accordance with the prescribed accounting standards in Singapore so as to ensure the quality of financial reporting in Singapore and to promote investors' confidence in the financial statements of Singapore companies.

ACRA expanded the scope of its FRSP in July 2014 to include reviews of financial statements of companies with clean auditor's reports for non-compliance with Singapore Financial Reporting Standards (FRS). Previously, the FRSP was mainly focused on the review of accounting issues highlighted in modified audit reports. If potential non-compliance is identified from the review of financial statements, ACRA sends

enquiry letters to directors, and evaluates explanations and supporting documents. After non-compliance is established, ACRA may apply one of a range of regulatory outcomes or sanctions. Warning letters may be sent to the relevant company directors for severe non-compliance with FRS that has a significant impact on the financial statements. Directors may also be required to restate and re-lodge corrected financial statements along with a new auditor's report with ACRA.

ACRA's 2015 FRSP Inaugural Report - Raising the Bar on Financial Reporting

In September 2015, ACRA published its inaugural report on the surveillance work of the first review cycle under the expanded FRSP. From this review cycle of 49 sets of FY2013 financial statements, ACRA issued warning letters for severe non-compliance with FRS to a few listed entities. The findings were reported using case studies to illustrate selected issues, with the intention of helping company directors to avoid common pitfalls. Directors are also encouraged to take the lead in raising the quality bar on financial reporting. Based on the FRSP review, ACRA has identified three root causes for the instances of non-compliance noted:

1. Insufficient scrutiny by directors when the reported financials did not accord with their understanding of the business;

2. Over-reliance on accounting team who may lack competence or diligence; and

3. Independent directors did not adequately challenge management's judgement.

ACRA believes that most of the instances of non-compliance could have been avoided if the directors had placed sufficient focus on the financial reporting process and had reviewed the financial statements with rigour and care.

FY 2015 FRSP focus topics

In December 2015, ACRA **issued Financial Reporting Practice Guidance No. 2 of 2015 Areas of Review Focus for FY 2015 Financial Statements under ACRA's Financial Reporting Surveillance Programme.**

This guidance is intended to remind directors and other financial statements preparers of potential risks of misstatements in the financial statements and questions to ask before approving FY 2015 financial statements for issue.

The following are the 10 areas of review focus for FY 2015 financial statements and highlights from some of ACRA's reminders about these areas:

1. Control over investees – bright line of 50% removed

- Could reserved matters in a shareholders' agreement that require unanimous consent prevent a substantial shareholder holding more than 50% of the voting power from having control?
- Remember to disclose significant judgements about the control assessment.

2. Call or put option over shares of investee

- What are the business reasons for such options?
- Do they impact on the assessment of control or significant influence? Should they be accounted for as derivatives?

3. Business acquisitions – reflecting the real value of the acquired business

- What were the reasons for acquiring the business and the factors considered in the determination of the price? This knowledge is important in accounting for business combinations.
- Have all specific intangible assets been differentiated from goodwill? Has an external valuer been appointed to identify and value such intangibles?

4. Long-lived assets value and impairment testing

- Are impairment assessments made reasonable and supportable, including all key inputs to the cash flow forecasts, any terminal value and the discount rate used?
- Low growth sectors such as energy, commodities and shipping require particular attention.
- Disclosures should be tailored to the facts and circumstances of the businesses including the commercial reasons for any impairment losses.

5. Breaches of borrowing covenants

- Have all borrowing covenants been complied with and have all loan repayments been paid on time? If not, the classification of liabilities may be affected.

6. Sale-and-leaseback transactions

- Have all the terms and the substance of sale-and-leaseback arrangements been considered to assess whether the risks and rewards of ownership have been transferred? If not, it could be a financing transaction instead and profits may need to be deferred.

7. Statement of cash flows

- Operating cash flow is an important indicator and can be misstated if balances related to investing and financing activities are inappropriately included within working capital e.g. deposits, prepayments for acquisitions and disposals of businesses.
- Foreign currency translation differences taken to equity should not be adjusted against operating cash flow. Instead, they should be tracked and allocated to the assets and liabilities in foreign subsidiaries giving rise to foreign exchange differences.

8. Impact from currency environment

- Significant currency movements may result in impairments on investments and assets even where the underlying values have remained constant as impairment assessments are to be conducted in the functional currency of the entity holding such investments and assets.

9. Earnings per share (EPS)

- Have there been capital structure changes such as share consolidations, share splits, bonus issue or rights issues without a corresponding change in resources? These may require retrospective adjustment of the number of shares used in the basic and diluted EPS calculations.

10. Fair value measurement

- Assets such as investment properties and biological assets involve many unobservable inputs and should be expected to be classified as Level 3 under the FRS 113 fair value hierarchy.
- Expect more disclosures for fair value measurements under Level 3, and at a meaningful level of aggregation.

If you have not looked into the above areas of focus, we recommend that you read and familiarise yourself with both ACRA's 2015 report of surveillance findings, including the case studies, and ACRA's detailed comments about the areas of review focus for FY2015 financial statements. In January 2016, ACRA also published a Mini Guide for Audit Committees - Hot topics that ACs and directors need to know which also includes guidance on the FRSP, including how directors should go about responding to ACRA if they receive an enquiry letter under the FRSP and how to avoid the non-compliance leading to such enquiry letters.

Please refer to ACRA's website https://www.acra.gov.sg/Financial_Reporting_Surveillance_Programme_Reports.aspx

https://www.acra.gov.sg/Publications/Practice_Guidance/

https://www.acra.gov.sg/Publications/Guides/

Navigate the Challenges Faced in Family Business

By definition, a family business is a business organisation in which two or more family members are involved and the business's majority controlling stake lies with the family. Given its nature, family businesses can be consider the oldest form of business organisation.

In a recent global family business survey, approximately 40% of respondents agreed that professionalising the business is the key challenge for business continuity, yet only 16% of family businesses have a discussed and documented succession plan in place. How is this landscape different in Singapore? A recent study conducted by Singapore Chinese Chamber of Commerce and Industry (SCCCI) and PricewaterhouseCoopers (PwC), noted that Singapore's family businesses demographic tend to be younger. Of a total of 120 family businesses that participated in this study, 33% were in their first generation and 54% in their second generation. This represents a significant issue – the longevity of Singapore's existing family businesses depend, to a large extent, on what they do now. In line with global findings, Singapore's family businesses are similarly concerned with two main issues. Namely, they are concerned with the professionalising of the family business, while maintaining family ownership and succession planning – passing the baton on to the next generation.

Professionalising 'Family' Business

As one of the oldest forms of business organisation, family business has its strengths and weaknesses, all of which lie in the name "family". Without a doubt, working with parents, siblings, uncles/aunties and cousins (known as a "Cousin Consortium") can

generate a high level of synergy, trust and commitment but it can also lead to tension, resentment and conflict. Professionalising a business can be difficult, but professionalising a family business is even harder because it involves decisions of the 'heart'.

Professionalising the family business simply means putting in place infrastructure to govern the interactions between the family and business. For instance, members of the Qian Hu Corporation, a public-listed company on the Singapore Stock Exchange, have to follow a set of stringent corporate governance requirements. Besides regular Board and Management meetings, the family has family meetings to discuss informal subjects that matter to the family.

Facing a tougher business environment, family businesses must adapt and innovate, and become more professional in the way they operate to remain competitive. For example, iwa Design's governance regime has been described as strict and strong. The company is now automating and improving its internal processes to support its decision-making, in preparation for the unlikely event that the second generation leaders are not around. Additionally, iwa Design has also implemented management policies, a CRM system, and HR processes and procedures.

Succession Planning

The topic of "passing the torch" has always been a challenging yet urgent matter for family businesses to address. This is especially true in the Asian context, in which it is culturally insensitive to discuss retirement and mortality. To make the conversation easier on all parties, the leader or current generation leader of the business should ponder:

- "Who should I pass the business to? Should it be based on entitlement or merit?"
- "Should I bring in external professionals to manage the business while family members remain as shareholders?"
- "What is the qualifying criteria to become the leader in family business?"

There is an old Chinese saying that, "wealth does not surpass three generations" – in fact, the transition from the first generation to the next one is often the trickiest one. As the family continues to grow and the business continues to expand, succession only gets progressively harder, giving rise to the need for a more demanding structured succession planning. A well-thought succession plan should be addressed, documented and communicated to key stakeholders early on, so they have time to make any necessary adjustments.

Singapore's family businesses form a major component of Small Medium Enterprises (SMEs), which are the critical backbone of the Singapore economy. They have seen great shifts in the past decade, moving forward, the Singapore's family businesses will need to make tough decisions on the way forward for their businesses, whether to keep it within the family, bring in outside expertise or map out the owner's exit strategies.

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