"True and Fair" in Times of Change

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The law and the investing public expect boards to present financial statements which are "true and fair" and the external auditors to confirm such. But what is "true and fair" when the basis of accounting changes, as recently occurred and in a major way?

2018 may be regarded as a milestone year in the history of accounting in Singapore.

The Singapore Financial Reporting Standards ["FRS" or "SFRS"] fully converged with the International Financial Reporting Standards ["IFRS"] on 1 January 2018, to create a new framework called the Singapore Financial Reporting Standards (International) [SFRS(I)].

Two other major accounting standards also became effective on the same date: SFRS(I) 9 – Financial Instruments, and SFRS(I) 15 – Revenue from Contracts with Customers.

A reader of financial statements could be forgiven if he struggles with trying to understand how financial statements can be "true and fair" in one year, and one year on, still be "true and fair" with accounts reclassified, balances and, profit and loss figures restated, and presentations revised.

It is a quirk in the world of accounting that financial statements are only "true and fair" with reference to the adopted accounting standards!

What happens then when accounting standards change or new ones become effective?

New Accounting Framework - SFRS(I)

When companies transition from FRS to SFRS(I), they have to apply all effective standards under SFRS(I) retrospectively from the date of incorporation, and in respect of subsidiaries, joint ventures and associates, from the date where control, joint control or significant influence was obtained, unless mandatory or optional exemptions are applied.

This transition exercise was complicated by the following:

- Not all SFRS(I) standards and interpretations were previously adopted under SFRS.
- There were different effective dates for the implementation of SFRS.
- There were different transitional provisions for new SFRSs.

Financial statements, prepared in accordance with SFRS(I), could therefore look quite different from those prepared under FRS in the previous years. The comparatives will likely contain restated balances as well.

SFRS(I) 9 – Financial Instruments

SFRS(I) 9 changes the way companies account for financial instruments in the areas of classification and measurement, impairment and hedge accounting.

The new standard has only three measurement categories versus four categories in the preceding FRS 39:

Under FRS 39	Under SFRS(I) 9
• Financial assets at fair value through profit or loss (FVTPL)	• Fair value through profit or loss (FVTPL)
• Held-to-maturity investments (HTM)	• Amortised cost
• Loans and receivables (L&R)	• Fair value through other comprehensive income (FVOCI)
• Available-for-sale financial assets (AFS)	

There is also a new impairment model – "expected credit losses" (ECL) versus "incurred losses". Now, impairment is recognised upfront based on estimates, whereas before impairment is only recognised upon occurrence of impairment events. This greatly impacts how banks account for loan losses, which was evident in the reported results of the local banks in 2018.

The new standard also relaxes the requirements for hedge effectiveness and, consequently to apply hedge accounting. It changes what qualifies as a hedged item, primarily removing restrictions that previously prevented some economically rational hedging strategies from qualifying for hedge accounting.

SFRS(I) 15 - Revenue from Contracts with Customers

SFRS(I) 15 introduces a 5-step model for revenue recognition. Prior to this, there was no one single model for revenue recognition. Various accounting standards covered different transaction types. Now, a single standard applies to revenue recognition from contracts with customers (except for insurance, leases, financial instruments and non-monetary exchanges between entities within the same business to facilitate sales).

The adoption of this standard requires every company to go through virtually all its customer contracts to identify and evaluate the accounting and business process impact of the new standard. In transitioning to the new standard, companies affected have had to restate their prior period numbers, and present significantly different revenue and income figures from 2018 onwards.

More changes in the works

Expect more changes to the accounting standards even after the major changes in 2018.

On 1 January 2019, another major accounting standard, SFRS(I) 16 – Leasing, became effective. This new leasing standard introduces a new accounting model which will impact the balance sheet, income statement and cash flows of all lessees.

Previously, a finance lease is capitalised whereas an operating lease is charged to the profit and loss from the usage of the asset. Under the new standard, there is only a single lessee accounting model. The balance sheet will need to recognise a right-of-use asset and a corresponding lease liability upfront. The income statement will recognise depreciation of the right-of-use asset and interest on the lease liability over the lease term (or useful life of the asset, if shorter). The main impact will be a front loading of expenses.

Come 1 January 2021, another new standard, SFRS(I) 17 – Insurance Contracts, will become effective. That's not counting the larger number of "interpretations" and amendments to existing accounting standards which could affect the numbers and presentations in financial statements going forward.

The fact is that accounting standards and rules will continue to change as the accounting profession seeks to keep pace with changes in business conditions and environment.

"True and fair" is, therefore, arguably "transient"; its underlying truth and fairness changes in tandem with changes in accounting standards. ■