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April 2017



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APRIL 2017



FINANCIAL DUE DILIGENCE

10 Rules That Make
Or Break An
Investment Deal

CORPORATE GOVERNANCE DISCLOSURES

How Do SGX-listed
Companies Measure Up?

FRS 116: LEASES

Diving Into The Complex

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SATURDAY, 27 MAY 2017
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PRESIDENT'S MESSAGE

IN TUNE AND IN-DEPTH, TIMELY INSIGHTS AND UPDATES

Dear members,

Many of you are directly involved in the implementation of FRS 116: Leases, or would be aware of the new standard – likely from the Institute's events and discussions in this journal, as well as from your own readings. ISCA works hard to keep our members in tune with industry updates, and to prepare our members early for impending changes so that members are well-equipped to ensure a smooth and timely transition every time.

For FRS 116, we had published a series of four articles in this journal last year – in March, August, September and October – focusing on various significant aspects that members need to be aware of. Broadly, the articles centred on the genesis of the right-of-use accounting model, guidance on how to determine if a contract contains a lease (ISCA Leases Roadmap) and implications to the financial metrics, financial debt covenants and consequences that may extend beyond the entity's accounting department. Also covered were the simplifications under FRS 116 to address concerns about costs and complexity, materiality considerations in scoping determinations, and challenges faced by companies when implementing the new leases standard. The October 2016 article shared the results of an ISCA-Nanyang Business School survey, on how prepared companies are for FRS 116.

FRS 116 contains a number of nuances and complexities which requires detailed considerations, accounting judgement and early preparation. In this cover story, "FRS 116: Leases", we

continue the discussion with the key requirements of lessee accounting under the new standard and the potential accounting complexities when applying its requirements. Taken together, it is clear that there is a need for more thinking and preparation to ensure a smooth transition. FRS 116 will be applicable from 1 January 2019, and if you or your clients have yet to get ready for its adoption and implementation, I urge you to do so with some urgency.

For the accounting profession, diligence, details and depth play important roles. In fact, a close eye to detail and depth of knowledge are a given, while financial due diligence is almost synonymous with the profession. Due diligence is a process that verifies and confirms statements and views about a business and its prospects. It enhances understanding of the risks and opportunities associated with an investment. Put simply, the investment success rate can be dramatically improved if due diligence were performed. In "Financial Due Diligence", we feature 10 rules that can make or break an investment deal. Keeping these rules front-of-mind can help to reduce investment risk in the target, and reap the rewards that investors, such as venture capitalists and general partners of private equity, hope to achieve.

Change is a constant, and this is something we must accept in order to navigate today's business world. Keeping in tune with industry happenings, and

adapting and/or acquiring new skills and know-how are essential to get ahead. A case in point is in the area of transfer pricing (TP). Ten years ago, TP was a relatively unfamiliar subject. Today, it features prominently and is widely recognised by C-suites to have a substantial impact on business profitability, income tax paid, shareholder value and the overall risk management framework. In this era of tax transparency, finance chiefs need to make sure that everything – including their related party transactions – is defensible in front of tax authorities; central to this is benchmarking analysis. Discover the four steps to a high-quality benchmarking analysis in "Breakthrough with TP Benchmarking".

The tax season is upon us and many companies are busy wrapping up their FY 2016 financial statements. It is timely to take another look at various tax compliance issues so as not to run afoul of the law. Tax compliance is essential in any business and getting it right – right from the start – is critical. The article, "Get Sturdy at Tax Compliance", features some important clarifications, reminders and dos and don'ts on tax compliance.

Just as being in tune with professional developments is important, maintaining a healthy work-life harmony is also essential. "Rest and Recreation" highlights exotic food and wellness destinations that promise to deliver top-notch experiences for rest and relaxation. If you have been feeling fatigued, perhaps it's time to take a break. Work hard and play hard. Find that ideal balance; be good to yourself.

Gerard Ee

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Advanced Analytics Drives Double-digit Growth: EY and Forbes Insights Survey



Nearly two-thirds of companies with well-established advanced analytics strategies report operating margins and revenues of 15% or more, according to a report developed by Forbes Insights, in collaboration with EY.

The report, "Data & Advanced Analytics: High Stakes, High Rewards", reveals that those organisations that have an analytics strategy that is well-established and central to the overall business strategy, rated their competitive ability in data and analytics as market-leading. Of these organisations, 66% achieved revenue growth of 15% or more, while 63% reported that operating margins had increased 15% or more in 2016. In addition, 60% of these companies said they also improved their risk profiles.

With returns of this calibre, a data and analytics strategy is both

effective and necessary for global organisations. Over the next two years, more than half of the global executive respondents are planning to invest at least US\$10 million in data and advanced analytics.

According to Manik Bhandari, EY ASEAN Analytics Leader, Ernst & Young Advisory Pte Ltd, "Traditional process-driven organisations are now being disrupted by the new era of businesses that use data as a strategic asset. Companies have moved from pilot projects that originated in business units or countries to using data and advanced analytics at an enterprise level to rethink and reimagine their entire business to identify new opportunities."

The survey of more than 1,500 global executives (73 in Singapore) from companies with at least US\$500 million in annual revenues was designed to deliver a

maturity assessment of how proficient organisations are in applying analytics throughout their operations.

ASIA-PACIFIC TOPS LEADERBOARD

Based on the maturity assessment scores, Asia-Pacific tops the leaderboard due to its strengths in data monetisation and advanced usage of sophisticated technologies, but respondents are concerned with the cost of and difficulty with capturing quality data. By country, China maintains the number one spot in the ranking, while the US comes in second, up from fifth, and the UK holds steady in third place.

"Singapore is also racing to grow its analytics capabilities for the digital economy. The government has made significant investments in strengthening the country's market access and connectivity, human capital, infrastructure, strong intellectual property and data security regulations," says Mr Bhandari. "This presents huge opportunities to Singapore organisations to grow and mature their analytics capabilities, particularly for certain sectors with advanced data capturing systems such as health care, transport and security services."

In terms of industry rankings, telecommunications came in first place while consumer products and retail dropped to 10th - down from fourth in 2015. Technology takes the number two spot this year, followed by manufacturing in third place. In the area of emerging technologies, market-leading organisations use predictive modelling (67%), artificial intelligence (53%) and robotic process automation (43%).

Steady Progress in Raising Female Economic Empowerment, but Gender Pay Gap still an Issue: PwC Women in Work Index

Slow but steady progress continues to be made in OECD countries towards greater female economic empowerment, according to a new PwC report, "PwC Women in Work Index". But the gender pay gap continues to be a major issue, with the average working woman in the OECD still earning 16% less than her male counterpart – despite becoming better qualified.

The latest Index, which measures levels of female economic empowerment across 33 OECD countries based on five

key indicators, shows that the Nordic countries – particularly Iceland, Sweden and Norway – continue to occupy the top positions. Poland stands out for achieving the largest annual improvement, rising from 12th to ninth place. This is due to a fall in female unemployment and an increase in the full-time employment rate.

PwC analysis shows that there are significant economic benefits in the long term from increasing the female employment rate to match that of

Sweden; the GDP gains across the OECD could be around US\$6 trillion.

When it comes to closing the gender pay gap, countries such as Poland, Luxembourg and Belgium could see the gap fully close within two decades if historical trends continue. But much slower historical progress in Germany and Spain means that their gap might not close for more than two centuries, although making this a policy priority could accelerate progress. The gains from achieving pay parity in the OECD are substantial – it could result in a potential boost in female earnings of around US\$2 trillion at today's values.

According to PwC economist and co-author of the report, Yong Jing Teow, "there is much more that businesses and governments could do to address the causes of the gender pay gap, which are deep-rooted. Policy levers that improve access to affordable childcare and shared parental leave have been shown to get more women in quality work.

"Businesses can also make flexible opportunities more widely available, enabling their employees to manage their family commitments around work," he adds.

The PwC Women in Work Index is a weighted average of various Index measures that reflect female economic empowerment, including the equality of earnings, the ability of women to access employment opportunities and job security.

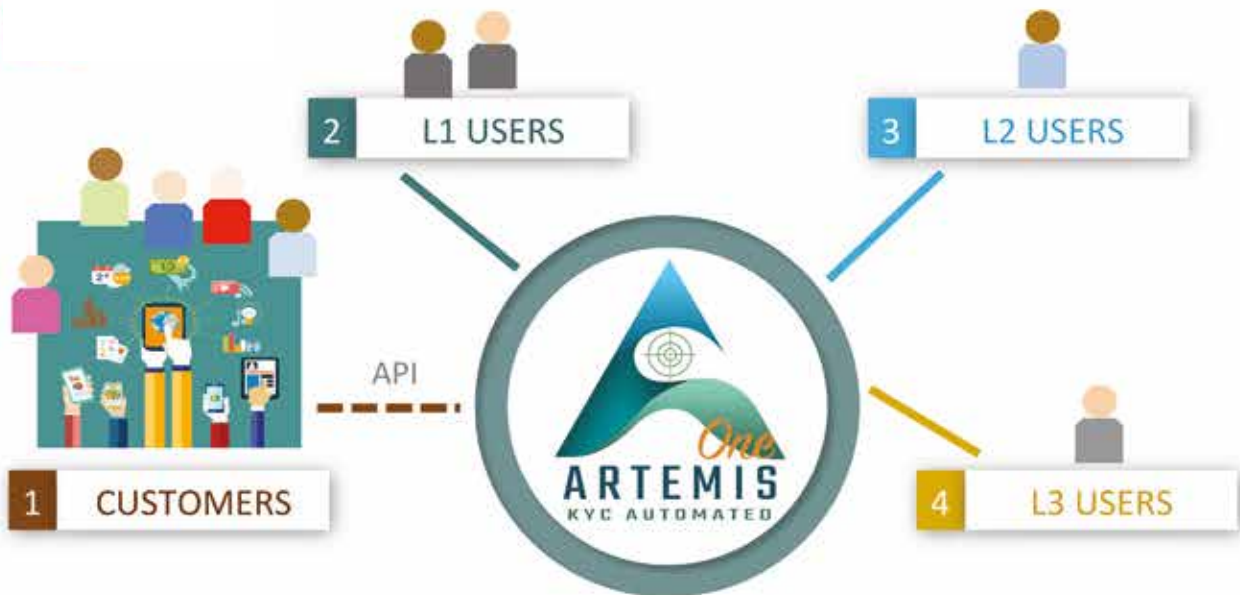


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DOMAINS & USERS

IN TUNE

ISCA NEWS



▲ Legal and tax practitioners alike benefited from this capacity-filled event

Building Bridges through Tax



▲ CIOT Deputy President John Preston and SIATP Chairman Gerard Ee shared their perspectives on the tax profession of their respective countries

Building bridges to connect two points, figuratively speaking, has always been the key thrust of ongoing initiatives of the Singapore Institute of Accredited Tax Professionals (SIATP) to achieve greater understanding of tax issues and facilitate business growth.

This was evident in the recent *Tax Excellence Decoded* session on various recent tax cases covering a range of tax issues. The session was proficiently facilitated by Accredited Tax Practitioner (Income Tax & GST) Allen Tan, Principal, and Ng Chun Ying, Senior Associate, from Baker & McKenzie.Wong & Leow.

Participants ended the session with greater familiarity on a range of complex tax issues.

SIATP continued its efforts in building bridges when it hosted the Chartered Institute of Taxation (CIOT) Deputy President John Preston, recently. SIATP Chairman Gerard Ee welcomed Mr Preston, and both parties gained a better understanding of the tax profession in Singapore and the United Kingdom. They also exchanged ideas on the possible areas of collaboration.

Email enquiry@siatp.org.sg to connect the dots in tax.

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ISCA BREAKFAST TALK

Introduction to New Leases Standard

On 30 June 2016, the Accounting Standards Council (ASC) issued FRS 116: Leases as the Singapore equivalent of IFRS 16 - the new standard on lease contracts that will replace the existing FRS 17 and will be effective for annual periods beginning on or after 1 January 2019. The new leasing standard seeks to make financial statements of lessees

more comparable and transparent with the recognition of all lease assets and liabilities on the balance sheet, unless exempted by provisions in the standard.

Facilitated by Senthilnathan Sampath, Deputy Head, Accounting and Financial Reporting Advisory, PwC Singapore, the March ISCA Breakfast Talk was attended by more than 80 participants. Mr Sampath highlighted that under the new FRS 116, companies

▲ Senthilnathan Sampath, Deputy Head, Accounting and Financial Reporting Advisory, PwC Singapore, provided an overview of the key changes and concepts introduced by the new FRS 116

will have to identify and assess whether a contract contains a lease, determine the lease term and the value of the lease asset and liability, and prepare the new disclosures. The session included case examples to provide guidance on how to handle the new requirements.



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IN TUNE

ISCA NEWS

ISCA MINGLES

The World's Whistleblowers

Captivating stories, fascinating facts and a Mingles evening to remember. There was an overwhelming participation of chartered accountants at the Mingles event on February 22. Jointly organised by ISCA and Chartered Accountants Australia and New Zealand (CAANZ), attendees heard contrasting tales of the world's whistleblowers.

Led by Sarjit Singh, Executive Chairman of Ardent Associates LLP, it was an inspiring and content-rich

evening with plenty of mind-blowing real-life illustrations, short case examples with role plays, fun facts, and an impressive audience participation to reinforce learning.

"Big thanks to our highly engaging speaker Mr Sarjit Singh for presenting on 'The World's Whistleblowers' - an insightful presentation and a captivating session which was filled with plenty of audience participation and quizzes. We received very positive feedback from the members who attended the event,"

said Samantha Chan, Relationship Director of CAANZ.

"It's important to understand how a series of events are related, not just a single event that causes one to become a whistleblower. We appreciate Sarjit sharing his perspective. This was my first Mingles event. It was a very interesting topic and very well organised," said Jessica Corvo, an Advisor at Global Social Enterprise Institute.

▲ (From left) Samantha Chan, Relationship Director, CAANZ; Andrew Er, Chairman of Singapore Members Committee, CAANZ, presenting a token of appreciation to Sarjit Singh, Executive Chairman of Ardent Associates



ISCA CALENDAR OF EVENTS 2017

APRIL

Thursday	ISCA Breakfast Talk
12	<i>Transformation to the Cloud – A Risk-Driven Approach</i>
Thursday	ISCA 6th SMP Dialogue
20	<i>Managing Risks in a VUCA* World</i> *VUCA refers to volatile, uncertain, complex and ambiguous

Dates and events are subjected to change without prior notice.
For more details, visit www.isca.org.sg

UPCOMING

May	ISCA Economic Updates
09	
May	ISCA Forum on Digital Disruptors
16	
May	ISCA Breakfast Talk
17	
May	ISCA Quality Assurance Seminar
22	<i>A biannual seminar for SMPs</i>
May	ISCA Run
27	<i>Don't miss your chance to be part of the ISCA Run! Register now at www.iscarun.sg</i>
June	ISCA Breakfast Talk
14	
June	ISCA Ethics Seminar
28	<i>Updates on Latest and Upcoming Changes</i>

SAVE THE DATE

October	Singapore Accountancy and Audit Convention
03	<i>Formerly known as the Singapore Accountancy Convention.</i> <i>Look out for more details!</i>

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With the active support of International Enterprise (IE) Singapore (through the Market Readiness Assistance (MRA) grant), 3E Accounting has established itself as a truly global one-stop solutions provider.

And the firm is not stopping there. It aims to become the world's leading corporate services provider, by expanding its global network coverage to 50 countries by 2018, and actively promoting its mission of 'efficiency, effectiveness and economy' internationally.

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ISCA-SHRI Future Employment Landscape Seminar

Local employment growth has been dampened in recent years by a structural slowdown in the growth of the local workforce, and cyclical weakness in the economy due to subdued global economic conditions, with the impact varied across sectors. Going forward, local employment growth is expected to continue to be modest. It was reported recently that Singapore aims to create about 25,000 to 40,000 jobs annually for the next three to five years, a pronounced dip from the heyday of 100,000 to 120,000 jobs a year.

Hence, there is now more pressure on people to adapt. At the individual level, employees have to understand that new skills are constantly needed as technologies change rapidly. This applies even to new growth sectors such as ICT. It is therefore essential for employees, regardless of the sectors they work in, to adopt an open mind towards change, and have a willingness to learn or relearn to stay relevant and cope with changes. The acquisition of new skills to take on changing jobs is key to maintaining employability in the new employment landscape.

ISCA and the Singapore Human Resources Institute (SHRI) co-organised the “Future Employment Landscape” seminar on February 22 to raise awareness of the changing employment landscape, disruptions to the sector, and opportunities available.

Our government also recognises the need for workers to adapt and thrive in a continually-changing job market. More place-and-train

programmes, stronger emphasis on companies developing staff, enhanced user experience of the national Jobs Bank, and improvements to government support schemes are some of the efforts to provide opportunities for Singaporeans to equip themselves with deeper skills and gain access to a wider range of employment opportunities. In this regard, Workforce Singapore was invited to provide an introduction to the Adapt & Grow initiatives and programmes that are available to individuals.

During the session, ISCA and AAT (Association of Accounting Technicians) officially announced the launch of the ISCA Accredited Accounting Technician - a skills-based qualification which is designed to meet the needs of employers



▲ Mr Tan, SHRI, shared his views on changes to the employment landscape and trends in career development



globally. In line with the increasing automation within the profession, the qualification acknowledges new technologies and higher-order skills through analysis, judgement and problem-solving.

Rounding off the session was a panel discussion on the capabilities required for accounting and finance professionals to thrive in future. Industry leaders and practitioners in various roles from Boardroom,

◀ **Ms Ng, Workforce Singapore, provided an introduction to the government's Adapt & Grow initiatives**

▼ **ISCA's first attempt at broadcasting an event live through Facebook Live**

Deloitte, Robert Half, AAT, and the Association of Small & Medium Enterprises (ASME) brought with them various perspectives to the discussion moderated by Ethan Tan, Executive Director, SHRI. Among the topics discussed were the top two disruptions expected to impact the accountancy sector; the lessons learned from the finance industry in dealing with fintech disruptions and how they can be applied to the accountancy sector; the relevance of accountancy education in the future, and whether the panellists would still encourage their children to opt for accountancy as a profession.

▲ **ISCA President Gerard Ee (4th from left) with (from left) moderator Ethan Tan, Executive Director, SHRI; panellists Ng May May, Deputy Director, Creative and Professional Services Division, Workforce Singapore; Seah Gek Choo, Talent Partner, Deloitte Singapore; Fen Teo, Senior Division Director (Finance and Accounting), Robert Half; Andrew Williamson, Director of Marketing and Commercial, AAT; Ang Yuit, Vice President (Membership & Training), ASME; Victor Lai, Director, Boardroom Limited**

"Think of what can help us improve in our job, and in our next career move. Actively upgrade ourselves, and don't just wait for change to come." This was the advice of panellist Seah Gek Choo, Talent Partner, Deloitte Singapore.

The seminar was attended by over 90 participants. In fact, it was fully subscribed within a week. This shows that members of the profession are taking active steps to find out how they can thrive in the changing employment landscape and remain relevant for the future.

As part of our support for members, ISCA has also recently set up a "career support" page on our website, providing career resources such as articles providing career advice, a list of career coaches, information on government support schemes and links to useful jobs portals. More information can be found at www.isca.org.sg/member-services/career-support/.



Rising to the Challenge

Since its establishment in 2013, the Singapore CA Qualification (formerly known as the Singapore QP), has aimed to nurture well-rounded individuals with an aptitude for leadership and an affinity for numbers. Candidates' skills are honed through a challenging mix of technical modules, *pro bono* work, workshops, and practical experience - a winning combination which equips candidates with the skills expected of a global leader in accountancy, business and finance.

As such, it is no surprise that there was an increasing number of candidates from non-accounting firms pursuing the Singapore CA Qualification among the recent batch of candidates who recently completed their Integrative Business Solutions Capstone module examinations.

Geraldine Lam, a Treasury Rotation Analyst at the Cargill Group of Companies, shared that while it may seem daunting as she was the only person in the company taking the examination, the support she has received from her employer has allowed her to complete the Singapore CA Qualification successfully. "When I was in my first job at one of the Big Four firms, I received the warm and strong support of the firm through the numerous training programmes it offered for staff members who were undertaking the Singapore CA Qualification. While there was no extensive training programme in my new company, I am grateful that my




"The three steps which helped me successfully complete the Singapore CA Qualification journey are not complicated but they require a strong will to adhere to. They are (1) make a plan, (2) set your mind to complete it, and (3) stay focused."
GERALDINE LAM
Treasury Rotation Analyst
Cargill Group of Companies

bosses supported me through their encouragement and mentorship. This gave me motivation to continue my Singapore CA Qualification journey," Ms Lam commented.

Song Qiurong, Deputy Head (Reviews) at the Accountant-General's Department (AGD), shared that as a non-accountancy graduate, she was concerned that she would be at an inherent disadvantage for certain technical modules as compared to classmates who deal with these issues as part of their work in the public accounting firms. However, she added, "My company provided great support in sourcing for training courses that I could attend."

Tan Pi Li, Manager (Group Tax) at Keppel Corporation Limited, remarked that "Keppel has always been very supportive in giving us

sufficient time off from work to focus on the programme as well as liaising with the accounting firms for supplementary classes which we can ride on".

Juggling full-time work and studies is definitely no mean feat. As such, good time management and constant discipline are key factors to stay on top of things. For candidates working in non-accounting firms, looking beyond the provided texts or approaching peers for a helping hand could prove to be extremely beneficial. "I made it a point to constantly get in touch with friends from other circles and to study together," said Ms Lam.

"My colleagues, many of whom have accountancy backgrounds, were very helpful and had provided me with useful advice as well as reference course materials,"

Ms Song added. "Reading beyond the Candidate Learning Pack will come in very useful for many modules, as the exams require demonstration of a wide breadth of knowledge and skills. You could also look for online materials from reliable sources, or check with your accounting colleagues if they have any relevant reference materials from their university days."

When asked what the most challenging part of his journey was, Mr Tan replied, "Coming from a non-accounting firm and having graduated from NTU Accountancy in 2008, the most challenging part of my journey was having to constantly refresh my accounting knowledge to keep up with the workshop discussions with fellow candidates, who are mostly new graduates or from the Big Four accounting firms."

In spite of the challenges they faced along their Singapore CA Qualification journey, candidates still found it to be an extremely enriching learning experience, during which they managed to gather interesting insights and form friendships. Said Ms Lam, "The most rewarding aspect of my Singapore CA Qualification journey were the friendships and camaraderie that I forged. From there, I gathered new perspectives and insights from numerous like-minded individuals."

Ms Song has come to see her Singapore CA Qualification journey as a personal challenge. "I had to quickly pick up professional knowledge in accounting, which was not my discipline of study in the university, in order to complete the programme and so there is a definite sense of achievement."




"The journey had been challenging, having to juggle studies with full-time work. So I am definitely exhilarated to have come to the end of this long but fruitful journey."

SONG QIURONG
Deputy Head (Reviews)
Accountant-General's Department


"With the right attitude towards continuous learning, completing the Singapore CA Qualification is not only achievable but worth the effort."

TAN PI LI
Manager (Group Tax)
Keppel Corporation Limited



Mr Tan feels that his journey was rewarding, value-adding, and will be helpful to his career going forward. He explained, "With commitment and self-discipline, we stand equal chances of completing this journey. My final advice would be to plan for it early and get the support of colleagues and the company."

As the candidates approach the end of their Singapore CA Qualification journeys, we hope to welcome them as full CA (*Singapore*) members who are equipped with the skills and confidence to rise to any challenge. We congratulate the Singapore CA Qualification candidates and wish them the very best in their future endeavours.

2017 ISCA-SAC Mentoring Programme for CFO Aspirants

First launched in January 2016, the ISCA-SAC Mentoring Programme is a joint collaboration between ISCA and the Singapore Accountancy Commission (SAC). It is designed to offer CFO aspirants with opportunities to learn and gain insights from experienced mentors within the accounting and finance profession. Through the programme, mentees will receive unique perspectives on the requisites needed to make the next step up in their careers, as well as impartial guidance on business issues and sharing of best practices.

The 2016 run of the programme attracted 36 mentees including participants of SAC's SME Business &

Financial Management Programme. Volunteering their time in helping to groom the next generation of finance leaders were 24 mentors including industry leaders from major listed companies and MNCs. Commenting on the programme, ISCA CEO Lee Fook Chiew said, "Making the step up to being a CFO can be a challenging task as individuals are expected to contribute beyond the financial aspects of the company, and pick up a wider range of soft skills and strategic acumen. This programme provides participants with the opportunity to be paired with a C-suite executive, giving them the chance to learn directly from a seasoned professional who has gone through the journey to be in the C-suite."

Now into its second run, the 2017 programme will accept up to 50 applications to be mentees. A formal approach will be adopted for the programme, where mentees will be expected to have clear career objectives and define what they hope to achieve out of the programme. Mentees will be asked to list the areas of expertise and skill sets they wish to gain from their mentors, and they will be paired based on the information submitted by both mentors and mentees during the application process.

Registration to be a mentee is now open. For more information about the programme, please visit our website at www.isca.org.sg/member-services/career-support/mentoring-programme/.

WHAT PIONEER MENTEES SAY ...



MENTOR

GOH GEOK CHENG
Regional Insurance
Risk Controls Officer
Prudential Services
Singapore



MENTEE

KHISI GISELE TJAN
Former Controller,
Finance
Westpac Banking
Corporation

"I appreciate my mentor's time and commitment despite her busy and packed schedules. Overall, the mentoring programme helped me to improve my leadership skills and also to gain insights into the industry."



"I like the candid discussion with Arthur on the different career paths I can take to broaden and deepen my skill sets as a senior finance executive. And what did I gain most from the programme? - The mentoring relationship with Arthur of course! The programme might span only six months, but I'm confident the informal mentoring could stretch for decades."



MENTOR

ARTHUR LANG
CEO, International
Singtel
Formerly Group CFO
CapitaLand Limited



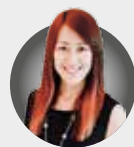
MENTEE

KOH KHAI YANG
Regional Finance Director,
Asia Pacific
Wood Mackenzie



MENTOR

TONY MALLEK
CFO
Singapore Press Holdings



MENTEE

JASMIN ONG
Regional Financial Controller, Finance
Services & SAP Centre of Excellence
Luxasia Pte Ltd



"I have learned that in order for me to be able to influence others with new ideas, I need to understand the personalities of those present at the meeting. Tony has shared with me the different personality profiles commonly used, which helped to widen my knowledge in this aspect."

Tony has also introduced two of his capable staff who shared a lot with me, and from whom I was able to learn. I have become more focused and now have a better understanding of my personal aspirations. For sure, I have become more confident over time."

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FRS 116: LEASES

Diving into the Complex



By
LIM JU MAY

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e are now one third of the way into the implementation period of FRS 116: Leases, following the Accounting Standards Council (ASC)'s issuance of

the Standard on 30 June 2016. On 15 December 2016, ASC Chairman Kevin Kwok issued a reminder letter to Directors and Chief Financial Officers, encouraging them to take the necessary steps to ensure a smooth and timely transition to three major Financial Reporting Standards – FRS 109: Financial Instruments, FRS 115: Revenue from Contracts with Customers, and FRS 116: Leases. He urged companies to undertake in-depth analyses to determine the full implications of the Standards to their financial reporting, bearing in mind that these Standards carry potential implications beyond financial reporting – such as financial covenants and regulatory requirements, income taxes, employee compensation, information technology systems and business processes. ASC highlighted that FRS 116 is expected to have widespread implications across different industries and improve



PHOTO SHUTTERSTOCK



transparency about lessees' financial leverage and capital employed. The accounting changes would potentially affect key financial metrics, such as gearing, liquidity and return on capital, and may have further implications for lessees' tax obligations and compliance with financial covenants and/or regulatory requirements, although their economic positions may have remained unchanged.

In my previous three articles (published in the March, August and September 2016 issues of *IS Chartered Accountant* journal), I have focused on the genesis of the right-of-use accounting model, guidance on determining whether a contract contains a lease (ISCA Leases Roadmap), the implications to financial metrics, financial debt covenants and consequences that may go beyond the entity's accounting department, simplifications under FRS 116 to address concerns about costs and complexity, materiality considerations in scoping determinations, and, last but not least, an examination of commercial and business challenges faced by companies when implementing the new leases standard. In this article, I will be expounding on several accounting complexities when applying the Standard's requirements, providing insights into areas requiring more thinking and preparation time.

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... ASC Chairman Kevin Kwok issued a reminder letter to Directors and Chief Financial Officers, encouraging them to take the necessary steps to ensure a smooth and timely transition to three major Financial Reporting Standards...

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... “cannot readily determine”, “reasonably able to do so” and “undue effort” are subjective and an entity would still be expected to exercise reasonable effort to consider facts and circumstances at inception of the contract when evaluating whether a supplier’s substitution right is substantive.

ACCOUNTING COMPLEXITIES IN APPLYING FRS 116

Contrary to the above sub-title, the leases accounting concepts under FRS 116 are relatively straightforward and easy to understand even though it took the accountancy profession a decade to finalise them. Before taking the plunge into the “complexities”, let me first explain the key requirements of lessee accounting under FRS 116.

FRS 116 defines a lease as a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. FRS 116 requires entities, at inception of a contract, to assess whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. For *all* contracts assessed to be or to contain a lease, a lessee shall recognise a right-of-use asset and a lease liability. Former operating leases are to be capitalised, and henceforth, there will be no more accounting distinctions made between finance leases and operating leases from the perspective of the lessee. All leases¹ are to be accounted for similarly to today’s finance leases.



A lease contract creates, for the lessee, a right to use an underlying asset during the lease term, and an obligation to make payments to the lessor for providing the right to use that asset. The lessee’s control of the right to use the underlying asset is demonstrated through the lessee’s ability to determine how to utilise the underlying asset and thus, how the reporting entity generates future economic benefits from the right-of-use. Accordingly, the lessee’s right to use an underlying asset meets the definition of an asset under the Conceptual Framework. The lessee’s

control of the right-of-use arises from past events – commitment to the lease contract and the underlying asset being made available for use. The lessee’s right-of-use is unconditional unless the lessee breaches the contract. The lessee’s obligation to make lease payments meets the definition of a liability under the Conceptual Framework, inasmuch as the lessee has a present obligation to make lease payments once the underlying asset has been made available to the lessee. Again, the obligation arises from past events – commitment to the lease contract



#1 Is a capacity portion of an asset an identified asset?

The issue here is whether a contract for the right to use only a portion of an asset qualifies as a lease contract. This brings us to “Roadblock 1 – Is there an identified asset? If NO, the journey ends. If YES, proceed to Roadblock 1A” of the ISCA Leases Roadmap.²

A capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fibre optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from the use of the asset (FRS116.B20). IASB concluded that a customer is unlikely to have the right to control the use of a capacity portion of a larger asset if that portion is not physically distinct (for example, if it is a 20% capacity portion of a pipeline). In this instance, the customer is unlikely to have the right to control the use of its portion because decisions about the use of the asset are typically made at the larger asset level and may be constrained by decisions of others also having rights to portions of the asset’s capacity.

Nonetheless, “physically distinct” and “substantially all of the capacity of the asset” concepts can be complex to apply in some situations, requiring accounting judgements.

#2 Are the supplier’s asset substitution rights substantive?

The issue here is whether a supplier (lessor) has the substantive right to substitute the asset throughout the period of use. This brings us to “Roadblock 1A – Does the supplier have substantive asset substitution rights? If YES, the journey ends. If NO,

and the underlying asset being made available for use. The International Accounting Standards Board (IASB) concluded that all leases provide finance to lessees and thus create assets and “debt-like” liabilities. FRS 116’s single lessee expense recognition model requires the recognition of interest expense on those debt-like liabilities separately from depreciation

expense of lease assets. Hence, there is the unavoidable front loading of total leases expenses. As for lessor accounting, only selected elements of prior guidance are changed under FRS 116 – accounting for subleases, the definition of a lease, initial direct costs and lessor disclosures.

Notwithstanding its conceptual simplicity, certain requirements are difficult to apply and require judgements and rigorous evaluations. Below are just four of the more complex requirements of the Standard; this is by no means an exhaustive list.

¹ Except for leases which lessees have elected to exclude under the “short-term leases and leases of low-value assets” recognition exemptions; the election for short-term leases shall be made by class of underlying asset to which the right-of-use relates, whereas the election for low-value assets can be made on a lease-by-lease basis.

² ISCA Leases Roadmap was published in the March 2016 issue of *IS Chartered Accountant Journal*.

proceed to Roadblock 2” of the ISCA Leases Roadmap.

A substitution right is substantive if the supplier has the practical ability to substitute the asset and would benefit economically from doing so. FRS 116.B14-B19 provides application guidance to help determine the circumstances in which substitution rights are substantive. The intention of the application guidance is to differentiate between (i) substitution rights that result in there being no identified asset because the supplier, rather than the customer, controls the use of an asset, and (ii) substitution rights that do not change the substance or character of the contract because it is not likely, or practically or economically feasible, for the supplier to exercise those rights. The requirement that a substitution right must benefit the supplier economically in order to be substantive is a new concept. The requirement is that economic benefits associated with substituting the asset must be expected to exceed the costs associated with substituting the asset.

FRS 116 states that if a customer cannot readily determine whether a supplier has a substantive asset substitution right, then the customer should presume that any such substitution right is not substantive. IFRS 16.BC115 clarifies that “it is intended that a customer should assess whether substitution rights are substantive if it is reasonably able to do so – if substitution rights are substantive, then the IASB thinks that this would be relatively clear from the facts and circumstances. However, the requirement is also intended to clarify that a customer is not expected to exert undue effort in order to provide evidence that a substitution right is not substantive”.

It is noted that the terms “cannot readily determine”, “reasonably able to do so” and “undue effort” are subjective and an entity would still be expected to exercise reasonable effort to consider facts and circumstances

at inception of the contract when evaluating whether a supplier’s substitution right is substantive. This may be a complex exercise and the efforts required would be multiplied by the number of different contracts an entity has with different suppliers.

#3 Who makes decisions about how and for what purpose an asset is used?

The issue here is whether the customer or the supplier has the decision-making rights to direct the use of the underlying asset stipulated in the contract. If the supplier holds the decision-making rights, the supplier has control over the underlying asset and only provides a service to the customer, in which case the contract is a service contract and not a lease contract. This brings us to “Roadblock 2B(i) – Does the customer have the right to direct how and for what purpose the asset is used throughout the period of use? If YES, the contract contains a lease. If NO, consider Roadblock 2B(ii)” of the ISCA Leases Roadmap.

In IASB’s view, the decisions about how and for what purpose an asset is used are more important in determining control of the use of an asset than are other decisions to be made about use, including decisions about operating and maintaining the asset. This is because decisions about how and for what purpose an asset is used determine how, and what, economic benefits will be derived from its use. Decisions regarding operating an asset are generally about implementing the decisions about how and for what purpose an asset is used and are dependent upon, and subordinate to, those decisions. The IASB observed that considering decisions about how and for what purpose an asset is used can be viewed as similar to considering the decisions made by a board of directors when assessing control of the entity. Decisions made by a board of directors about the operating and



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In view that the Standard includes only limited guidance on how to interpret in-substance fixed payments, unravelling any contingent payments “disguised” as variable lease payments will be a complex exercise requiring significant accounting judgements.

financing activities of an entity are generally the decisions that matter in that control assessment, rather than the actions of individuals in implementing those decisions.

An entity is to consider the decision-making rights that are most relevant to changing how and for what purpose the asset is used throughout the period of use. FRS 116.B26 provides examples of relevant decision-making rights – right to change what type of



output is produced, when the output is produced, where the output is produced and how much of the output is produced. Decision-making rights that are most relevant are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract.

Depending on the terms and conditions of the contracts, assessment of decision-making rights can be a complex exercise requiring accounting judgements.

#4 Are variable lease payments in-substance fixed payments?

Variable lease payments are excluded from the measurement of lease liability except for variable lease payments that depend on an index or a rate. Variable lease payments that are linked to the lessee performance derived from the underlying asset are not included in the lease payments unless they meet the definition of in-substance fixed lease payments. In-substance fixed lease payments are payments that may, in

form, contain variability but which in substance, are unavoidable. FRS 116 requires a lessee to include in-substance fixed lease payments in the measurement of lease liabilities because those payments are unavoidable and, thus, are economically indistinguishable from fixed lease payments.

FRS 116 does not contain any specific guidance on in-substance fixed payments but indicates that lease payments are in-substance fixed if there is no genuine variability. FRS 116 includes four examples of the types of payments that are considered to be in-substance fixed payments to help in applying the requirement, as follows:

- (i) Payments that must be made only if an asset is proven to be capable of operating during the lease, or only if an event occurs that has no genuine possibility of not occurring;
- (ii) Payments that are initially structured as variable lease

payments linked to the use of the underlying asset but for which the variability will be resolved at some point after the commencement date so that the payments become fixed for the remainder of the lease term. Those payments become in-substance fixed payments when the variability is resolved;

- (iii) There is more than one set of payments that a lessee could make, but only one of those sets of payments is realistic. In this case, an entity shall consider the realistic set of payments to be the lease payments, and
- (iv) There is more than one realistic set of payments that a lessee could make, but it must make at least one of those sets of payments. In this case, an entity shall consider the set of payments that aggregates to the lowest amount (on a discounted basis) to the lease payments.

In view that the Standard includes only limited guidance on how to interpret in-substance fixed payments, unravelling any contingent payments “disguised” as variable lease payments will be a complex exercise requiring significant accounting judgements.

CLOSING REMARKS

Contrary to the perception of some, FRS 116 does contain a number of nuances and complexities which requires detailed considerations, accounting judgement and early preparation. Accountants are accordingly cautioned to not underestimate the amount of preparation time that will be required if appropriate decisions are to be reached. ISCA

Lim Ju May is Deputy Director, Financial Reporting Standards & Corporate Reporting, ISCA.

REST AND RECREATION

Exotic Food and Wellness Destinations that Leave You Wanting More

Let's face it, vacations are meant to be comfortable. After all, it's your hard-earned time off, and surely you deserve some top-notch rest and relaxation? With that in mind, we have hand-picked top destinations around the world that will go a long way to satisfy you in body, mind and soul. Let a therapist ease your aches and pains, or try a relaxing yoga class to help your busy mind find some stillness. Or let your stomach take the lead – rediscover your joie de vivre with a Michelin star-worthy tasting menu or a delectable street eat.

No matter your preference, there's something in this list that will be sure to inspire.



Rishikesh, India



Reykjavik, Iceland

THERE'S NO PLACE LIKE OM Rishikesh, India

In 1968, the Beatles discovered Eastern spirituality in the monasteries of Rishikesh. Since then, it has become the yoga capital of the world (thanks to *Lonely Planet*) and it is definitely the place to head to if you yearn to deepen your understanding of this ancient practice that encompasses physical, mental and spiritual aspects.

Located at the base of the Himalayas, Rishikesh perches on the banks of Ganges, and is surrounded by cool, green forests – perfect for a week or month of mindful chilling out. There are hundreds of ashrams or retreats to suit any budget or fitness level – from a week-long beginner yoga package that includes adventurous

non-yoga pursuits such as river-rafting and trekking, to a spiritually-intense silent meditation retreat in a rustic ashram.

If you prefer to build your own adventure from scratch, check out the Aranyan River Retreat, set within the Rajaji National Park. Featuring home-cooked meals, luxurious rooms and a setting deep in the heart of nature, you'll be rested and relaxed in no time at all.

Best time to visit Try the cooler months of spring (March to May) and fall, but avoid the scorching summers (June to late September) and the rainy winters.

- www.dhamma.org/en/schedules/schsalila
- www.bookyogaretreats.com/akshi-yogashala/7-days-beginners-meditation-and-yoga-retreat-rishikesh-india
- www.aranyam.in/

FANCY SOME FERMENTED SHARK?

Reykjavik, Iceland

Game for a truly unforgettable experience? Why not try some fermented shark meat – or hakaarl, as the Icelanders call it. Like a durian, once you get past its smell (“rotten cheese mixed with ammonia” is one description), you are rewarded with sweet-tasting flesh and a pungent, fishy aftertaste. Other exotic treats on offer in Iceland include svio (sheep's head, sans brain) and slatur (the island's answer to Scottish haggis). Wash it all down with a shot or two of brennivin – a local schnapps made from fermented potatoes and caraway.

The Icelandic capital is establishing itself as a haven for fine dining as well – try the extremely palatable classic dishes on offer at DILL restaurant, including plokkskur – a hearty fish stew made from local and seasonal ingredients. And don't miss the reindeer sliders, minke whale steak and puffin at Grillmarkadurinn (Grill Market), housed in a beautiful Art Nouveau building.

Best time to visit If you want to see the Northern Lights, then head there in deepest winter, between December and February. Summers are warm and bright (the sun doesn't set till midnight).

- www.dillrestaurant.is/
- www.grillmarkadurinn.is/en/

TAKE THE LUXE APPROACH Vinh Hy Bay, Vietnam

The beautiful blue waters of Vinh Hy Bay along Vietnam's southern coast are tranquil and untouched, making the bay a great place to unplug from the modern world. The majestic coastline of the nearby 29,000-hectare national park spans a wide range of eco systems to explore, from dry tropical forests to lush ravines.

Tucked among it all is the incredible luxurious Amanoi Resort – two spa houses that enable guests to experience a total wellness immersion, comprised of personalised treatment regimens tailored to their specific needs. Choose from wellness plans that focus on detoxification, weight management or stress control; balance your qi through various modalities including yoga, meditation, tai chi, qi gong, reiki and craniosacral therapy, and wrap it all up with some of the most decadent spa treatments in the onsite hammam and banya.

Best time to visit April to August can be rainy but you enjoy better value.

○ www.aman.com/amanoi



Davos, Switzerland

STEP BACK IN TIME Davos, Switzerland

It was 1856 when the Victoria-Jungfrau Grand Hotel & Spa Interlaken opened its doors to alpine adventurers eager to explore the ski areas of the Bernese Oberland. It's 5,500-square-metre Spa Nescens is one of the oldest – and most beautiful – in Switzerland. Now updated with 16 modern treatment rooms, and a Sensai Select spa designed by Japanese cosmetic company Kanebo, the Victoria Jungfrau is the place to be if skiing and spa treatments are your two favourite things.

Visit in winter, when a thick layer of snow carpets the nearby world-class pistes, and the outdoor pools of Spa Nescens are steamy and inviting. Hop on a local railway to explore the nearby sights, including the 3,454-metre Jungfrauoch pass. Or explore nearby Lake Thun and Lake Brienz via one of the last of Switzerland's steam trains.

Best time to visit Avoid the Christmas crowds and go during the Chinese New Year instead; fewer tourists and more snow – what's not to like?

○ www.victoria-jungfrau.ch/en



Vinh Hy Bay, Ninh Thuan, Vietnam



Marrakech, Morocco



Buenos Aires, Argentina

EAT LIKE A GAUCHO Buenos Aires, Argentina

From delectable cuts of beef served any way you can imagine to luscious red wines that you can down by the gallon, Buenos Aires is the food destination that should be on any serious foodie's travel list in 2017. Restaurants in the Argentinian capital have once again dominated *Restaurant's* Latin America 50 Best list – you should definitely check out Cabrera (No. 19, massive steaks for hungry cowboys) and Baqueano (No. 15, llama carpaccio) and Tarquino (No. 48, known for its nose-to-tail cow tasting menu).

But the pièce de résistance is the minimalist Tegui (No. 7 on the list), with its food-as-art plates of Mediterranean-style seafood. Think red tuna in an almond gazpacho, oysters

with trout roe and shrimp ravioli with a scallop-mango foam.

There's also plenty to do in Buenos Aires when you're not busy stuffing your face – try your hand at dancing the tango at the famous *Maldita Milonga* (the live orchestra is a bonus) or take in a Boca Juniors football match. Snack on dulce de leche (caramel) bonbons, make a pilgrimage to the Museo Evita, which celebrates the life and times of Argentina's iconic former First Lady Eva Peron and go relic hunting in San Telmo.

Best time to visit Don't forget that the seasons are reversed Down Under, so plan your trip to take advantage of long days and sultry nights of the Argentinian summer (December to February).

○ <https://turismo.buenosaires.gob.ar/en>

MUM'S DEFINITELY NOT COOKING! Marrakech, Morocco

Sitting at the crossroads of Europe, Africa and the Middle East, Morocco's cuisine is forged from a mix of Berber, Jewish, Arab and French influences. No visit would be complete without sampling a tagine or two – the Moroccan equivalent of our local briyani. Try the kefta version, with minced lamb meatballs, cooked in tomatoes and topped with an egg.

Other dishes to try include couscous, pastille and tanjia, which is cooked in the embers of the coals used to heat the bathhouses. Wrap up your meal with some decadent sweet treats such as briouat, nougat and shebakia, plus a cup of mint tea (sometimes known as Berber whisky).

The best thing about Marrakech is that it's a haven for foodies and spa fans alike. It's also known for its hammams – steam bathhouses where you can be exfoliated to within an inch of your life. Try a no-frills local version at the Hammam es Salam near the Menara gardens or go upmarket at Les Bains de Marrakech – a historic choice that's still one of the best in town.

Best time to visit Avoid the peak tourist season (and the hot weather) of summer (late June to late September); try the spring and fall shoulder seasons instead.

○ www.lesbainsdemarrakech.com/en/home
○ www.marrakech.travel/en ISCA

FINANCIAL DUE DILIGENCE

10 Rules that Make or Break an Investment Deal



BY
MICHAEL CHIN

Numbers tell a story, but is the story good enough to invest in?

Venture capitalists and general partners of private equity funds are constantly looking out for attractive investments in private companies that can give them the mega returns they want. Yet for every 10 investments, how many would be considered successful based on their timeline and exit via trade sale or IPO? The failure rate is high, but if even one out of 10 investments is a superstar that reaps huge returns, the investment can pay off. To take one local example, Singapore billionaire Peter Lim backed Wilmar International with US\$10 million in the late nineties, a move that netted him a return on investment of close to S\$1 billion Singapore dollars.

The investment success rate can be dramatically improved by performing due diligence once a target is identified. This due diligence would normally cover financial, legal and regulatory compliance, operations, commercial data, corporate governance, and taxation. It would also include site visits of the target's operations, as well as exhaustive interviews with owners, management, employees, customers and suppliers, corroborated

by background checks by private investigators or intelligence firms.

Financial due diligence is one of the many forms of due diligence to be carried out. In this respect, there are 10 crucial insights that every venture capitalist and general partner of private equity funds should be aware of to reap the returns they want. Failing to pay attention to these recommendations could be costly. These 10 takeaways are as follows:

1 Think cash first, profits second

Profit is important but cash is the reality. Focus on cash flows first and profits second. Ask for cash flows for the past five years and the projection for the next three to five years. For example, a company can pay commissions to its salesmen to sell the products aggressively, but without monitoring the quality of the sales, this oversight can result in significant credit risk.

In short, high profit may be initially recorded, only to come up against the poor results when it is time to collect cash from customers. In cases like these, numbers can tell a misleading story as significant doubtful debts are pushed back into subsequent reporting periods.

2 Numbers should be prepared using internationally accepted accounting rules

Numbers can be prepared in many ways based on accounting policies and principles selected



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Good management is critical to the success of the companies they own and manage, but honest management is even more important... Numbers can be beautified, packaged, and presented to tell the story the way the owners intend it to be and not the way it should be.



by the company. Different accounting principles give rise to different numbers that can influence decision-making.

Focus on numbers prepared based on generally accepted accounting principles such as International Financial Reporting Standards (IFRS). For instance, profit can be improved simply by capitalising substantial repair and maintenance costs and then depreciating them over 10 years, or not eliminating a sales transaction by the investor entity with its joint venture partner for the share it controlled.

3 Sustain the future growth

One of the fundamental assumptions when reviewing financial information of the target entity is that its financial statements and information are prepared on a going concern basis. This means the entity has the financial capability either through its own profitable operations, or through borrowings from third parties or related parties, or even owners' funding to continue in operational existence for the foreseeable future.

Thus, it is important to ask for financial forecasts or projections for the next five years and to examine the inputs and assumptions used for cash inflows and cash outflows, including capital expenditure and funding needs of the entity as it journeys through its life cycle. It is wise to scrutinise the past for indications of historical performance, but more important to focus on the present to form a realistic picture of the current reality and the future for sustainable growth.

4 Discover hidden gems in the company

There could be hidden gems not reflected on the balance sheet, example, a solid customer base, talent capital, brand name, exclusive distributorship rights for large MNCs, control of market share, proprietary technical know-how, and patents. The balance sheet normally records assets that are tangible, because accounting rules generally set strict criteria for the recognition of intangible assets and thus, such assets are not valued and not recorded on the balance sheet.

5 Look out for undervalued assets

Look out for undervalued assets on the balance sheet like properties, plant and equipment that are recorded at historical cost less accumulated depreciation but whose fair market values may have escalated two to three times their original cost. Conversely, also beware of overvalued or underperforming assets on the balance sheet such as receivables from third parties and related parties that are not collectible, inventories that cannot be sold above cost, as well as investments that are not performing and not impaired.

6 Watch out for unrecorded liabilities

Unrecorded liabilities are like a time bomb waiting to explode. You may notice them without being fully aware of their accounting implications. Examples of these dangers include goods shipped based on agreed incoterms but not recorded by the company as payable to supplier; provision for warranty costs; provision for reinstatement cost of the premises occupied if the landlord requires the tenant to reinstate the premises to its original state upon vacating the premises; provision for unutilised leave; cash settled stock compensation; oral or written guarantees given by owners and their related companies or assets and shares of the company

pledged against borrowings; contingent liabilities that are probable such as claims in litigation that are in progress, and more.

7 Key employees are assets, but can be costly

Scrutinise employment contracts with key management personnel including directors (key employees), and the implications these have on costs, including any stock options granted to them by the founders of the company.

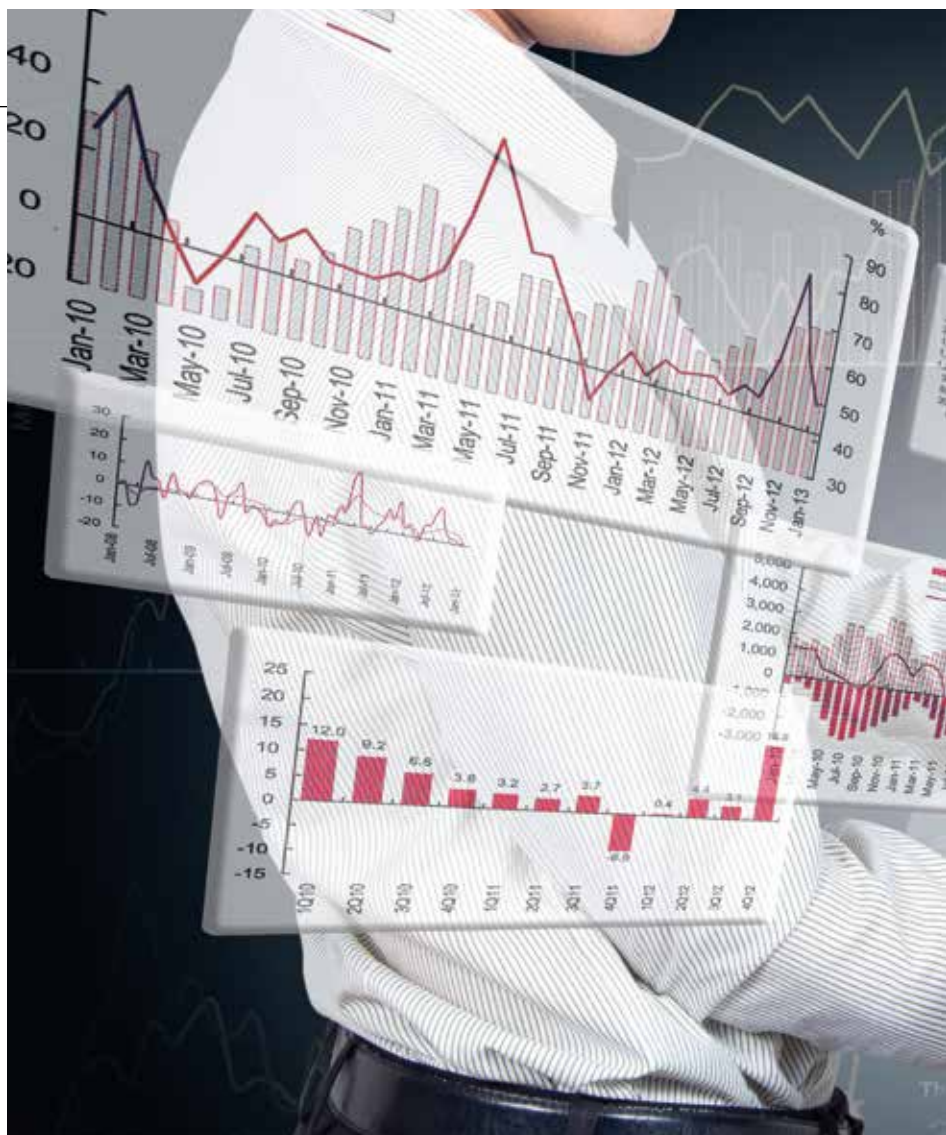
Stock options or shares granted to key employees as incentives would give rise to a charge to profit or loss like employee salaries, but this fact may not be recorded. Key employees that are on a fixed contract term of three or more years could require heavy financial

payouts by the company if their contracts are terminated prematurely in the event that they are not the right people to take the company forward.

A non-competition clause should also be included in revised employment contracts, as this risk can cause damage to the company's performance in the future should key employees leave the company and set up on their own to compete with the company.

8 Good management is not good enough, honest management counts more

Good management is critical to the success of the companies they own and manage, but honest management is even more important. If a company's revenue and profit figures are too good





★
... tax losses have a value as they can be carried forward to offset against future years' profits, subject to the tax rules of the country where the losses arose.

balance sheet on grounds of prudence. In fact, these tax losses have a value as they can be carried forward to offset against future years' profits, subject to the tax rules of the country where the losses arose. For instance, in Singapore, tax losses including unclaimed tax incentives and unabsorbed capital allowances can be carried forward indefinitely to offset against future profits so long as there is no substantial change in ultimate shareholders.

10 Don't buy on emotion and justify on reasons thereafter

Finally, be honest with yourself whether the return on capital invested which you desired can be achieved based on the due diligence exercises you have carried out. Be objective and impartial and don't let your emotions dictate your rational thinking. Psychologists have long observed that human beings buy on emotion and justify the purchase decision with reasons thereafter.

For venture capitalists and general partners of private equity, investing huge sums of money in private companies, be they start-ups, growth or mature companies, requires careful financial due diligence. Bearing in mind the 10 rules would reduce investment risk in the target and help you reap the rewards you are aiming for. **ISCA**

Michael Chin is ISCA Council Member; Chairman, ISCA Public Accounting Practice Committee, and Managing Partner, PKF-CAP LLP.

compared to its peers in the industry, beware the possibility that these numbers may have been manipulated.

Numbers can be beautified, packaged, and presented to tell the story the way the owners intend it to be and not the way it should be. This effect can be achieved by way of management override of controls over financial reporting, such as adopting accounting practices that are not in line with generally accepted accounting principles, suppressing or amending journal entries, and making accounting estimates or fair value estimates that are aggressive.

Examples of these practices include depreciating assets over a longer period of time than its economic useful life, not providing for doubtful debts for

trade receivables that are in dispute, recognising revenue when collection is not probable at the inception of sale, and not recording a claim by the creditor when it is probable that the lawsuit would materialise in the plaintiff's favour. Such aggressive accounting practices can lead to fraudulent financial reporting.

Remember to ask for audited financial statements for the last five years, while also evaluating the reputation of the audit firm that performed the audit.

9 Business losses sound terrible, but tax losses can potentially offset them

Don't ignore tax losses as these are normally not recorded as assets on the

CORPORATE GOVERNANCE DISCLOSURES

How Do SGX-listed Companies Measure Up?



BY
IRVING LOW

In every listed company's annual report, the Singapore Exchange (SGX) Listing Rule 710 requires that they disclose whether they "comply" with the principles and guidelines as specified in the Singapore Code of Corporate Governance (Code) 2012, or "explain" any departure from the Code. How do companies listed on the SGX measure up?

The SGX-KPMG Corporate Governance Study of 545 mainboard-listed companies found that while the state of disclosures is good, there is room for improvement. Many companies appear to view the Corporate Governance (CG) section of the annual report as a compliance-driven exercise – disclosing only the minimum level of detail. Other companies view disclosures as a driver of value, and choose to provide more forthcoming and specific details.

The objective of the study was to identify the extent to which CG disclosures were present (either a positive or negative statement) and of good quality (the disclosure, including explanations for alternative practices, provides forthcoming and meaningful information to enable the reader to



PHOTO SHUTTERSTOCK



★
As the nature of the risks that companies face becomes more complex, and the requirement to disclose Key Audit Matters and material misstatements of other information contained in the annual report come into force, more granularity in disclosure will be expected.

understand the practices adopted by the company) in relation to the key requirements specified in the CG Code, the SGX Disclosure Guide (issued in January 2015) and the SGX Listing Rule 1207 (10) (the Listing Rule).

Disclosures on each of the 16 principles and 82 guidelines of the Code and the SGX Listing Rule 1207 (10) requirements were evaluated based on whether the disclosure was present, which would account for one-third of the score, and the quality of the disclosure if present, which would carry two-thirds of the score. The heavier weighting reflects the focus of this study on substance over form.

RESULTS OF THE STUDY

Figure 1 shows the results of the study.

Figure 1 Findings and results

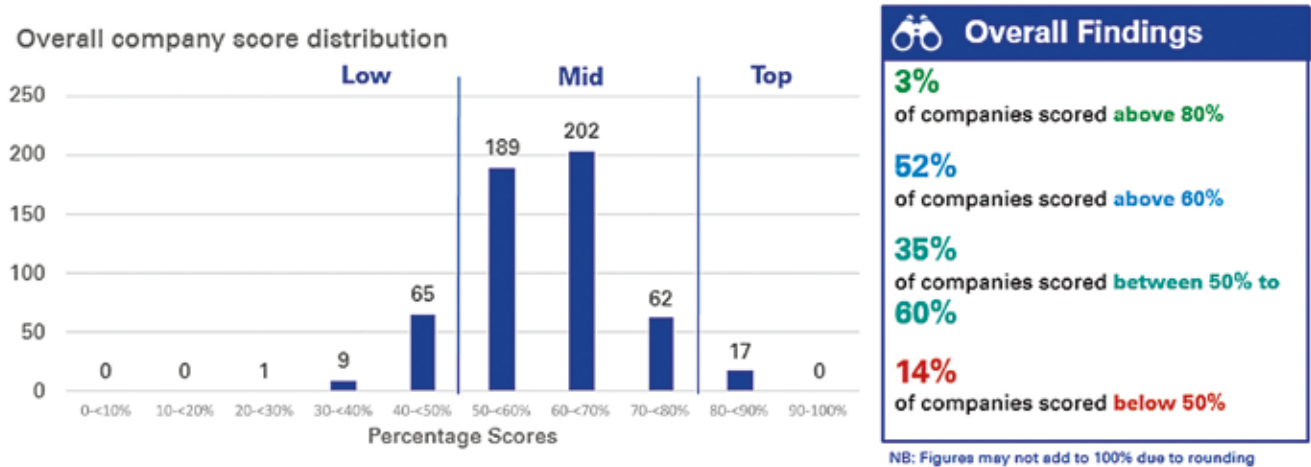
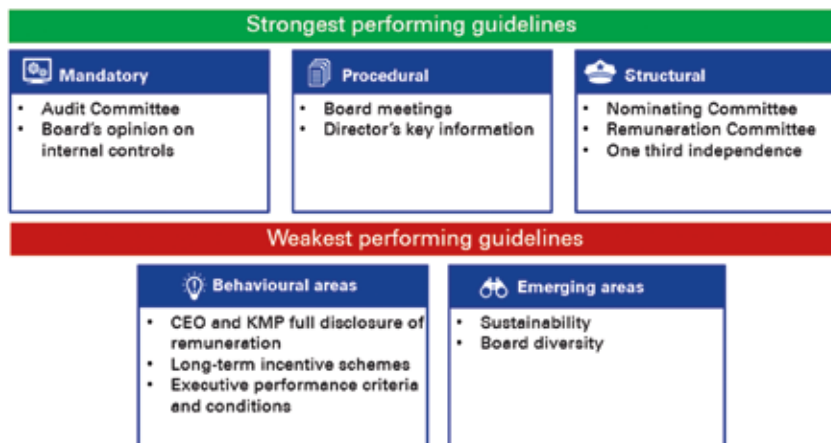


Figure 2 Corporate governance disclosure characteristics



Source: SGX-KPMG Study 2016

Disclosures were generally more forthcoming where the CG criterion in question was more structural (the Audit Committee scored 91%, Reumeration Committee 80% and Nomination Committee 83%); procedural in nature (Board meetings scored 87%), or supported by mandatory requirements (shareholder rights scored 71%) (Figure 2).

Improvement, however, is needed in areas that drive behaviour and culture (performance-linked remuneration scored just 50%) or are emerging practices (Board diversity scored 41%). Companies were silent on their compliance with a number of guidelines in the Code. Not only does this contravene the existing "comply or explain" requirement, it makes it challenging for the reader to determine whether the recommended CG best practice was actually applied by the company.

IMPLICATIONS FOR BOARDS AND PREPARERS OF ANNUAL REPORTS

There are a number of key areas on which directors and those responsible for compiling the CG disclosures can focus their attention, to improve the standard of the disclosures. These include self- accountability, self-assessment, benchmarking and assurance (Figure 3).

- **Accountability** Directors should ensure there is a process that builds accountability for CG disclosures across all levels of the company. This extends to having a clearly-defined process owner for each key CG practice.

In this regard, we have seen an emerging good practice to formally assign oversight responsibility for CG disclosures to a Board committee, such as a CG Committee, or a combined Nominating and CG Committee. Where such a body is established, it is important to formally define its terms of reference, and clarify communication channels between

committees with potentially overlapping roles. An example of a potential overlap is the Audit Committee (AC), which among other things, would typically oversee internal control practices and disclosures, and the Board Risk Committee (BRC), which looks at risk management processes, thereby overlapping with the internal control work of the AC.

- **Self-assessment** It's important that management conducts a self-assessment of the company's CG disclosures. The results should be presented to the Board, highlighting any gaps and mitigating measures. The assessment should not be a static description of the company's state of affairs. Instead, it needs to be a comparative view of how the company is growing and maturing in CG stature and development.
- **Benchmarking** Directors should also check how the company compares against relevant benchmarks, such as competitors in the same sector or with similar market capitalisation. This exercise yields a competitive advantage in that clear and transparent disclosures can help stakeholders to more easily assess if the practices adopted by the company are in line with their expectations.

Figure 3 Key areas of focus for directors and those in charge of CG disclosures



Figure 4 Risk governance structures



➤ **Assurance and review of CG disclosure** While the financials in the annual report are subject to an audit by the external auditors, there is no requirement that the underlying CG practice described in a specific disclosure needs to be formally and independently reviewed and verified to confirm that it exists and that it is accurately and completely represented in the disclosure. An emerging and leading practice is to seek an independent check, typically from the internal auditors, of the veracity and accuracy of the CG disclosures made.

THE FUTURE

The Monetary Authority of Singapore (MAS) has recently indicated that a review of the Code is being considered, and this has been welcomed by the industry. Any review would need to weigh the differing perspectives of the various stakeholders, including due consideration for some of the following potential changes:

➤ **Risk governance structures**

While most companies continue to assign responsibility for risk governance to the AC (Figure 4, Diagram 1), an increasing percentage is establishing an Audit and Risk Committee or BRC (Figure 4, Diagram 2). Companies should conduct a holistic review of the Board governance structure as emerging committees such as the CG Committee and Sustainability Committee also start to gain momentum (Figure 4, Diagram 3).

➤ **Risk culture** Companies should establish a risk culture framework which includes defining the “tone at the top”; embedding risk culture into daily business activities; establishing a formal risk management training programme, and establishing mechanisms to measure the effectiveness of risk culture.

➤ **Fraud risk management** As the frequency and scale of fraud-related events increase, companies should review the holistic fraud risk management framework in place to manage such risks. This framework should be integrated as part of the Enterprise Risk Management (ERM) framework to minimise duplication of effort and standardise the tools and approach to identify, assess, manage and mitigate fraud risks.

➤ **Risk management function resources and capabilities**

As stakeholder expectations continue to increase in relation to risk governance, companies need to reconsider the right operating model for their risk management activities. The key to this is clarifying the senior executive responsible for risk management and the scope and objectives of the risk function.

➤ **Risk disclosures** While the Code and the Listing Rule encourage companies to disclose key risk categories, there is no specific directive to disclose more detailed risk information. As the nature of the risks that companies face becomes more

complex, and the requirement to disclose Key Audit Matters and material misstatements of other information contained in the annual report comes into force, more granularity in disclosure will be expected. The aim is to give stakeholders comfort and assurance that the company has identified the key risks and is monitoring its potential severity, likelihood and velocity of impact.

➤ **Internal audit (IA)** While companies are forthcoming in the disclosures around the existence of an IA function, there is no visibility on the scope and depth of coverage in the audit plan for the year. The role could be more clearly defined to look beyond financial, operational, compliance and IT processes and controls, to review governance and culture, ERM, fraud risk management, crisis management, etc.

Although the KPMG study has shown that there is a robust level of disclosure for CG requirements, especially in structural areas, there are still significant areas for improvement, in particular in behavioural areas, although these are not currently specified in the Code. Boards, and those responsible for the preparation of annual reports, should focus on enhancing the disclosures for the current requirements, given that further obligations may be included in the next version of the Code. ISCA

Irving Low is Partner, Risk Consulting, KPMG Singapore.

THE NEED FOR SUSTAINABLE FINANCE

"Green" Finance Requires a Convergence of Policy and Profitability

FROM *PERSPECTIVES@SMU*

It is estimated that between US\$5–\$7 trillion of investment in green infrastructure globally would be required to mitigate the effects of climate change globally in order to meet the goals of the 2015 Paris Agreement.¹ It is clear that public finance cannot play a major role in funding this amount – the answer must lie in the private sector. However, goals for financial sustainability are often out of alignment with profitability goals in the real economy.

The Bank of England governor, Mark Carney, has stated that “there is a need to reset the financial system” so that the finance industry will be able to constructively help achieve the goals as set out in the September 2015 UN Sustainable Development Goals by 2030.²

This is more than simply redeploying funds to support sustainability initiatives. It is about taking concrete action to develop solutions to current problems in sustainability. Financial innovation is emerging through the efforts of multiple players in the financial system, such as central banks, stock exchanges and accounting bodies. Much of the innovation is coming from the emerging economies in Asia, Africa and Latin America, such as Mongolia, Kenya and Bangladesh.



PHOTO SHUTTERSTOCK



Green finance serves the interests of a sustainable society. The Sustainable Stock Exchanges initiative is one example of how regulatory bodies are working with the private sector to bring about awareness and discipline with regard to sustainability practices.

A COLLABORATIVE APPROACH

Green finance serves the interests of a sustainable society. The Sustainable Stock Exchanges (SSE) initiative is one example of how regulatory bodies are working with the private sector to bring about awareness and discipline with regard to sustainability practices. The SSE was founded in 2009 to introduce non-financial reporting for listed companies, encompassing environmental, social and corporate governance (ESG) dimensions.

This promotes corporate social responsibility on the one hand, and on the other, increases business reporting transparency to encourage sustainable investment.³ Sixty-one participating stock exchanges around the world, with a combined market capitalisation exceeding the world's GDP, collaborate on the following to encourage sustainable finance – teaching listed companies how to take part in sustainable reporting, issuing guidelines for ESG reporting, and sharing best practices on how private funds can be made available for sustainability projects, for example, “green bond” issuance.

¹ Matt Scuffham and Fergal Smith “BoE’s Carney warns of \$7 trillion green infrastructure need”, *Reuters*, 15 July 2016; www.reuters.com/article/us-britain-cenbank-climate-idUSKCN0ZV1PH

² Erik Solheim “Quiet financial revolution nurtures green growth”, *China Daily*, 6 September 2016, www.chinadaily.com.cn/opinion/2016-09/06/content_26709315_2.htm

³ “About the Sustainable Stock Exchanges (SSE) initiative”, SSE, www.sseinitiative.org/about/

★
... the pursuit of sustainable finance, at the end of the day, is a strategic choice by governments, dictated by the political economy.

In Kenya, other than marathon runners and safari tours, one other thing the country is famed for in certain circles is the peer-to-peer mobile payment platform, M-PESA. M-PESA came about in 2008 in response to people having to send information and money to those in the Nairobi slums during the chaotic post-election period. From there, the system became increasingly adopted and widespread. Nuru Mugambi, Director of Communications and Public Affairs, Kenya Bankers Association, shared, "The platform was so successful because the political economy and the culture were in place. In Kenya, before M-PESA, if you wanted to send someone money, it would mean a five-to 10-hour drive. Now, it is done very quickly. We also have the culture to send money, whether it is to help pay for hospital bills or to send someone to school. So, fintech exists in the context of society, and also whether innovation is accepted."

"Initially, the banks saw M-PESA as competition, but the central bank gave the approval for M-PESA to proceed on an experimental basis. Now, banks see M-PESA as co-competition, using M-PESA as a point of leverage to extend credit and other services."

The financial innovation of M-PESA has brought about unexpected social benefits to Kenya. The privately-run M-Kopa, which was able to receive instalment payments through the platform, started offering solar energy in electricity-starved parts of the country. Mugambi recounted, "Regulation is behind innovation. M-Kopa was struggling to get capital because investors could not understand its cash flows and the product."

Regulatory policy partnered with market innovation has thus helped to spur some businesses to bring about social good.

MAKING GREEN FINANCE SUSTAINABLE

Piyush Gupta, CEO of DBS Bank in Singapore, notes that the interest in green finance has escalated in recent years due to the confluence of two factors. "Technology, such as artificial intelligence, has changed the economics of the world today," he explained. "Previously, driving a sustainable development agenda was not supported by a commensurate return on capital invested. Today, financial inclusion is more compelling both from a distribution

and credit standpoint. Shareholders can be convinced to provide capital."

The second factor driving green finance to greater importance is that sustainable development has been put firmly on the agenda. Gupta elaborated, "Sustainability was not on the DBS board agenda until two years ago. Now we have issued our own set of ESG guidelines and have been spending a lot of time thinking about it."

"Singapore, which wants to be the fintech hub for Asia, has also done quite a lot in terms of regulatory development, such as the Monetary Authority sandbox. We've also built up

⁴"Ant Financial and UN Environment Sign a Memorandum of Understanding", *UNEP*, 5 September 2016, <http://unepinquiry.org/news/ant-financial-and-un-environment-sign-a-memorandum-of-understanding/>





platforms for financial inclusion and credit underwriting. Fintechs, banks and startups are starting to work together to solve problems.”

THE ROAD AHEAD

Simon Zadek, Visiting Professor DSM Senior Fellow in Partnership and Sustainability at SMU, talks about repurposing existing private sector products and services to support sustainability initiatives. Ant Financial, the Chinese payments platform which focuses on individuals and small businesses, has a wide reach. It has an estimated 600 million users, processes 170 billion transactions a year, and on days such as Singles’ Day, can peak at 83,000 transactions a second.

In 2016, Ant Financial leveraged on its extensive coverage and big data store to offer a green finance feature on its payment app. Working with the China Beijing Environmental Exchange, the company was able to calculate the carbon footprint for each of its users through their mobile usage.⁴ Users would be rewarded with carbon credits for performing better compared to their baseline carbon footprint.

“In the first three months of the service, 50 million people signed up,” Zadek said. “Carbon can be integrated into social identity formation through social media. Ant (Financial) has acquired a liability to plant a million trees.” This is a prime example of how private companies can repurpose

technology for public-good outcomes and public-gain technologies.

It is important to note that the pursuit of sustainable finance, at the end of the day, is a strategic choice by governments, dictated by the political economy. On the one hand, investors could be educated to fund, say, more renewable energy compared to coal. On the other hand, governments may decide that building a new coal plant could be the answer to creating more jobs. Policy and pricing need to go hand in hand, and regulators and the private sector will need to be aligned in order to collaborate on sustainability. **ISCA**

This article was first published in the January 2017 edition of *Perspectives@SMU*. Reproduced with permission.

TECHNICAL HIGHLIGHTS

IFRS LEASES IMPLEMENTATION WEBCAST SERIES

In response to feedback received from stakeholders, the IASB staff has recorded a webcast addressing modifications for lessees. In this webcast, IASB discussed the modification requirements in IFRS 16, and questions received from those currently implementing the new Standard. This webcast was published in March 2017. The subsequent webcast in the planned series, on lessee disclosure requirements, is expected to be published in May 2017.

For more information, please visit
www.ifrs.org/Alerts/ProjectUpdate/Pages/Leases-implementation-webcast-series.aspx

AUDITING AND ASSURANCE

ISCA COMMENTS ON IAASB DATA ANALYTICS PAPER

ISCA commends the IAASB's efforts in exploring the growing use of technology in audits to enhance audit quality. Generally, ISCA is of the view that the IAASB has done a comprehensive analysis of the circumstances and factors that impact the use of data analytics in a financial statement audit. ISCA also highlights challenges faced in the current business environment and suggests ways to address them.

For more information, please visit
<http://isca.org.sg/media/780179/iaasb-rfi-data-analytics-comment-letter-final.pdf>

ETHICS

ISCA ISSUES AMENDED EP 200

Amendments have been made to Ethics Pronouncement (EP) 200 to address the findings of the Financial Action Task Force in its Mutual Evaluation Report of Singapore. The amendments mainly relate to the area of customer due diligence and will be effective from 1 June 2017.

For more information, please visit
<http://isca.org.sg/ethics/ethics-headlines/ethics-headlines/2017/march/ep-200-amendments-effective-1-june-2017/>

IESBA RELEASES NEW Q&AS - RESPONDING TO NOCLAR

IESBA has released two Q&A publications to support the adoption and implementation of the IESBA's Non-Compliance with Laws and Regulations (NOCLAR) pronouncement, which will come into effect from 15 July 2017.

- The Q&As for professional accountants in public practice cover issues related to applicability, audits of financial statements, and professional services other than financial statement audits, and
- The Q&As for professional accountants in business (PAIBs) cover issues related to scope, PAIB responsibilities (for senior vs other PAIBs), organisational culture, and NOCLAR disclosure.

For more information, please visit
www.ifac.org/news-events/2017-02/iesba-staff-release-new-qas-responding-non-compliance-laws-regulations



Cutting Operational Costs through Centralisation of IT Assets

CHALLENGE

Established over a century ago, the client produces power systems for land vehicles, aircraft and ships. With many offices in the Asia-Pacific region, the client faced a huge challenge in managing the diverse IT infrastructures and multiple applications of the different entities. The large number of physical IT assets in these offices also led to escalating operational costs.

Seeking a solution, the client approached Stone Forest IT (SFIT) for assistance to centralise the management and support of all regional entities' IT assets in its Singapore office, as well as to strengthen business continuity.

SOLUTION

After evaluating the client's requirements, SFIT recommended the following actions:

- Migrate client's existing Sage 300 accounting system in China and data in all regional entities to a new centralised server in Singapore
- Grant business users in all regional entities access to Sage 300 via Remote Desktop Protocol (RDP)
- Establish robust information security controls and a disaster recovery plan to strengthen business continuity

RESULTS

Following implementation of the centralised system, the client has achieved several benefits:

- Cost-effective use of human resources as fewer employees are now required to manage the centralised system
- Greater data management efficiency and information security for all regional entities
- Peace of mind over business continuity

The successful deployment is a result of SFIT's extensive experience in providing clients with solutions to meet specific business needs.

HIGHLIGHTS

Industry:

Power Systems

Location:

Singapore

Solution:

Sage 300 migration and improved business continuity

Results:

- Significantly lower operational costs
- Cost-effective use of human resources
- Greater data management efficiency and information security
- Peace of mind over business continuity

BREAKTHROUGH WITH TP BENCHMARKING

All about Benchmarking Analysis



BY
FELIX WONG

Ten years ago, transfer pricing (TP) was still a relatively unfamiliar subject to many businesses. Fast forward to today and it has been pushed into the spotlight.

TP is widely recognised by C-suites to have a significant impact on business profitability, income tax paid, shareholder value and the overall risk management framework. Getting it wrong can potentially lead to huge tax bills or even negative exposure to the global media. It is therefore crucial for businesses, especially in this era of tax transparency, to ensure that their related party transactions are defensible in front of tax authorities. Central to it all is benchmarking analysis.

TP DOCUMENTATION

To minimise the risk of TP adjustments by tax authorities, companies must be able to satisfy the tax authorities that their related party transactions are indeed conducted at arm's length.¹ Often, the best defence for taxpayers in times of TP disputes is a well-thought-out TP policy supported by contemporaneous TP documentation.

¹ The arm's length principle is the international standard to guide TP. It requires the transaction with a related party to be made under comparable conditions and circumstances as a transaction with an independent party.

Applying the principles set out in the OECD's and IRAS' approaches, TP documentation should include the following in practice:

- + an introduction of the purpose, scope, regulatory environment and how the legislation applies;
- + company and industry analyses;
- + overview of international related party transactions and commercial and financial relations;
- + functional analysis and characterisation of entities;
- + selection of TP methods, and
- + application of the TP methodology (including benchmarking analysis and determination of arm's length result).

The company and industry analyses provide the big picture on the company's business model and the macro economic factors influencing the model. After the overview is set out, the functional analysis and characterisation of entities are performed to identify each party's role in the transaction (taking into account the functions performed, assets used and risks assumed) and to provide justification that the amount earned by each party commensurates with its respective contribution.

★
Benchmarking analysis is the backbone of TP documentation.



PHOTO SHUTTERSTOCK



Adriana Calderon, Director, Transfer Pricing Solutions Asia, shared her vast professional experiences on TP benchmarking

The benchmarking analysis involves the use of economic data to support the company's transfer prices. This is achieved by comparing a tested transaction with transactions entered between third parties in same or similar circumstances. Essentially, the benchmarking analysis is performed to validate, using comparable data that the price of the transaction was indeed carried out at arm's length.

"Benchmarking analysis is the backbone of TP documentation," explained Adriana Calderon, Director, Transfer Pricing Solutions Asia, at a recent *Tax Excellence Decoded* (TED) event organised by the Singapore Institute of Accredited Tax Professionals. "It uses economic data to support the taxpayer's prices agreed with related parties."

Indeed, a well-conducted benchmarking analysis is the backbone of TP documentation. It can provide strong support for the company in justifying that its transfer price has been determined as per the arm's length principle and based on commercial drivers, and hence mitigate the risk of undesired TP adjustments by tax authorities. The question then is: How should companies conduct their benchmarking analysis?

TECHNICAL EXCELLENCE

TRANSFER PRICING

BENCHMARKING ANALYSIS

There are four steps to a high-quality benchmarking analysis.

1 Determine the TP Method

Generally, related party transactions are characterised based on their nature. Common characterisations from a TP perspective include the following groups: (1) distribution transactions, (2) services transactions, (3) manufacturing transactions, (4) intercompany loans, and (5) transactions involving royalties.

The appropriate TP method should be selected based on the characterisation of the related party transaction and the entities (as determined by the functional analysis). There are five commonly-accepted TP methods:

(i) Comparable Uncontrolled Price (CUP)

The CUP method is a TP method that compares the price for properties or services transferred in a related party transaction to the price charged for properties or services transferred in an independent party transaction in comparable circumstances;

(ii) Cost Plus

The Cost Plus method focuses on the gross markup obtained by a supplier for property transferred or services provided to a related purchaser. Essentially, it values the functions performed by the supplier of the property or services;

(iii) Resale Price

The Resale Price method is applied when a product that has been purchased from a related party is resold to an independent party. Essentially, it values the functions performed by the “reseller” of a product;

(iv) Profit Split

The Profit Split method is based on the concept of splitting the combined profits of a transaction between related parties in a similar way as

how independent parties would under comparable circumstances;

(v) Transactional Net Margin Method (TNMM)

The TNMM is a TP method that compares the net profit relative to an appropriate base (for example, costs, sales, assets) that is attained by a taxpayer from a related party transaction to that of comparable independent parties.

Once the appropriate TP method is decided, the next step is to assess the data to use in the comparability analysis.

2 Assess the Data to Use

Comparable data may be internal or external. Internal comparables are transactions carried out by the tested party with unrelated companies in comparable circumstances to the tested transaction, while external comparables involve transactions between unrelated and independent companies, one of which is comparable to the tested party.

Typically, companies will start by examining if there are any existing internal arrangements where similar products or services are sold to both related and unrelated parties. In the absence of internal comparables, the company will have to perform benchmarking searches using databases for external comparables.

3 Consider Comparability Factors

More often than not, comparable data are not identical to the existing transaction. If so, how would companies know whether the comparable data used are indeed relevant to the tested transaction? It is important for companies to ensure that none of the differences (if any) between the transactions compared may materially affect the price or margin being compared, and that reasonably accurate adjustments can be made to eliminate the effect of such differences.



★
If your company is making significant related party transactions but you have not started thinking about TP, now is the time.

When identifying and comparing economically relevant characteristics of the transaction, companies should consider all of the following five comparability factors:

- ✚ characterisation of the property or service;
- ✚ functions performed by the parties (taking into account the assets used and risks assumed);
- ✚ contractual terms of the transaction;
- ✚ business strategies employed by each party, and
- ✚ economic circumstances affecting each party.

4 Select an Appropriate Database

There is a myriad of TP databases



available in the market, each of which may have its own strengths – some may contain more information on certain types of transactions, others may be better for certain geographical locations. In this regard, companies should ensure to use an appropriate database taking into consideration the nature of the tested transaction.

Performing a search for external comparables using a database

Navigating unfamiliar databases in search of appropriate external comparables can be daunting for the uninitiated. To conduct an effective search, it is essential for the company to have a clear idea of the tested transaction and the tested party at the start. By definition, the tested party is the one where a TP method can be applied in the most reliable manner, and most reliable comparables can be found. In practice, the tested party is typically the less complex entity (and not the entrepreneur).

After the company is clear on the tested transaction and tested party, it may then set its search strategy, taking into account comparability factors. To avoid manually looking through hundreds of irrelevant sets of data, bulk rejections criteria should be considered (for example, companies with incomplete financial data for the last three years may be excluded).

It is good practice to review the data in two stages. The company can first scan through the general information of the companies to create a shortlist of potential comparable companies. This can be followed by a more detailed review of the shortlisted comparables where annual reports and company websites are thoroughly examined.

Once the company has selected the appropriate comparables, it may proceed to carry out a financial analysis to calculate the appropriate arm's length range. In practice, it is generally advisable to ensure the transfer price falls within the interquartile range of the arm's length range and is as close as possible to the median.

The final and most important (yet oft-neglected) step when performing a search, is to document the entire search process for record-keeping purposes. Without proper documentation of the search process, tax authorities may not understand the rationale behind the company's search and as such, the company's transfer price may not be accepted.

OTHER NOTABLE AREAS

Most countries do not accept loss makers as comparables. In Singapore, the IRAS views persistently loss-making independent parties to be less reliable comparables than profit-making independent parties. Taxpayers are expected to exclude independent parties as comparables if they have a weighted average loss for the tested period or incurred loss for more than half of the tested period.

It cannot be emphasised enough that TP documentation must reflect the reality of the company's business and transactions. A simple interview with an employee, a public announcement by the company or even a generic review of publicly-available information can provide vital information about the company and alert tax authorities that the company's TP documentation is not reflective of its business. TP documentation that does not reflect business reality is of no value to the company in defending its TP position.

TP benchmarking is both a science and an art. While there are certain methodologies guiding the benchmarking process, judgements have to be exercised at certain points to arrive at a reasonable conclusion. One thing though is for sure, the tax authorities are focusing on this space. If your company is making significant related party transactions but you have not started thinking about TP, now is the time to do so. ISCA

Felix Wong is Head of Tax, SIATP. This article is based on SIATP's *Tax Excellence Decoded* session facilitated by Adriana Calderon, Director, Transfer Pricing Solutions Asia. For more tax insights, please visit www.siatp.org.sg.

GET STURDY AT TAX COMPLIANCE

Get It Right, Right from the Start



BY
FELIX WONG

As many companies get busy wrapping up their FY 2016 financial statements, the corporate income tax filing due date for Year of Assessment 2017 is inching closer and it is timely to review the salient points of tax compliance issues. Sharing their insights at a *Tax Excellence Decoded* technical session by the Singapore Institute of Accredited Tax Professionals (SIATP) were Lee Tai Tea, Doreen Chan, and Accredited Tax Practitioner (Income Tax) Nancy Ng from the Corporate Tax Division, Inland Revenue Authority of Singapore (IRAS).

CLASSIFICATION OF INCOME

Companies on tax incentive schemes, such as the Global Trader Programme (GTP) and Pioneer Incentive, may enjoy lower income tax rates on their qualifying income. The key challenge for these companies is to accurately classify the qualifying and non-qualifying income (as well as the accompanying expenses incurred to generate such income) into the correct tax categories.

Unsurprisingly, incorrect classification of income and expenses into the different tax categories ranks among one of the most common compliance errors for incentive

companies. For example, GTP companies often erroneously treat the income from sales to overseas persons as qualifying income even though the goods were purchased from local non-GTP suppliers (such income are non-qualifying for GTP purposes).

To reduce classification errors, companies are encouraged to familiarise themselves with the specific legislations or regulations of the incentives applicable to them. They may also consider allocating distinct tax codes to the different types of income and expenses to allow for easy identification and proper segregation into the different tax categories.

It is not uncommon for companies' allocation bases (for common expenses and capital allowances on common fixed assets) to come under IRAS' scrutiny. Therefore, it is advisable for companies to ensure careful thought is put into establishing their allocation bases and (where necessary) communicate their rationale in the tax schedules. Commonly-used allocation bases include turnover and gross profit margin.

FOREIGN-SOURCED DIVIDENDS

A Singapore resident company may enjoy tax exemption on its foreign-sourced dividend remitted into Singapore if the foreign headline tax rate is at least 15%, the foreign-sourced dividend has been subject to tax in the foreign jurisdiction, and the tax exemption is beneficial to the taxpayer. In some cases,





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companies may wrongly treat their foreign-sourced dividends as tax exempt when it may appear that the qualifying conditions are met, only to find out that they are not.

In a classic example, foreign-sourced dividend received from a Hong Kong-listed company may first appear to have met the “headline tax rate” condition (given Hong Kong’s corporate tax rate of 16.5%). However, as the company is incorporated in a tax haven jurisdiction (for example, Bermuda which has a tax rate of 0%), the “headline tax rate” condition is not met. Similarly, foreign-sourced dividend chargeable to tax under a special tax legislation where the highest stipulated tax rate is under 15% (such as Labuan in Malaysia) will likewise fail the “headline tax rate” condition (even though the country, in this case, Malaysia, has a headline tax rate of over 15%).

Apart from the “headline tax rate” condition, there may be occasions when foreign-sourced dividends remitted into Singapore are taxed in Singapore because they have not been subject to tax in the foreign jurisdiction. These could be due to special circumstances such as the foreign payer company being in a loss position.

FOREIGN EXCHANGE GAINS OR LOSSES

Generally, foreign exchange differences arising from the translation of year-end balances of foreign currency bank accounts into functional currencies are regarded as capital in nature and hence, neither

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Incorrect classification of income and expenses into the different tax categories ranks among one of the most common compliance errors for incentive companies.

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TAX COMPLIANCE

taxable nor deductible. Companies may designate a specific foreign currency bank account (designated bank account) solely for the purpose of receiving trade receipts and paying revenue expenses in a particular foreign currency. Where the account is not used for any other purpose other than the above designated purpose, IRAS is prepared to treat the account as revenue in nature. Foreign exchange differences arising from the translation of year-end balances in the designated bank account will be taxable or deductible.

NON-DEDUCTIBLE EXPENSES

Companies should note that deduction claims on expenses have to be made based on actual amounts (supported by receipts and invoices) and not estimates. Similarly, deduction claims for cost of sales should be made based on actual closing stock value and not projected figures.

Companies often erroneously claim tax deductions on private car expenses. While motor vehicle expenses incurred on goods and commercial vehicles (such as vans, lorries and buses) are deductible, no deduction is allowed on motor vehicle expenses incurred on S-plate cars, RU-plate cars and company cars even if they are used for business purposes.

If a company provides a monthly car allowance (instead of a reimbursement) to its employee for using his private car for business purposes, the expense will be deductible for the company (but taxable as part of employment income at the hands of the employee). In this scenario, the company will have to declare this car allowance in the employee's Form IR8A.

INTEREST EXPENSES

Interest expenses relating to non-income producing assets are not tax deductible. A common compliance mistake involves the claiming of tax deduction on interest expense incurred on the investment in shares which have not yielded any dividends.



In cases where the company cannot identify and track the use of an interest-bearing loan to specific assets financed by the loan and not all the assets are income-producing, the "total asset method" may be adopted to attribute the common interest expense to the various assets.

EXPENSES PERTAINING TO DOUBLE TAX DEDUCTION FOR INTERNATIONALISATION SCHEME

To promote expansion beyond Singapore, companies may claim automatic double tax deduction (DTD) up to \$100,000 on expenses incurred

on four qualifying activities under the DTD for Internationalisation Scheme. Expenditure exceeding \$100,000 will require approval from IE Singapore or Singapore Tourism Board.

Often, companies may wrongly claim expenses on activities that are not part of the four qualifying activities, or exceed the maximum cap of \$100,000 without seeking approval from the relevant authorities. Besides avoiding these mistakes, companies should also note that the Scheme is only applicable for qualifying expenditure on up to two employees per trip, mission or fair.



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Tax compliance is essential in any business and getting it right, right from the start, is key.

ENHANCED TAX DEDUCTION FOR R&D

Companies carrying out research and development (R&D)¹ may claim enhanced tax deduction on qualifying R&D expenditure (comprising staff costs and consumables) under section 14DA of the Income Tax Act. One typical mistake companies make is to claim enhanced tax deduction on post-R&D expenditure (such as repair or maintenance expenses) and capital expenditure (on plant and machinery) even though they are not qualifying R&D expenditure.

¹ More information can be found in IRAS' e-Tax guide on Research and Development Tax Measures

Companies that outsource their R&D projects should be aware that they are generally only entitled to claim 60% of the invoices expenses. They should also note that no enhanced tax deduction will be allowed if the company is an R&D service provider which conducts R&D on behalf of the customer or related company (where the R&D results are owned by the customer or related company).

CAPITAL ALLOWANCES

Capital allowances (CA) are deductions that companies can claim for wear and tear of plant and machinery bought and used in their

trade or businesses. They are, however, not meant for companies' stock-in-trade or other assets which are specifically prohibited under the Income Tax Act (such as S-plate private cars).

Companies are allowed to claim one-year write-off for low-value assets not more than \$5,000. However, many companies may not realise that the total claim for one-year write-off for such low-value assets is capped at \$30,000 per year of assessment.

DONATIONS

To ensure that companies are allowed to claim enhanced tax deductions on the donations that they have made to approved Institutions of Public Character (IPC), the donation receipts need to be in their names. Each company should ensure that its identification number (and not the identification number of a related or third party through which the donations may be made) is given to the IPC.

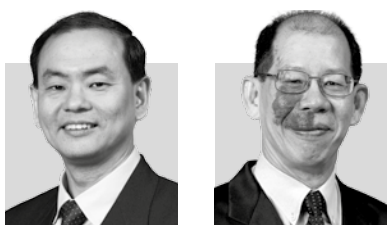
Tax compliance is essential in any business and getting it right, right from the start, is key. To minimise tax risks or resources diverted from the core business to manage tax queries and unnecessary tax penalties, not to mention the potential reputational risks from protracted tax disputes, effective internal controls and proper record-keeping are crucial. Of course, having a competent, trusted (and accredited) tax advisor would certainly help ensure a good night's rest too. ISCA

Felix Wong is Head of Tax, SIATP. For more tax insights, please visit www.siatp.org.sg.

DON'S COLUMN

AMENDMENTS TO FRS 12

Applicability in the Singapore Context



BY
TAN KIA GUAN, CLEMENT
AND NG ENG JUAN

On 11 March 2016, the Accounting Standards Council (ASC) issued Amendments to FRS 12: Recognition of Deferred Tax Assets for Unrealised Losses (hereafter referred to as the Amendments). The Amendments, which are effective for annual periods beginning on or after 1 January 2017, address the issue of recognition of deferred tax assets arising from deductible temporary differences.

As provided for in FRS 12: Income Taxes, “an entity recognises deferred tax assets only when it is probable that taxable profits will be available against which the deductible temporary differences can be utilised” (para 27).

The Amendments basically contain two new paragraphs that provide guidance on measuring the “taxable profits that will be available against which the deductible temporary differences can be utilised”, as follows:

- (i) In paragraph 27A, the Amendments provide that “when an entity assesses whether taxable profits will be available... it considers whether tax law



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restricts the source of taxable profits against which it may make deductions on the reversal of that deductible temporary difference”; and

- (ii) In paragraph 29A, the Amendments provide that “the estimate of probable taxable profit may include the recovery of some of an entity’s assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this”.

This article discusses and illustrates the provision of paragraph 27A of the Amendments in the context of carry-forward relief for capital allowances (CA), trade losses and donations under Singapore tax laws.

UNABSORBED CAPITAL ALLOWANCES, TRADE LOSSES AND DONATIONS

In Singapore, under the carry-forward relief, there are conditions that must be satisfied before the carry-forward amount of unabsorbed CA, trade losses and donations can be utilised. Specifically, a company can claim the unabsorbed CA, trade losses and donations as deductions against its future assessable income provided it satisfies the shareholding test. Additionally, for unabsorbed CA, an additional test (that is, same business test) must be satisfied, and any

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The implication of the Amendments is that where a company has unabsorbed CA, it will recognise deferred tax asset thereof only if it expects to have sufficient future taxable profits and that it expects to pass both the same business test and the shareholding test.

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unutilised amount of donations after five years will be disregarded.

If the company fails the same business test, its unabsorbed CA will be disregarded and will not be available for deduction against its future assessable income.

If the company fails the shareholding test, its unabsorbed CA, trade losses and donations will be disregarded and will not be available for deduction against its future assessable income.

If the company is unable to satisfy the shareholding test but is granted waiver of the shareholding test upon application to the Comptroller of Income Tax, then its unabsorbed CA, trade losses and/or donations can only be setoff against the future gains or profits derived from the same trade or business as that from which such unabsorbed items arose.

ILLUSTRATIVE EXAMPLE

Consider the following example: Company X, a trading company, has a 31 December year-end. During its current financial year ended 31 December 2016, it has unabsorbed CA of \$100,000 and trade loss of \$300,000 for the year of assessment (YA) 2017. Assume no previous unabsorbed trade losses, CA and donations are carried forward. Company X expects to be profitable in two years' time, that is, in the financial year ending 31 December 2018 (YA 2019).

Under the carry-forward relief, Company X will be able to utilise the unabsorbed CA for YA 2017 to setoff against its YA 2019 assessable income (from all sources) if it satisfies both the shareholding test and the same business test. It will also be able to utilise the unabsorbed trade losses for YA 2017 to setoff against its YA 2019 assessable income (from all sources) if it satisfies the shareholding test.

The same business test requires Company X to continue to carry on the same trade or business as that for which the YA 2017 CA are given, when

carrying forward the unabsorbed CA. This test is satisfied if the same trade or business is continued. However, if, for example, Company X changes its business from "trading" to "property development" in the year 2018, then the YA 2017 unabsorbed CA will not be available as a setoff against its assessment income for YA 2019.

The shareholding test compares the percentage of shareholdings of Company X that is held by the same persons as at the relevant dates. This test is satisfied if there is no substantial change in the percentage of shareholdings held by the same persons as at the relevant dates. There is no substantial change in shareholders if at least 50% of the company's total number of issued shares are held by the same persons as at the relevant dates.

To illustrate the shareholding test, assume the following shareholdings of Company X as at the relevant dates (Table 1).

For purposes of the unabsorbed CA, the relevant dates are 31 December 2017 (last day of the YA in which the CA were given) and 1 January 2019 (first day of the YA in which the CA are to be deducted). The same persons in this case are

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If the company is unable to satisfy the shareholding test but is granted waiver of the shareholding test upon application to the Comptroller of Income Tax, then its unabsorbed CA, trade losses and/or donations can only be setoff against the future gains or profits derived from the same trade or business as that from which such unabsorbed items arose.

shareholders A, C and D who hold shares on 31 December 2017 and 1 January 2019. As these same persons hold 80% of the total shareholdings on 31 December 2017 but less than 50% of the total shareholdings on 1 January 2019, Company X fails the shareholding test and hence will not be able to utilise the unabsorbed CA to setoff against

Table 1 Shareholdings of Company X

Shareholders	Relevant date as at		
	31 December 2016	31 December 2017	1 January 2019
	Shareholding %	Shareholding %	Shareholding %
A	30	20	10
B	30	20	
C	40	40	10
D		20	20
E			60
Total	100	100	100



its future assessable income (YA 2019) even if it carries on the same trade or business.

For purposes of the unabsorbed trade losses, the relevant dates are 31 December 2016 (last day of the year in which the trade losses were incurred) and 1 January 2019 (the first day of the YA in which the trade losses are to be deducted). The same persons in this case are shareholders A and C who hold shares on 31 December 2016 and 1 January 2019. As these same persons hold 70% of the total shareholdings on 31 December 2016 but less than 50% of the total shareholdings on 1 January 2019, Company X fails the shareholding test and hence will not be able to utilise the unabsorbed trade losses for setoff against its future assessable income (YA 2019).

In this illustration, both the unabsorbed CA and trade losses will be disregarded. However, Company X may apply for waiver of the shareholding test if the substantial change in shareholders is due to the following circumstances:

- (a) Change is carried out for genuine commercial reasons and not for the purpose of deriving any tax benefit or obtaining any tax advantage;
- (b) Nationalisation of Company X;
- (c) Privatisation of Company X, or
- (d) Stocks of Company X or that of its holding parent company are being publicly listed and traded on a recognised stock exchange.

Where the waiver is granted, Company X can only setoff its unabsorbed CA, trade losses and

donations against the future gains or profits derived from the same trade or business as that from which such unabsorbed items arose.

IMPLICATION

The implication of the Amendments is that where a company has unabsorbed CA, it will recognise deferred tax asset thereof only if it expects to have sufficient future taxable profits and that it expects to pass both the same business test and the shareholding test.

Also, where a company has unabsorbed trade losses and donations, it will recognise deferred tax asset thereof only if it expects to have sufficient future taxable profits and that it expects to pass the shareholding test.

Where the company does not expect to satisfy the shareholding test but expects to be granted waiver of the shareholding test upon application (for example, in cases where it expects to be listed on the Singapore Exchange, or be acquired by another company due to privatisation or nationalisation), then it should recognise deferred tax assets only to the extent of future gains or profits derived from the same trade or business as that from which such unabsorbed items arose.

CONCLUSION

For a Singapore company to recognise deferred tax assets in relation to its unabsorbed CA, trade losses and donations, it should comply with the new provisions of the Amendments. Specifically, it should take into account the same business test and the shareholding test, and if it fails the shareholding test, to consider whether it qualifies for the waiver of the shareholding test that restricts the source of taxable profits against which the unabsorbed CA and trade losses may be utilised. *ISCA*

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Prizes Up for Grabs

Stand to win the book of your choice! Simply email your answers to the quiz questions to comms@isca.org.sg by 24 April 2017. Please provide your full name, NRIC number, mailing address, contact number and the book you're interested in.

QUIZ

1 In "Financial Due Diligence", good management is more important than honest management when it comes to the success of a company.

A True
B False

2 In "Get Sturdy at Tax Compliance", incorrect classification of income and expenses into the different tax categories ranks among one of the most common compliance errors for incentive companies.

A True
B False

3 In "Breakthrough with TP Benchmarking", a well-conducted benchmarking analysis provides strong support for the company in justifying that its transfer price has been determined as per the arm's length principle and based on commercial drivers, and hence mitigate the risk of undesired TP adjustments by tax authorities.

A True
B False

CONGRATULATIONS

MARCH QUIZ WINNERS: **Kimberly Clemen Yap**
Sxxx022G

Arief Lesmana Constantine
Sxxx035J

Peh Yew Mian
Sxxx607C

Answers for March quiz: (1) A, (2) B, (3) A



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