The KPMG Guide:
Improvements to Financial Reporting Standards
incorporating FRSs 101, 108, 116, 117 and 124
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Introduction

The Malaysian Accounting Standards Board ("MASB") embarked on an improvements project in July 2004 to review 13 of its existing Financial Reporting Standards ("FRSs"). The objective of MASB in undertaking the improvements project was to reduce or eliminate alternatives, redundancies and conflicts within the standards, in a bid to converge with the revised International Accounting Standards ("IASs") issued by the International Accounting Standards Board ("IASB").

The 13 FRSs affected by the improvements project are:

- FRS 101 2004 Presentation of Financial Statements
- FRS 102 2004 Inventories
- FRS 108 2004 Accounting Policies, Changes in Accounting Estimates and Errors
- FRS 110 2004 Events After the Balance Sheet Date
- FRS 116 2004 Property, Plant and Equipment
- FRS 117 2004 Leases
- FRS 121 2004 The Effects of Changes in Foreign Exchange Rates
- FRS 124 2004 Related Party Disclosures
- FRS 127 2004 Consolidated and Separate Financial Statements
- FRS 128 2004 Investments in Associates
- FRS 131 2004 Interests in Joint Ventures
- FRS 132 2004 Financial Instruments: Disclosure and Presentation
- FRS 133 2004 Earnings per Share

This KPMG Guide aims to highlight and provide guidance on the main changes from the following 5 FRSs, while the changes to some of the other FRSs will be covered in separate KPMG Guides:

- FRS 101 2004 Presentation of Financial Statements
- FRS 108 2004 Accounting Policies, Changes in Accounting Estimates and Errors
- FRS 116 2004 Property, Plant and Equipment
- FRS 117 2004 Leases
- FRS 124 2004 Related Party Disclosures

The revised standards will apply to financial periods beginning on or after 1 January 2006.
Executive summary

**FRS 101, Presentation of Financial Statements:**

- Significant new requirements for disclosure are introduced as follows:
  - judgements made by management in applying the accounting policies that have the most significant effect on the amounts recognised in the financial statements; and
  - key assumptions concerning the future, and other sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.
- A range of its existing requirements have been clarified namely:
  - “impracticable” is now defined; and
  - new criteria for classifying assets and liabilities as current.
- FRS 101 rationalises the topics covered as opposed to FRS 101 2004, *Presentation of Financial Statements*:
  - the requirements and guidance on choosing appropriate accounting policies have been moved to FRS 108, *Accounting Policies, Changes in Accounting Estimates and Errors*; and
  - the presentation requirements for profit or loss for the period, formerly contained in FRS 108 2004, *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies* have been transferred to this standard.
- There are no transitional provisions contained in FRS 101 and therefore, any changes in accounting policies, including those affecting presentation, should be adopted retrospectively, unless impracticable.

**FRS 108, Accounting Policies, Changes in Accounting Estimates and Errors:**

- FRS 108 rationalises the topics covered as opposed to FRS 108 2004.
- The criteria on when to make retrospective adjustments have been tightened up, in particular when to adjust retrospectively for errors and when an entity can assert that adjustment is “impracticable”, and when it cannot.
- Disclosure of changes in accounting policies, changes in accounting estimates and correction of errors have been improved. FRS 108 now requires an entity to disclose impending changes in accounting policies when an entity has yet to implement a new standard or an interpretation that has been issued but has not yet come into effect. The extent of disclosure required include an estimation of the possible impact that application of the new standard or interpretation will have on the entity’s financial statements in the period of initial application.
- There are no transitional provisions contained in FRS 108 and therefore any changes in accounting policies or correction of errors, should be adopted retrospectively, unless impracticable.

**FRS 116, Property, Plant and Equipment:**

- Each part of an item of property, plant and equipment (“PPE”) with a cost that is significant in relation to the total cost of the item shall be depreciated separately.
- The revised definition of residual value effectively means that the residual value of most assets is likely be immaterial. FRS 116 requires the effect of inflation to be taken into account in arriving at the residual value. The justification of non-depreciation on
Executive summary (cont’d)

the basis of high residual value (therefore immaterial depreciation charges) is no longer valid.

- The cost of a major overhaul or inspection is treated as a part (“component”) of the costs of an asset.
- The costs of dismantlement, removal or restoration should be included in the cost of property, plant and equipment.
- Depreciation of PPE is to continue until the asset is derecognised, even during the period the asset is idle.
- PPE acquired in a swap is measured at fair value unless it lacks commercial substance or the fair value of the assets exchanged cannot be reliably measured.

FRS 117, Leases:

- Leasehold land and buildings are now required to be split into two elements in determining their classification as finance or operating lease.
- Since land has an indefinite economic life, if the title for a lease on the land does not pass to the lessee by the end of the lease term, the lease is deemed an operating lease. Such leasehold land is no longer classified as property, plant and equipment but classified as “prepaid lease payments”.
- A leasehold property held under an operating lease which meets the definition of investment property may be accounted for as an investment property, subject to fulfilling certain criteria.
- Initial direct costs are now defined (e.g. commissions, legal fees and internal costs that are incremental and directly attributable to negotiating and arranging a lease, but exclude general overheads) and prohibited from being immediately expensed off.
- The carrying amount of a leasehold land that had been revalued under FRS 116, Property, Plant and Equipment is to be regarded as the surrogate carrying amount of “prepaid lease payments”.

FRS 124, Related Party Disclosures:

- The scope restriction to public listed companies and their subsidiaries has been removed and FRS 124 now applies to all entities (except exempt entities - see SOP 1), including state controlled enterprises. The revised standard requires related party disclosures in the separate financial statements of a parent, venturer or investor.
- The identities of related parties are no longer required to be disclosed.
- The home-grown scope exemption from making related party disclosures if it interferes with confidentiality protected by various laws has not been retained.
- The term “key management personnel” has been included in the definition in the revised standard and now clearly includes non-executive directors.
- Disclosure of the entity’s parent and ultimate controlling party (if different).
- Additional disclosure of the next most senior parent that produces financial statements available for public use, if neither the parent nor the ultimate controlling party do so.
- Sub-classification of amounts payable to, and receivable from, related parties into different categories of related parties.
- Disclose that the terms of related party transactions are equivalent to those that prevail in arm’s length transactions only if such terms can be substantiated.
1. **FRS 101, *Presentation of Financial Statements* (supersedes FRS 101*2004*)

**Executive summary**

FRS 101, *Presentation of Financial Statements*, following the amendments to IAS 1, *Presentation of Financial Statements*, is still the back-bone to all the other financial reporting standards. For example, it contains the general rules concerning the presentation of a true and fair view, the format of the balance sheet, income statement and statement of changes in equity, and disclosure requirements, such as the name of the ultimate parent entity, that are applicable to all financial statements.

- Significant new requirements for disclosure are introduced as follows:
  - judgements made by management in applying the accounting policies that have the most significant effect on the amounts recognised in the financial statements; and
  - key assumptions concerning the future, and other sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.
- Existing requirements have been clarified as follows:
  - “impracticable” is now defined; and
  - new criteria for classifying assets and liabilities as current.
- FRS 101 rationalises the topics covered, as opposed to FRS 101*2004*: *Presentation of Financial Statements*:
  - the requirements and guidance on choosing appropriate accounting policies have been moved to FRS 108, *Accounting Policies, Changes in Accounting Estimates and Errors*; and
  - the presentation requirements for profit or loss for the period, formerly contained in FRS 108*2004*, *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies* have been transferred to this standard.
- There are no transitional provisions contained in FRS 101 and therefore, any changes in accounting policies, including those affecting presentation, should be adopted retrospectively, unless impracticable.

1.1 **New definition for “impracticable”**

The standard now contains a definition of “impracticable”, being that something is impracticable when the entity cannot apply it after making every reasonable effort to do so. “Impracticable” is retained as the only get-out from requirements to restate comparatives. It also has been included as the only get-out from the new requirements to discuss sources of key estimation uncertainty as discussed below. The proposal in the exposure draft, which was to relieve entities from these requirements if they would cause undue cost or effort, has not been retained. The reasoning for this is given in BC38 - 40 of the Basis of Conclusions to FRS 101.

1.2 **Fair presentation and departures from FRSs**

FRS 101 now contains a definitive statement as to what is required in order to give a true and fair view. This now emphasises that a fair presentation requires faithful representation of the effects of transactions, other events and conditions in accordance with MASB’s Discussion Paper 1, A Proposed Framework for Preparation and Presentation of Financial Statements (“Proposed Framework”)’s definitions and recognition criteria for assets, liabilities, income and expenses.
Compliance with FRSs, with additional disclosure as necessary, is presumed to give a true and fair view.

The standard still expects that true and fair overrides will be extremely rare where application of FRSs would be so misleading and reiterates that, in virtually all circumstances, a true and fair view is achieved by compliance with applicable FRSs. A fair presentation requires an entity to present information in a manner that provides information that is:

- relevant;
- reliable;
- comparable; and
- understandable.

Where a true and fair override has been invoked, FRS 101 now explicitly requires continuing disclosure if the departure in a prior period still has a consequential effect on the amounts recognised in the current period.

### 1.3 Classification of assets and liabilities

The requirements and guidance relating to the classification of current and non-current assets and liabilities have been clarified. FRS 101.51 requires a balance sheet to be classified between current and non-current assets and current and non-current liabilities. A balance sheet presentation based on the order of liquidity would be acceptable only when it provides more reliable and relevant information.

#### 1.3.1 Criteria for classifying assets as current

FRS 101.57 defines current assets as those assets that:

- are either expected to be realised in, or are held for sale or consumption in, the normal course of the entity’s operating cycle;
- held primarily for trading purposes;
- expected to be realised within 12 months of the balance sheet date; or
- cash or a cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least 12 months after the balance sheet date.

Therefore, an item or an asset held for trading will always be a current asset.

Operating cycle refers to the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. In the case of property development entities, the normal operating cycle may range from 2 to 3 years and as such land held for property development is classified as current (as property development costs) when development activities have commenced and where it can be demonstrated that such activities can be completed within the operating cycle.

FRS 101.68A requires that a non-current asset that is classified as held for sale and the assets of a disposal group classified as held for sale should be presented separately from other assets in the balance sheet. Likewise, the liabilities of a disposal group classified as held for sale should be presented separately from other liabilities in the balance sheet. Those assets and liabilities shall not be offset and presented as a single amount.

#### 1.3.2 Criteria for classifying liabilities as current

Liability is classified as current when it satisfies any of the following criteria:

- it is expected to be settled in the entity’s normal operating cycle;
- it is held primarily for trading purposes;
The presentation requirements for profit or loss for the period, formerly contained in FRS 108 2004, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies have been transferred to FRS 101.

Extraordinary items are banned

FRS 101 specifically prohibits the presentation of income and expense items as “extraordinary”. Currently this topic is dealt with in FRS 108 2004 (superseded by FRS 108), which allows extraordinary items in some extremely rare circumstances. By implication, once FRS 101 becomes effective, the term “ordinary activities” becomes redundant and should be avoided.

FRS 101 BC14 to 18 discuss the rationale for the ban; extraordinary items result from the normal business risks faced by the entity and as such do not warrant presentation in a separate component of the income statement. The nature or function of a transaction or other event, rather than its frequency, should determine its presentation within the income statement. Items currently classified as “extraordinary” are only a subset of the items of income and expense that may warrant disclosure to assist users in predicting an entity’s future performance.

Separate disclosure required for individually material items

The requirement to disclose individually significant items, which is currently in FRS 108 2004, has also been moved to FRS 101. However, instead of the FRS 108 2004 requirement to disclose items that are of “such size, nature and incidence that their disclosure is relevant to explain the performance of the entity for the period”, FRS 101 now simply states that when items of income and expense are material, their nature and amount shall be disclosed separately.

FRS 101 includes the same list of examples of individually material items, such as restructurings, litigation settlements and disposals of investments, used in FRS 108 2004.
Management will have to make new disclosures concerning key sources of estimation uncertainty and other judgements made in the application of accounting policies (101.113, 116)

1.4.4 Amended disclosure requirement on face of income statement

FRS 101 requires separate disclosure on the face of the income statement of “profit or loss attributable to minority interest” and “profit or loss attributable to equity holders of the parent”.

FRS 101 removes the requirement to disclose “results from operating activities” as a line item on the face of the income statement. The reason for this is that “operating activities” are not defined in the standard and the IASB decided not to require disclosure of an undefined item. However, an entity may elect to disclose the results of operating activities or similar line items, even though this term is not defined. In such cases, the IASB notes in BC13 that the entity should ensure the amount disclosed is representative of activities that would normally be considered to be “operating”.

1.5 New disclosure on judgements made by management

FRS 101 introduces significant new disclosure requirements concerning judgements made by management in the process of applying the entity’s accounting policies that have the most significant effect on the amounts recognised in the financial statements.

An entity is required to disclose in the summary of significant accounting policies or other notes, as appropriate, management’s judgement in respect of the following:

- judgements made by management, apart from those involving estimations, in applying its accounting policies that have the most significant effect on the amounts recognised in the financial statements; and
- key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

1.5.1 Disclosure on key sources of estimation uncertainty

In respect of the disclosure concerning key sources of estimation uncertainty, the nature and carrying amount of the affected assets and liabilities should be disclosed.

The key assumptions and other key sources of estimation uncertainty disclosure relate to the estimates that require management’s most difficult, subjective or complex adjustments. As the number of variables and assumptions affecting the possible future resolution of the uncertainties increases, those judgements become more subjective and complex, and the potential for a consequential material adjustment to the carrying amounts of assets and liabilities normally increases accordingly.

An accounting estimate may be considered critical if:

- the estimate requires management to make assumptions about matters that were highly uncertain at the time the estimate was made;
- different estimates reasonably could have been used;
- changes in the estimate that would have a material impact on the Group’s financial condition or results of operations are reasonably likely to occur from period to period.

Generally, the disclosure of individually material items can be on the face of the income statement or in the notes, depending on management’s judgement (101.83 - 84)

Whether or not disclosure of such items should be on the face of the income statement or in the notes is left to the judgement of management, as the requirement is that additional line items shall be presented on the face of the income statement when such presentation is relevant to an understanding of the entity’s financial performance. However, there are separate rules being introduced in respect of discontinued operations, which do require primary statement disclosure. Further details are in the KPMG Guide discussing FRS 5, Non-current Assets Held for Sale and Discontinued Operations.

Information to be presented on the face of the income statement (101.81 - 82, BC12 - 13)

The disclosures of information relating to key sources of estimation uncertainty would involve sensitivity analysis and explanations of changes in past assumptions (101.116 - 124)
The following are examples of accounting estimates:

- bad debts;
- inventory obsolescence;
- fair value of financial instruments;
- fair value in a business combination;
- fair value of property;
- useful life of, or expected pattern of consumption of the future economic benefits embodied in, depreciable assets; and
- warranty obligations.

In respect of the additional information needed, guidance in FRS 101 states that the nature and extent of information provided varies according to the nature of the assumption and other circumstances. However, it also lists examples of the types of disclosures made:

- the nature of the assumption or other estimation uncertainty;
- the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity;
- the expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected; and
- an explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved.

This list indicates that the information required could be far more revealing than current disclosures. However, no example disclosure is given in the standard and, in some cases, following the requirements of existing standards may already satisfy this new requirement. The examples given include:

- FRS 137, Provisions, Contingent Liabilities and Contingent Assets, requires disclosure, in specified circumstances, of major assumptions concerning future events affecting classes of provisions;
- FRS 132, Financial Instruments: Disclosure and Presentation, requires disclosure of significant assumptions applied in estimating fair values of financial assets and financial liabilities that are carried at fair value;
- FRS 116, Property, Plant and Equipment, requires disclosure of significant assumptions applied in estimating fair values of revalued items of property, plant and equipment.

The disclosure on key assumptions concerning the future and other key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year as required in paragraph 116 of FRS 101 is not required for assets and liabilities if, at balance sheet date, they have been measured at fair value based on recently observed market prices because using observed market prices (i.e. fair values) obviates the need for estimates.

Appendix 1 provides examples of disclosures of key sources of estimation uncertainty as required by FRS 101.116.

### 1.5.2 Disclosure on judgements made by management in applying accounting policies

In respect of disclosing judgements made by management, other than those involving estimations, in applying the accounting policies, it appears from the discussion in FRS 101 that in some instances the disclosure will be a more detailed disclosure of accounting policy and in other cases, the disclosure may be of how judgement has been used in applying the policy to an individual circumstance. Examples given include:

- deciding whether financial assets will be held to maturity;
whether certain sales of goods are in substance financing arrangements and therefore should not give rise to revenue; and 

whether the substance of a relationship with a special purpose entity indicates that it should be consolidated.

FRS 101 acknowledges that requirements in this respect may already be included in other FRSs. Examples given include:

- FRS 127, *Consolidated and Separate Financial Statements*, requires disclosure of the reasons why an entity’s ownership interest does not constitute control in respect of an investee that is not a subsidiary even though more than half of its voting or potential voting power is owned directly or indirectly through subsidiaries;

- FRS 140, *Investment Property*, requires disclosure of the criteria developed by the entity to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business, when classification of the property is difficult.

Appendix 2 provides examples of disclosure notes on judgements made in applying accounting policies as required by FRS 101.113.

Where it is impracticable to disclose the extent of the possible effects of a key assumption or another key source of estimation uncertainty at the balance sheet date, the entity has to disclose that:

> “it is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the asset or liability affected.”

In all cases, the entity discloses the nature and carrying amount of the specific asset or liability (or class of assets or liabilities) affected by the assumption.

### 1.6 Other changes

#### 1.6.1 Minority interests are now part of equity

Under FRS 101 minority interests are to be treated as part of equity and not as a deduction from net assets as minority interest does not meet the definition of a liability. It follows that on the face of the income statement the total profit or loss for the period will be “allocated” between the minority interest and equity holders of the parent.

Similarly, a reconciliation of movements in minority interests will need to be disclosed, either in the statement of changes in equity or in the notes, in the same way as is currently disclosed for all other categories of equity (such as share capital, retained earnings etc.).

Appendix 3 illustrates a possible format of consolidated balance sheets, income statements and statements of changes in equity that illustrates the disclosure required by FRS 101.

#### 1.6.2 Choosing accounting policies

Finally, the requirements and guidance on choosing appropriate accounting policies have been moved from FRS 101 to FRS 108.
2. **FRS 108, Accounting Policies, Changes in Accounting Estimates and Errors** (supersedes FRS 1082004)

## Executive summary

- FRS 108 rationalises the topics covered as opposed to FRS 1082004, *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*.
- The criteria on when to make retrospective adjustments have been tightened up, in particular when to adjust retrospectively for errors and when an entity can assert that adjustment is “impracticable”, and when it cannot.
- Disclosure of changes in accounting policies, changes in accounting estimates and correction of errors have been improved. FRS 108 now requires an entity to disclose impending changes in accounting policies when an entity has yet to implement a new standard or an interpretation that has been issued but has not yet come into effect. The extent of disclosure required include an estimation of the possible impact that application of the new standard or interpretation will have on the entity’s financial statements in the period of initial application.
- There are no transitional provisions contained in FRS 108 and therefore any changes in accounting policies or correction of errors, should be adopted retrospectively, unless impracticable.

### 2.1 Selection of accounting policies

The requirements relating to choosing appropriate accounting policies have been moved from FRS 1012004, *Presentation of Financial Statements*, to FRS 108. The requirements are similar to the existing FRS 1012004 text.

FRSs set out accounting policies that the MASB has concluded result in financial statements containing relevant and reliable information about transactions, other events and conditions to which they apply. Those policies need not be applied when the effect of applying them is immaterial. However, they include the warning that it is inappropriate to make, or leave uncorrected, immaterial departures from FRSs to achieve a particular presentation of an entity’s financial position, financial performance or cash flows. For example, changing the classification of assets from non-current to current to rectify a net current liability position.

In the absence of available accounting policies, management is required to use judgement in developing and applying accounting policies that will achieve information that is relevant and reliable (i.e. represents faithfully, reflect substance over form, is prudent, free from bias (neutral) and complete).

### 2.2 Consistency required in application of accounting policies

Entities are required to apply accounting policies consistently for similar transactions unless otherwise allowed by another standard or interpretation.

### 2.3 Changes in accounting policies

An accounting policy, once adopted, can only be changed provided the change is required by a standard or interpretation. An entity can also change existing accounting policies if and only if the change results in financial statements that provide reliable and more relevant information in respect of the entity’s financial position, financial performance or cash flows.
It should be noted that the following are not changes in accounting policies:

- the application of an accounting policy for transactions that differ in substance from those previously occurring; and
- the application of a new accounting policy for transactions that did not occur previously or were immaterial.

2.4 Applying changes in accounting policies

2.4.1 Retrospective application is required

FRS 108 requires an entity to account for a change in accounting policy resulting from the initial application of a standard or an interpretation in accordance with the specific transitional provisions. FRS 108 also requires voluntary changes in accounting policies to be applied retrospectively i.e., as if the new accounting policy had always been applied, by adjusting the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period.

2.4.2 Removal of allowed alternative treatment in FRS 1082004

The standard also removes the allowed alternative treatment previously provided in FRS 108 2004. As a result, comparative information for prior periods is presented as if new accounting policies had always been applied.

This is in contrast to the current FRS 108 2004 which allows presentation in the current period income statement of the adjustment resulting from changing an accounting policy or the amount of a correction of a fundamental error, with comparative information from financial statements of prior periods presented unchanged.

2.4.3 Limitations on retrospective application

An entity shall apply the change in accounting policy retrospectively except to the extent that it is impracticable to determine either:

- the period-specific effects; or
- the cumulative effect of the change.

When it is impracticable to determine the period-specific effects of changing an accounting policy on comparative information for one or more prior periods presented, the entity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period. In this respect, the entity shall also make a corresponding adjustment to the opening balance of each affected component of equity for that period.

When it is impracticable to determine the cumulative effect, at the beginning of the current period, of applying a new accounting policy to all prior periods, the entity is required to adjust the comparative information to apply the new accounting policy prospectively from the earliest date practicable.

2.5 Fundamental errors vs. other material errors

There is no longer a distinction between fundamental errors and other material errors. This means that all material errors (or immaterial errors made intentionally to achieve a particular presentation of an entity’s financial position, financial performance or cash flows), should be corrected through
prior period adjustments, to the extent practicable, together with disclosure of the details of the error and corrections made. This includes earnings per share (”EPS”) amounts under FRS 133, *Earnings per Share*, if the entity is required to disclose EPS. FRS 108 now includes a definition of ”material”, which is the same as is included in FRS 101.

2.6 Correction of material prior period errors

2.6.1 Retrospective application is required

As highlighted above, FRS 101 removes the allowed alternative treatment for corrections of errors. Consequently, an entity would no longer be permitted to include the amount of the correction of an error in profit or loss for the current period and present comparative information as it was reported in the financial statements of prior period.

Instead, the correction of an error would be accounted for retrospectively in the first set of financial statements authorised for issue after their discovery by:

– restating the comparative amounts for the prior period presented in which the error occurred;

or

– if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

2.6.2 Limitations on retrospective restatement

The “impracticable” clause that limits the application of retrospective restatement is the same as that available for changing accounting policies i.e. an entity is required to correct material prior period errors retrospectively except to the extent that it is impracticable to determine either:

– the period-specific effects; or

– the cumulative effect of the change.

When it is impracticable to determine the period-specific effects of an error on comparative information for one or more prior periods presented, the entity shall restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable, which may be the current period.

When it is impracticable to determine the cumulative effect, at the beginning of the current period, of an error on all prior periods, the entity is required to restate the comparative information to correct the error prospectively from the earliest date practicable.

2.7 “Impracticable”

The standard contains some fairly detailed rules and guidance on the meaning of “impracticable”, presumably to tighten up on its use to justify not restating comparative information for prior periods or making required disclosures. There is an overriding requirement that entities should make every reasonable effort to apply a requirement before deciding that it is impracticable. This includes doing partial restatement to the extent practicable, even when full retrospective adjustments are impracticable. The reasoning for this is discussed in the Basis of Conclusions section.

However, FRS 108 also states that if the retrospective adjustments would require assumptions about what management’s intent would have been, or it is impossible to distinguish objectively what information provides evidence of what the circumstances were at the relevant past date, that would indicate that adjustment is impracticable.
More detailed disclosures are required

This includes disclosure of impending changes in accounting policies when an entity has yet to implement a new standard or an interpretation that has been issued but has not yet come into effect. Previously such disclosures were encouraged by FRS 108 2004, but not required. Note, however, that as FRS 108 does not come into effect until 1 January 2006, this requirement need not be applied in 2005 to disclose the effects of all the other changes the MASB is making this year.

Example disclosure note

Preparers of financial statements may use the following wording in the notes to the financial statements for the last financial year before the new/revised standards become effective to describe the possible impact of their future application:

“The Malaysian Accounting Standards Board has issued a number of new and revised Financial Reporting Standards (“FRSs”) which are effective for financial years beginning on or after 1 January 20X7.

The Group has not early adopted these new FRSs in the financial statements for the year ended [Date]...

i) Additional wording for situation 1 where the Group has commenced an assessment but is not in a position to state the impact:

…The Group has already commenced an assessment of the impact of these new FRSs but is not yet in a position to state whether these new FRSs would have a significant impact on its results of operations and financial position.

ii) Additional wording for situation 2 where the Group has made a preliminary assessment and reached an initial conclusion on the impact:

…The Group is in the process of making an assessment of the impact of these new FRSs and has so far concluded that:

[(a) the adoption of [name of the FRSs] would have the following significant effects:
[Descriptions of the effects]

OR

(b) the adoption of [name of the FRSs] would not have a significant impact on its results of operations and financial position.]

The Group will be continuing with the assessment of the impact of the other new FRSs and other significant changes may be identified as a result”.

Summary of disclosures required when changing accounting policies and correcting prior period errors

Changes in accounting policies - on initial application of FRSs or an interpretation or voluntary changes, disclose:

– identify change;
– whether change is in accordance with transitional provisions and description of transitional provisions;
– reasons why new accounting policy is reliable and more relevant (applies to voluntary changes only);
– amount of adjustment to each item;
– amount of adjustment to basic and diluted EPS;
– amount of adjustment to prior periods; and
– more disclosures required if application is impracticable.

When new standard or interpretation not applied but issued and is not yet effective, disclose:
– the fact and estimate of impact of application now required (was encouraged before).

Prior period errors, disclose:
– nature;
– amount of correction for each item;
– amount of correction for basic and diluted EPS;
– amount of correction at the beginning of earliest period; and
– if retrospective restatement is impracticable, more disclosures are required.

2.9 Other changes

Finally, the requirements in relation to the income statement disclosure have been moved to FRS 101. This includes, in particular, the restrictions on disclosing extraordinary items (which in FRS 101 have now become a complete ban) and the requirement to disclose individually significant (now “material”) items.
3. FRS 116, Property, Plant and Equipment (supersedes FRS 116_2004)

Executive summary

- Each part of an item of property, plant and equipment ("PPE") with a cost that is significant in relation to the total cost of the item shall be depreciated separately.
- The revised definition of residual value effectively means that the residual value of most assets is likely to be immaterial. FRS 116 requires the effect of inflation to be taken into account in arriving at the residual value. The justification of non-depreciation on the basis of high residual value (therefore immaterial depreciation charges) is no longer valid.
- The cost of a major overhaul or inspection is treated as a part ("component") of the costs of an asset.
- The costs of dismantlement, removal or restoration should be included in the cost of property, plant and equipment.
- Depreciation of PPE is to continue until the asset is derecognised, even during the period the asset is idle.
- PPE acquired in a swap is measured at fair value unless it lacks commercial substance or the fair value of the assets exchanged cannot be reliably measured.

3.1 Residual value

The definition of residual value has been revised. An entity is required to measure the residual value as the amount it estimates it would receive currently for the asset if the asset were already of the age and in the condition expected at the end of its useful life, i.e. the effects of inflation are to be taken into account in arriving at the residual value.

FRS 116_2004 did not specify whether the residual value was to include the effects of inflation. FRS 116 now requires such effect to be taken into account in arriving at the residual value.

Based on the revised definition, the residual value of most assets are likely to be immaterial and hence depreciation is required for most assets, including hotel properties.

In addition, paragraph 56 of FRS 116_2004 which said that “There are circumstances, for example in the case of hotel properties and brewer properties, where an enterprise may adopt the view that depreciation is immaterial…”, has been removed. Hence, all hotel properties need to be depreciated once FRS 116 takes effect.

As there is no transitional provision on this, the change in accounting policy should be applied retrospectively in accordance with FRS 108, Accounting Policies, Changes in Accounting Estimates and Errors.

Under FRS 116, entities are required to review the residual value at least at each balance sheet date.

FRS 116 states that depreciation is recognised even if the fair value of the asset exceeds its carrying amount, as long as the asset’s residual value does not exceed its carrying amount. If the residual value increases to an amount equal to or greater than the asset’s carrying amount, the asset’s depreciation charge is zero unless until its residual value subsequently decreases to an amount below the asset’s carrying amount.
Material residual values usually only arise when the asset’s useful life, being generally the period over which the entity expects to use the asset, is shorter than the economic useful life or it has a significant scrap value. An example would be a new building (with an economic life of 30 years) that an entity expected to use for only 10 years and then sell.

### Elements of cost

- **Cost of PPE to include costs of dismantlement, removal and restoration at time of installation and during period of use** (116.16(c))

The cost of an item of PPE includes not only the costs of its dismantlement and removal and site restoration obligation incurred at the time of acquisition, but also any such obligation arising because of having used the item for purposes other than producing inventory.

### Subsequent costs

- **The same recognition principle is applied to all PPE costs, including subsequent costs** (116.7 - 14 & 67 - 72)

Under the revised standard, the recognition rules have been simplified. An entity applies the same recognition principle in determining both costs incurred initially to acquire/construct an item of PPE and costs incurred subsequently to add to, replace part of or service an item.

If the cost of a replacement for part of an item of property, plant and equipment is recognised in the carrying amount of an asset, the carrying amount of what was replaced would be derecognised. The gain or loss arising from the derecognition of an item of PPE shall be included in the income statement when the item is derecognised, unless required otherwise by the other Financial Reporting Standards. Such gains shall not be classified as revenue.

- **Major inspection too** (116.12 - 14)

It is now clear that the cost of an inspection or overhaul should be treated as a component of the costs of an asset if it is major expenditure that occurs at regular intervals over the life of an asset. Routine repairs and maintenance would be expensed as incurred.

### Depreciation

- **Clearer rules for recognising and depreciating components** (116.43 - 47)

The standard now states clearly that each part of an item of PPE with a cost that is significant in relation to the total cost of the item shall be depreciated separately. An example would be separately depreciating the cost of the airframe of an aircraft from its engines.

- **Depreciation must continue even when the asset is idle** (116.55)

An entity is required to begin depreciating an item of PPE when it is available for use and to continue depreciating it until it is derecognised, even if during that period the item is idle.

However, FRS 5, *Non-current Assets Held for Sale and Presentation of Discontinued Operations* proposes to cease depreciation on assets that meet the criteria for classification as “held for sale”.

### Exchange of assets

- **New rules to recognise exchange of assets** (116.24 - 26 & 80)

PPE acquired in exchange for a non-monetary asset(s) or a combination of monetary and non-monetary asset is measured at fair value unless:

- the exchange transaction lacks commercial substance; or
- fair value of neither asset received nor given up is reliably measurable.
FRS 116, 2004, prescribed that exchange of similar assets be measured at the carrying amount of the asset given up. For non-similar exchange of assets, the previous standard required such exchange to be measured at fair value.

This new requirement shall be applied prospectively only to future transactions.

### 3.6 Assets under construction

- **Income earned during the construction phase should be recognised as income, not a reduction of cost, unless it is a direct consequence of the construction process (116.17(c) & 21)**

FRS 116 contains clear guidance on the treatment of income earned while an asset is still being constructed:

- if the income is a direct result of an activity necessary to complete the asset (such as revenue from selling test items), then it should be deducted from the cost of the asset; but
- any other incidental income, such as car parking fees while a development site is vacant, should be recognised as income, not as a reduction of construction cost.

### 3.7 Revaluation model

- **Revaluation model can be used if fair value can be measured reliably (116.31 - 36)**

FRS 116 states that a class of PPE can be carried at revalued amount less any subsequent accumulated depreciation and impairment losses, if the fair value can be measured reliably. The previous standard was silent on whether the use of revalued amounts would depend on whether the fair value were reliably measurable.

### 3.8 Derecognition

- **To derecognise PPE when criteria for the sale of goods are met (116.67 - 70)**

An entity is required to derecognise the carrying amount of an item of PPE that it disposes of on the date the criteria for the sale of goods in FRS 118, 2004 are met. Similar derecognition rule to be applied for part of a PPE that has been replaced.

- **Gain from disposal of PPE cannot be classified as revenue (116.68)**

It is now clarified in the standard that gain from the disposal of PPE cannot be classified as revenue.

### 3.9 Disclosures

- **Comparatives required for the reconciliation of the PPE movements (116.73)**

The standard now requires comparative information to be provided for the reconciliation of the carrying amount of PPE at the beginning and end of the period.

### 3.10 Transitional provisions

- **Transitional provision for disclosing the carrying amount of revalued PPE under cost model (116.77A)**

- **Transitional provision to continue recording revalued PPE as surrogate costs (116.74A)**

Where, upon adoption of FRS 116, 2004 an entity is not able to provide information on the carrying amount for each revalued class of PPE that would have been recognised had the assets been carried under the cost model, due to the absence of historical records, that fact shall be disclosed.

FRS 116 retains the transitional provision which allows an entity to continue to avail itself the transitional provision when the MASB first adopted IAS 16 in 1998. An entity that had recorded its PPE at revalued amounts but had not adopted a policy of revaluation has been allowed to continue carrying those assets on the basis of their previous revaluations.
## 3.11 Summary of comparisons between the revised IAS 16, FRS 116 and FRS 116_2004

<table>
<thead>
<tr>
<th>Revised IAS 16</th>
<th>FRS 116</th>
<th>FRS 116_2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Definitions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New definitions include “Entity-specific value”</td>
<td>Incorporated. [116.6]</td>
<td>No such provision.</td>
</tr>
<tr>
<td>“Recoverable amount”</td>
<td>No change.</td>
<td>Existing definition.</td>
</tr>
<tr>
<td>The “residual value” of an asset is the estimated amount that an entity would currently obtain from disposal of the asset after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.</td>
<td>Incorporated. [116.6]</td>
<td>“Residual value” is the net amount which the enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.</td>
</tr>
<tr>
<td><strong>2. Recognition – subsequent costs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>An entity applies the recognition principle in determining whether PPE cost should be capitalised. This applies to both costs incurred initially to acquire/construct an item of PPE and costs incurred subsequently to add to, replace part of or service an item.</td>
<td>Incorporated. [116.12]</td>
<td>Prescribes that “Subsequent expenditure relating to an item of property, plant and equipment that has already been recognised should be added to the carrying amount of the asset when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing asset, will flow to the enterprise. All other subsequent expenditure should be recognised as an expense in the period in which it is incurred”. [15.27]</td>
</tr>
<tr>
<td><strong>3. Measurement at recognition – asset dismantlement, removal and restoration costs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The cost of PPE also includes the costs of its dismantlement and removal and site restoration, the</td>
<td>Incorporated. [116.16(c)]</td>
<td>Provided examples of directly attributable costs which include among others, the estimated cost of</td>
</tr>
</tbody>
</table>
### Revised IAS 16

#### 3. Measurement at recognition – asset dismantlement, removal and restoration costs (cont’d)

If FV can be measured reliably, an entity may carry all items of PPE of a class at a revalued amount, which is the FV of the items at the date of the revaluation less any subsequent accumulated depreciation and accumulated impairment losses.

- **Revised IAS 16**
- **FRS 116**
- **FRS 116<sup>2004</sup>**

<table>
<thead>
<tr>
<th>Revised IAS 16</th>
<th>FRS 116</th>
<th>FRS 116&lt;sup&gt;2004&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>3. Measurement at recognition – asset dismantlement, removal and restoration costs (cont’d)</strong></td>
<td></td>
<td>dismantling and removing the asset and restoring the site, to the extent that it is recognised as a provision.</td>
</tr>
<tr>
<td></td>
<td>Incorporation.</td>
<td>116.31</td>
</tr>
<tr>
<td></td>
<td>Prescribed that PPE acquired in exchange or part exchange is measured at FV unless the exchanged assets were similar, in which case the carrying amount of the asset given up would be used.</td>
<td></td>
</tr>
<tr>
<td><strong>4. Measurement after recognition – asset exchange transactions</strong></td>
<td>PPE acquired in exchange for a non-monetary asset(s) or a combination of monetary and non-monetary asset is measured at fair value (“FV”) unless a) the exchange transaction lacks commercial substance; or b) FV of neither asset received nor given up is reliably measurable.</td>
<td>Incorporation.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>5. Measurement after recognition – revaluation model</strong></td>
<td>If FV can be measured reliably, an entity may carry all items of PPE of a class at a revalued amount, which is the FV of the items at the date of the revaluation less any subsequent accumulated depreciation and accumulated impairment losses.</td>
<td>Incorporation.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The use of revalued amounts did not depend on whether FV was reliably measurable.</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>Revised IAS 16</th>
<th>FRS 116</th>
<th>FRS 116&lt;sub&gt;2004&lt;/sub&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>6. Depreciation – unit of measure</strong>&lt;br&gt;An entity is required to determine the depreciation charge separately for each significant part of an item of PPE.</td>
<td>Incorporated. [116.43]</td>
<td>Did not clearly set this out but prescribed “in certain circumstances, it is appropriate to allocate the total expenditure on an asset to its component parts and account for each component separately... component assets have different useful lives or provide benefits to the enterprise in a different pattern thus necessitating the use of different depreciation rates and methods”.&lt;br&gt;[15.16]</td>
</tr>
<tr>
<td><strong>7. Depreciation – depreciable amount</strong>&lt;br&gt;An entity is required to measure the residual value of an item of PPE as the amount it estimates it would receive currently for the asset if the asset were already of the age and in the condition expected at the end of its useful life.</td>
<td>Incorporated. [116.51 &amp; 6]</td>
<td>Did not specify whether the residual value was to be this amount or the amount, inclusive of the effects of inflation, that an entity expected to receive in the future on the asset's actual retirement date. However, when the allowed alternative treatment is adopted, a new estimate is made at the date of any subsequent revaluation of the asset. The estimate is based on the residual value prevailing at the date of the estimate for similar assets which have reached the end of their useful lives and which have operated under conditions similar to those in which the asset will be used.&lt;br&gt;[15.53]</td>
</tr>
</tbody>
</table>
### Revised IAS 16

<table>
<thead>
<tr>
<th>8. Depreciation – depreciation period</th>
<th>FRS 116</th>
<th>FRS 116&lt;sub&gt;2004&lt;/sub&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>An entity is required to begin depreciating an item of PPE when it is available for use and to continue depreciating it until it is derecognised, even if during that period the item is idle.</td>
<td>Incorporated. [116.55]</td>
<td>Did not specify when depreciation of an item began and only specified that an entity should cease depreciating an item that had been retired from active use and held for disposal. [15.77]</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>9. Derecognition – derecognition date</th>
<th>FRS 116</th>
<th>FRS 116&lt;sub&gt;2004&lt;/sub&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>An entity is required to derecognise the carrying amount of an item of PPE that it disposes of on the date the criteria for the sale of goods in IAS 18, Revenue would be met. An entity is required to derecognise the carrying amount of a part of a PPE if that part has been replaced and the replacement cost included in the carrying amount of the item.</td>
<td>Incorporated. [116.67-69]</td>
<td>Did not require an entity to use those criteria to determine the date on which it derecognised the carrying amount of a disposed item of PPE. [15.73]</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>10. Derecognition – gain classification</th>
<th>FRS 116</th>
<th>FRS 116&lt;sub&gt;2004&lt;/sub&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>A gain from the disposal of PPE cannot be classified as revenue.</td>
<td>Incorporated. [116.68]</td>
<td>No such provision.</td>
</tr>
</tbody>
</table>
4. **FRS 117, Leases (supersedes FRS 117 2004)**

**Executive summary**

- Leasehold land and buildings are now required to be split into two elements in determining their classification as finance or operating lease.
- Since land has an indefinite economic life, if the title for a lease on the land does not pass to the lessee by the end of the lease term, the lease is deemed an operating lease. Such leasehold land is no longer classified as property, plant and equipment but classified as “prepaid lease payments”.
- A leasehold property held under an operating lease which meets the definition of investment property may be accounted for as an investment property, subject to fulfilling certain criteria.
- Initial direct costs are now defined (e.g. commissions, legal fees and internal costs that are incremental and directly attributable to negotiating and arranging a lease, but exclude general overheads) and prohibited from being immediately expensed off.
- The carrying amount of a leasehold land that had been revalued under FRS 116, Property, Plant and Equipment is to be regarded as the surrogate carrying amount of “prepaid lease payments”.

**4.1 Lease of land and buildings are considered separately**

Under FRS 117, a lease of land and building should be split into two elements i.e. a lease of land and a lease of building. Land usually has an infinite life and a lease over land cannot transfer substantially all the risks and rewards to the lessee unless ownership (title) of that land passes at the end of the lease. Therefore, most leasehold land is held under operating leases. The building element is classified as an operating or finance lease by applying the lease classification criteria.

**Example - Splitting leasehold property into two elements**

**Scenario**

A new 30 year lease is entered into with the lessor on payment of a land premium. The lessee constructs a building on the site for its own use.

**Suggested treatment**

The land premium is assumed to be the fair value of the land. This will be accounted for as an operating lease under FRS 117 i.e. the land premium will be spread over 30 years.

Conversely, assuming that the building meets the requirements in paragraphs 10 and 11 of FRS 117 to be classified as a finance lease, the building will be accounted for as property, plant and equipment in accordance with the policies adopted for that class of asset.

As explained below, any payment made on entering into or acquiring a leasehold land and/or building held under an operating lease represents a prepayment. Therefore, the cost of land, which is classified as an operating lease, will be disclosed separately from the building cost as “prepaid lease payments” as part of “non-current assets”. Linking the two amounts in the notes would be useful to help readers of financial statements understand the extent of the entity’s property interests.
In splitting a lease of land and building into two elements, the minimum lease payments (including any lump sum upfront payment) should be allocated between the land and building elements in proportion to the relative fair values of the leasehold interests in the land and building elements of the lease at the inception of the lease. In other words, the allocation of the minimum lease payments is weighted to reflect their role in compensating the lessor, and not by reference to the relative fair values of the land and buildings.

In the extreme case that a building is fully depreciated over the lease term, the minimum lease payments would need to be weighted to provide a return plus the full depreciation of the building’s value at the inception of the lease. The leasehold interest in the land would, assuming a residual value that equals its value at the inception of the lease, have a weighting that reflects only a return on the initial investment.

If the lease payments cannot be allocated reliably between the two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case the entire lease is treated as an operating lease (e.g. if building is leased for only 10 or 20 years).

However, for a lease of land and building in which the amount that would initially be recognised for the land element is immaterial, the land and building may be treated as a single unit for the purpose of lease classification. The classification as a finance or operating lease would then depend on the extent to which risks and rewards incidental to ownership of the leasehold property lie with the lessor or lessee.

---

**Example - Leasehold property classified as finance lease**

**Scenario**
An entity acquires a leasehold property with 25 years left to run on the lease and a right of renewal for a further 30 years.

**Suggested treatment**
The land lease has characteristics of an operating lease, while the building lease has characteristics of a finance lease. At the inception of this leasing arrangement, one lump sum was paid to the lessor to obtain interest over the leasehold property.

In the absence of recent transactions in vacant sites that are otherwise comparable, it may not be possible to reliably identify the fair values of the separate elements. If this is the case, the whole lease would be accounted for as a finance lease under FRS 116, *Property, Plant and Equipment*, or FRS 140, *Investment Property* (if the property otherwise has the characteristics of an investment property, which will be discussed further below).

The renewal and any minimum lease payments that would arise from that renewal would be included in the original assessment of minimum lease payments and lease term if the exercise of that option was reasonably certain at the start of the lease.

---

**Example - Leasehold property classified as operating lease**

**Scenario**
An entity enters into a 5 year lease to rent some space in a new office building.

**Suggested treatment**
Both the land and building elements of the lease are clearly operating leases. Therefore, there is no need to split the leasehold property into two separate portions. Instead, the rentals paid under the lease will be spread over the lease term.
**Example - Leasehold property split into operating and finance leases**

**Scenario**

Entity A enters into a lease agreement with Entity B to lease a leasehold property i.e. land and building, from Entity B. The total lease amount agreed is RM10m payable over the lease term of 30 years. The building being leased is new and has a useful life of 50 years.

Assumptions:

1) Recent transactions in nearby sites indicate that similar leases of land and building provide a 5% return per annum to the owner/lessor.

2) Similar buildings with a useful life of 50 years have a fair value of approximately RM4m while similar land have a fair value of about RM6m, at the inception of the lease.

3) The residual value of the land equals its value at the inception of the lease.

**Suggested treatment**

The land lease has characteristics of an operating lease while the building lease has characteristics of a finance lease. At the inception of this leasing arrangement, the total lease amount of RM10m should be allocated between land and building since information on comparable recent transactions is available.

\[
\begin{array}{lcl}
\text{Return on investment in the building} & 6,000 \\
(5\% \times \text{RM4m} \times 30 \text{ years}) & \\
\text{Recoupment of the value of building used up} & 2,400 \\
\text{over the lease term of 30 years} & \\
\text{(RM4m} \times 30 \text{ years } / 50 \text{ years}) & \\
\hline
\text{Total} & 8,400 \\
\text{Return on investment in the land} & 9,000 \\
(5\% \times \text{RM6m} \times 30 \text{ years}) & \\
\hline
\text{Total} & 17,400 \\
\end{array}
\]

Allocation of the total lease amount is as follows:

\[
\begin{array}{lcl}
\text{Weighted average amount attributable} & 4,828 \\
\text{to the building portion} & \\
\text{(RM10m} \times \text{RM8.4m } / \text{RM17.4m}) & \\
\text{Weighted average amount attributable} & 5,172 \\
\text{to the land portion} & \\
\text{(RM10m} \times \text{RM9.0m } / \text{RM17.4m}) & \\
\text{Total lease amount} & 10,000 \\
\end{array}
\]

An allocation of the minimum lease payment by reference to the relative fair values of the land and building would not reflect the fact that land often has an indefinite economic life and therefore would be expected to maintain its value beyond the lease term. In contrast, the future economic benefits of a building are likely to be used up, at least to some extent, over the lease term.

Therefore, it would be reasonable to expect that the lease payments relating to the building would be set at a level that enabled the lessor not only to make a return on initial investment, but also to recoup the value of the building used up over the term of the lease. In the case of land, the lessor would not normally need compensation for using up the land and thus, assuming that the residual value of the land equals its value at the inception of the lease, the lease payments relating to the land would be set at a level that reflects only the lessor’s return on initial investment.
4.2 Prepaid lease payments

- Payments made on entering into or acquiring a leasehold held under an operating lease represent a prepayment (117.14)
- Surrogate cost of previously revalued leasehold land (117.67A)

Any payment made on entering into or acquiring a leasehold that is accounted for as an operating lease represents “prepaid lease payments”, which are amortised over the lease term in accordance with the pattern of benefits provided.

Where a Group/company’s existing accounting policy requires the periodic revaluation of land and building, but leasehold land is reclassified as an operating lease following the adoption of FRS 117 while leasehold building is classified as a finance lease, the leasehold building should continue to be revalued under the Group/company’s existing accounting policy but the leasehold land should not be subject to any further revaluation. The unamortised revalued amount of such leasehold land can be retained as the surrogate carrying amount of “prepaid lease payments” to be amortised over the remaining lease term.

In these circumstances, the entity must disclose the fact that the transitional provision of FRS 117 is being followed and that the valuation has not been updated. The entity must also disclose the date of the last revaluation.

4.3 Leasehold property classified as investment property

- A classification alternative for operating leases that meet the definition of investment property is introduced (117.18 - 19, 140.3, 5 & 6)

If a leasehold property that is classified as an operating lease meets the definition of investment property i.e. being held to earn rentals or for capital appreciation, it can be accounted for as an investment property, provided that it is:

1) recognised as a finance lease. It will continue to be accounted as such even if a subsequent event changes the nature of the lessee’s property interest so that it is no longer an investment property; and
2) measured using the fair value model under FRS 140, Investment Property. Once this classification alternative is selected for one such property interest held under an operating lease, all property classified as investment property shall be accounted for using the fair value model.

When both leasehold land and building is classified as an investment property and the fair value model is adopted, separate measurement of the land and building elements is not required.

Although the alternative above refers to a lessee’s property interest held under an operating lease, a lessee’s property interest held under a finance lease that meets the investment property definition of being held to earn rentals or for capital appreciation can also be accounted for as an investment property under FRS 140.

4.4 Initial direct costs

- Initial direct costs are defined (117.4 & 38)
- Lessors’ initial direct costs are to be recognised over the lease term (117.38 & 52)

Initial direct costs are specifically defined in FRS 117 as incremental costs that are directly attributable to negotiating and arranging a lease, except for such costs incurred by manufacturer or dealer lessors. They include amounts such as commissions, legal fees and internal costs that are incremental and directly attributable to negotiating and arranging the lease. However, initial direct costs exclude general overheads such as those incurred by sales and marketing teams.

FRS 117 now prohibits immediate expensing of initial direct costs, except in the case of manufacturer/dealer lessors where initial direct costs are recognised as an expense when the selling profit is recognised, which for a finance lease is normally at the commencement of the lease term. For other lessors, initial direct costs would be treated as follows:

1) finance lease – included in the initial measurement of the finance lease receivable and recognised in the income statement by reducing the amount of finance income recognised over the lease term; and
2) operating lease – initially added to the carrying amount of the asset that has been leased out and recognised over the lease term on the same basis as lease income. This means that initial direct costs are treated as a separate component of the cost of the leased asset, with a shorter useful life over which to be depreciated.

Example - Initial direct costs recognised in the financial statements of lessors

### Finance lease

**Background**

Entity A, who is not a manufacturer or dealer, enters into a lease agreement with Entity B to lease a vehicle to Entity B for 5 years. At the end of the 5 years, B can buy the vehicle from A for RM1. An analysis of the risks and rewards determines that B has substantially all the risks and rewards incidental to ownership and so this is classified as a finance lease.

The vehicle cost A RM1,000. In addition, A spent RM100 on legal fees and commission to its sales agent. The total lease payments to be made by B is RM1,500 in annual installments and therefore, the finance income to be earned by A over the 5 years is RM1,500 - RM1,100 = RM400. On an effective yield basis, A recognised RM90 (assumption) of finance income in the first year.

**Suggested treatment**

<table>
<thead>
<tr>
<th>RM</th>
<th>RM</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Initial recognition:</strong></td>
<td></td>
</tr>
<tr>
<td>Dr Investment in finance lease</td>
<td>1,100</td>
</tr>
<tr>
<td>Cr Cash/ Payables</td>
<td>1,100</td>
</tr>
<tr>
<td><strong>First year of the lease:</strong></td>
<td></td>
</tr>
<tr>
<td>Dr Cash</td>
<td>300</td>
</tr>
<tr>
<td>Cr Investment in finance lease</td>
<td>300</td>
</tr>
<tr>
<td>Dr Investment in finance lease</td>
<td>90</td>
</tr>
<tr>
<td>Cr Finance income (I/S)</td>
<td>90</td>
</tr>
<tr>
<td><strong>Summary at end of year 1:</strong></td>
<td></td>
</tr>
<tr>
<td>Cash (overdraft)</td>
<td>800</td>
</tr>
<tr>
<td>Investment in finance lease</td>
<td>890</td>
</tr>
<tr>
<td>Finance income (I/S)</td>
<td>90</td>
</tr>
</tbody>
</table>

**Note:**

As A is not a manufacturer or dealer, the initial direct costs are spread over the lease term through the effective yield calculation. There is no separate recognition. If entity A had been a manufacturer or dealer, the initial costs would have been recognised immediately. This would result in finance income of RM500, rather than RM400, being recognised on an effective yield basis over the 5-year lease.

### Operating lease

**Background**

The facts are as above except that entity B has the option to cancel the lease after 2 years. As it is not reasonably certain that B will continue after the 2 year period, the lease is classified as an operating lease. The useful life of the vehicle is estimated to be 5 years.

**Suggested treatment**

<table>
<thead>
<tr>
<th>RM</th>
<th>RM</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Initial recognition:</strong></td>
<td></td>
</tr>
<tr>
<td>Dr Vehicles (PPE)</td>
<td>1,100</td>
</tr>
<tr>
<td>Cr Cash</td>
<td>1,100</td>
</tr>
</tbody>
</table>
First year of the lease:
Dr Cash 300
Cr Operating lease rentals (I/S) 300
Dr Depreciation expense on vehicle over 5 years (I/S) 200
Dr Depreciation expense on initial costs over 2 years (I/S) 50
Cr Vehicles (PPE) 250

Summary at end of year 1
Cash (overdraft) 800
Carrying value of vehicles (PPE) 850
Operating lease income (I/S) 300
Depreciation expense (I/S) 250

Note:
It appears that this treatment is required to be adopted by lessors for all operating leases, to the extent the costs are material. For example, the rules would apply when the lessor of an investment property incurs costs each time a new tenancy agreement is entered into with its tenants. These costs would be held in the balance sheet together with the investment property, until written off over the lease term, irrespective of whether the property is carried under the fair value or cost model.

Any initial direct costs incurred by a lessee for a lease held under a finance lease must be added to the amount recognised as an asset and depreciated over the shorter of the lease term and the asset’s useful life (117.20 & 27).

FRS 117 states that the depreciation policy for depreciable leased assets should be consistent with that for depreciable owned assets. It further states that when there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its useful life.

It therefore follows any initial direct costs added to the cost of the asset would be similarly depreciated over the shorter of the lease term and the asset’s useful life.

Since FRS 117 does not specify the treatment for initial direct costs incurred by a lessee for an operating lease, such costs can either be capitalised and subsequently amortised or immediately expensed. However, this should be applied consistently.

4.5 Transitional provisions

Retrospective application of FRS 117 is encouraged but not required. However, an entity that has previously applied FRS 117_2004 retrospectively, shall similarly apply the amendments made by this standard retrospectively for all leases. If FRS 117_2004 was not previously applied retrospectively, the entity need only apply the amendments made by this standard for all leases entered into since it first applied FRS 117_2004 (i.e. since 1 January 2000).

If this standard is not applied retrospectively, the balance of any pre-existing finance lease is deemed to have been properly determined by the lessor and shall be accounted for thereafter in accordance with the provisions of this standard.

• Initial direct costs incurred by a lessee for a lease held under a finance lease must be added to the amount recognised as an asset and depreciated over the shorter of the lease term and the asset’s useful life (117.20 & 27).
• Transitional provisions require retrospective adoption in certain circumstances (117.67 - 68).
### 4.6 Summary of comparisons between the revised IAS 17, FRS 117 and FRS 117<sub>2004</sub>

<table>
<thead>
<tr>
<th>Revised IAS 17</th>
<th>FRS 117</th>
<th>FRS 117&lt;sub&gt;2004&lt;/sub&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Scope</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>This standard shall not be applied as the basis of measurement for:</td>
<td>Incorporated. [117.2]</td>
<td>No such provision.</td>
</tr>
<tr>
<td>a) property held by lessees that is accounted for as investment property (“IP”);</td>
<td></td>
<td></td>
</tr>
<tr>
<td>b) IP provided by lessors under operating leases;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>c) biological assets (i.e. living animals or plants) held by lessees under finance leases; or</td>
<td></td>
<td></td>
</tr>
<tr>
<td>d) biological assets provided by lessors under operating leases.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>2. Classification of leases</strong></td>
<td>Removed.</td>
<td>Provided a guide that:</td>
</tr>
<tr>
<td>No such provision.</td>
<td></td>
<td>– the lease term is for the major part of the economic life of the asset when the lease term is for 75% or more of the economic life of the leased asset; and</td>
</tr>
<tr>
<td>When classifying a lease of land and building, an entity normally considers the land and building elements separately. Land usually has an indefinite economic life and is thus normally classified as an operating lease unless title passes to the lessee at the end of the lease term. The building element is classified as an operating or finance lease by applying the standard's classification criteria.</td>
<td>Incorporated. [117.15]</td>
<td>No such provision.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>[10.10]</td>
</tr>
</tbody>
</table>
### 2. Classification of leases (con’t)

Any payment made on entering into or acquiring a leasehold that is accounted for as operating lease represents prepaid lease payments that are amortised over the lease term.

The MLPs are allocated between the land and building elements in proportion to the relative FVs of the leasehold interests in the land and building elements of the lease at the inception of the lease. If the lease payments cannot be allocated reliably between the 2 elements, the entire lease is classified as a finance lease. If it is clear that both elements are operating leases, the entire lease is classified as an operating lease.

Provided that if the value of land at the inception of lease is immaterial, land and building may be treated as a single unit and classified as a finance or operating lease in accordance with the standard’s classification criteria.

Separate measurement of the land and building elements is not required when the lessee’s interest in both land and buildings is classified as an IP.

A lessee can classify a property interest held under an operating lease as an IP under IAS 40. If it does so, the property interest is accounted for as a finance lease and shall continue to be accounted for as such even if a subsequent event changes the nature of the lessee’s property interest so that it is no longer an IP.

<table>
<thead>
<tr>
<th>Revised IAS 17</th>
<th>FRS 117</th>
<th>FRS 117 2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Classification of leases (con’t)</td>
<td>Incorporated. [117.14]</td>
<td>Leasehold land and buildings are treated as fixed assets in accordance with MASB 15 and the 9th Schedule of the Companies Act 1965. [10.14]</td>
</tr>
<tr>
<td>The MLPs are allocated between the land and building elements in proportion to the relative FVs of the leasehold interests in the land and building elements of the lease at the inception of the lease. If the lease payments cannot be allocated reliably between the 2 elements, the entire lease is classified as a finance lease. If it is clear that both elements are operating leases, the entire lease is classified as an operating lease.</td>
<td>Incorporated. [117.16]</td>
<td>No such provision.</td>
</tr>
<tr>
<td>Provided that if the value of land at the inception of lease is immaterial, land and building may be treated as a single unit and classified as a finance or operating lease in accordance with the standard’s classification criteria.</td>
<td>Incorporated. [117.17]</td>
<td>No such provision.</td>
</tr>
<tr>
<td>Separate measurement of the land and building elements is not required when the lessee’s interest in both land and buildings is classified as an IP.</td>
<td>Incorporated. [117.18]</td>
<td>No such provision.</td>
</tr>
<tr>
<td>A lessee can classify a property interest held under an operating lease as an IP under IAS 40. If it does so, the property interest is accounted for as a finance lease and shall continue to be accounted for as such even if a subsequent event changes the nature of the lessee’s property interest so that it is no longer an IP.</td>
<td>Incorporated. [117.19]</td>
<td>No such provision.</td>
</tr>
</tbody>
</table>
### 3. Initial direct costs

Initial direct costs incurred by **lessors** in negotiating a **finance lease** are included in the initial measurement of the finance lease receivable (leased asset). This treatment does not apply to manufacturer or dealer lessors, who recognise such costs as an expense when the selling profit is recognised.

Initial direct costs reduce the amount of income recognised over the lease term.

---

Initial direct costs incurred by **lessors** in negotiating an **operating lease** are added to the carrying amount of the leased asset.

Initial direct costs should be recognised as an expense over the lease term on the same basis as the lease income.

---

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Initial direct costs</strong></td>
<td>Incorporated. [117.38]</td>
<td>No such provision.</td>
</tr>
<tr>
<td>Initial direct costs incurred by <strong>lessors</strong> in negotiating a <strong>finance lease</strong> are included in the initial measurement of the finance lease receivable (leased asset). This treatment does not apply to manufacturer or dealer lessors, who recognise such costs as an expense when the selling profit is recognised.</td>
<td>Incorporated. [117.38]</td>
<td>Initial direct costs are either recognised immediately in income or allocated against finance income over the lease term.</td>
</tr>
<tr>
<td>Initial direct costs reduce the amount of income recognised over the lease term.</td>
<td>Incorporated. [117.52]</td>
<td>No such provision.</td>
</tr>
<tr>
<td>Initial direct costs incurred by <strong>lessors</strong> in negotiating an <strong>operating lease</strong> are added to the carrying amount of the leased asset.</td>
<td>Incorporated. [117.52]</td>
<td></td>
</tr>
<tr>
<td>Initial direct costs should be recognised as an expense over the lease term on the same basis as the lease income.</td>
<td></td>
<td>Initial direct costs are either deferred and allocated to income over the lease term in proportion to the recognition of rent income or are recognised as an expense in the income statement in the period in which they are incurred.</td>
</tr>
<tr>
<td>Revised IAS 17</td>
<td>FRS 117</td>
<td>FRS 117\textsuperscript{2004}</td>
</tr>
<tr>
<td>---------------</td>
<td>---------</td>
<td>-------------------------</td>
</tr>
</tbody>
</table>
| **4. Leases in the financial statements of lessors - Operating leases** | No such provision. | Removed. | Required disclosure for each class of asset: 
– at the balance sheet date; the gross carrying amount, the accumulated depreciation and accumulated impairment losses; and 
– in income for the period; the depreciation recognised, impairment losses recognised and impairment losses reversed. [10.57(a)] |
| **5. Transitional provision** | An entity that has previously applied IAS 17 (revised 1997) is required to apply the amendments made by this standard retrospectively for all leases or, if IAS 17 (revised 1997) was not applied retrospectively, for all leases entered into since it first applied that standard. | An entity that has previously applied FRS 117\textsuperscript{2004} is required to apply the amendments made by this standard retrospectively for all leases or, if FRS 117\textsuperscript{2004} was not applied retrospectively, for all leases entered into since it first applied that standard. [117.68] | No such provision. |
5. FRS 124, Related Party Disclosures
(supersedes FRS 124[2004])

Executive summary

- The scope restriction to public listed companies and their subsidiaries has been removed and FRS 124 now applies to all entities (except exempt entities - see SOP 1), including state controlled enterprises. The revised standard requires related party disclosures in the separate financial statements of a parent, venturer or investor.
- The identities of related parties are no longer required to be disclosed.
- The home-grown scope exemption from making related party disclosures if it interferes with confidentiality protected by various laws has not been retained.
- The term “key management personnel” has been included in the definition in the revised standard and now clearly includes non-executive directors.
- Disclosure of the entity’s parent and ultimate controlling party (if different).
- Additional disclosure of the next most senior parent that produces financial statements available for public use, if neither the parent nor the ultimate controlling party do so.
- Sub-classification of amounts payable to, and receivable from, related parties into different categories of related parties.
- Disclose that the terms of related party transactions are equivalent to those that prevail in arm’s length transactions only if such terms can be substantiated.

5.1 Scope and scope exemption

There are no longer scope exemptions for particular types of entities except exempt entities (SOP 1). The previous standard applied to the financial statements of public listed companies and their subsidiaries.

The revised standard requires disclosure of related party transactions and outstanding balances in the separate financial statements of a parent, venturer or investor presented in accordance with FRS 127, Consolidated and Separate Financial Statements.

The home-grown scope exemption from making related party disclosures if it interferes with confidentiality protected by various laws has not been retained.

5.2 Definitions

The term “key management personnel” has been included in the definition in the revised standard and now clearly includes non-executive directors. Key management personnel are those responsible for planning, directing and controlling the activities of the entity, i.e. all directors (both executive and non-executive) and senior managerial personnel.

The definition of related parties has been expanded and includes the following parties in the definition:

a) parties with joint control over the entity; and
b) joint ventures in which the entity is a venturer.

However, the standard continues to caution that, in considering each possible related party relationship, attention is paid to the substance of the relationship and not merely the legal form. Despite the above expanded definition, the standard, e.g., goes on to state that in the context of...
the standard, two venturers are not necessarily related parties simply because they have control over a joint venture.

The definition of “close members of the family of an individual” i.e. those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity, in the IAS 24 (revised) has not been adopted because the definition is inconsistent with the Companies Act 1965. The definition of “close members of family” i.e. his or her spouse, parent, child (including adopted child and step-child), brother, sister and the spouse of his or her child, brother or sister, in the revised standard is the same as FRS 124, 2004.

5.3 Disclosures

The requirement to disclose compensation of key management personnel in total and for each of the following categories is now explicitly stated:

- short-term employee benefits;
- post-employment benefits;
- other long-term benefits;
- termination benefits; and
- share-based payment.

The standard now specifically states that disclosures should be made separately for each of the following categories:

- the parent;
- entities with joint control or significant influence over the entity;
- subsidiaries;
- associates;
- joint ventures in which the entity is a venturer;
- key management personnel of the entity or its parent; and
- other related parties.

Entities disclose that the terms of related party transactions are equivalent to those that prevail in arm’s length transactions only if such terms can be substantiated.

Other new disclosure is the expense recognised during the period in respect of bad or doubtful debts due from related parties.

Disclosure of the identity of the following parties is required, even where there have been no transactions:

- the immediate parent entity;
- the ultimate controlling party (n.b. the chain of control might not stop at a corporate level. Therefore, this disclosure may require revealing the name of a controlling individual or trust); and
- if neither of the above produces financial statements available for public use, disclose the name of the next most senior parent that does so.
### 5.4 Summary of comparisons between the revised IAS 24, FRS 124 and FRS 124\textsubscript{2004}

<table>
<thead>
<tr>
<th>Revised IAS 24</th>
<th>FRS 124</th>
<th>FRS 124\textsubscript{2004}</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Scope</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Standard now requires the disclosure of related</td>
<td>Incorporated.</td>
<td>Only applicable to a public listed company (“PLC”) or a</td>
</tr>
<tr>
<td>party transactions and outstanding balances in the</td>
<td></td>
<td>subsidiary of a PLC.</td>
</tr>
<tr>
<td>separate financial statements (“FS”) of a parent,</td>
<td></td>
<td>No disclosure of transaction was required:</td>
</tr>
<tr>
<td>venturer or investor presented in accordance with</td>
<td></td>
<td>a) in consolidated FS in respect of intra-group transactions;</td>
</tr>
<tr>
<td>FRS 127, *Consolidated and Separate Financial</td>
<td></td>
<td>b) in parent FS when they are made available or published</td>
</tr>
<tr>
<td>Statements*.</td>
<td></td>
<td>with the consolidated FS;</td>
</tr>
<tr>
<td>All exemption provisions have been removed.</td>
<td>Included exemptions for exempt entities via</td>
<td>c) in FS of a wholly-owned subsidiary if its parent is</td>
</tr>
<tr>
<td></td>
<td>SOP 1 (all owners are directors, no public</td>
<td>incorporated in Malaysia and provides consolidated FS; and</td>
</tr>
<tr>
<td></td>
<td>accountability and not “large”). [124.2A]</td>
<td>d) in FS of state-controlled enterprises of transactions</td>
</tr>
<tr>
<td></td>
<td></td>
<td>with other state-controlled enterprises.</td>
</tr>
<tr>
<td>No such provision.</td>
<td>No such provision.</td>
<td>Included that “related party disclosure provisions do not</td>
</tr>
<tr>
<td></td>
<td></td>
<td>apply in circumstances where to comply with such</td>
</tr>
<tr>
<td></td>
<td></td>
<td>provisions conflicts with the reporting enterprise’s duties</td>
</tr>
<tr>
<td></td>
<td></td>
<td>of confidentiality arising by operation of law”. [8.6 - 7]</td>
</tr>
<tr>
<td><strong>2. Purpose of related party disclosures</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Removed the discussion of the methods used to price</td>
<td>Also removed.</td>
<td>Included discussion of the methods to price transactions</td>
</tr>
<tr>
<td>transactions between related parties.</td>
<td></td>
<td>between related parties.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>[8.14 -19]</td>
</tr>
</tbody>
</table>
3. Definitions

Included examples of related parties into the definition of related party.

Added the following parties to the definition of related party:
1) parties with joint control over the entity;
2) joint ventures in which the entity is a venturer; and
3) post employment benefits plans for the benefit of employees of an entity, or of any entity that is a related party to that entity.

Added definitions for
- “key management personnel”
- “compensation”
- “close members of the family of an individual”

Added a provision to indicate that two venturers are not related parties simply because they share joint control over a joint venture.

<table>
<thead>
<tr>
<th>Revised IAS 24</th>
<th>FRS 124</th>
<th>FRS 124_{2004}</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incorporated.</td>
<td>Incorporated.</td>
<td>Similar to the previous IAS 24, it provides examples of related party under the scope section instead of the definition section.</td>
</tr>
<tr>
<td>Incorporated.</td>
<td>No such provision.</td>
<td>No such provision.</td>
</tr>
<tr>
<td>No change as FRS 124_{2004} had included employee benefit plans of an entity, or any entity that is related party to that entity.</td>
<td>FRS 124_{2004} included employee benefit plans of an entity, or any entity that is related party to that entity. [8.4(h)]</td>
<td>No such provision.</td>
</tr>
<tr>
<td>Incorporated.</td>
<td>No such provision.</td>
<td>No such provision.</td>
</tr>
<tr>
<td>Retained existing definition for “close members of family” as the new definition is inconsistent with Companies Act 1965. [124.9]</td>
<td>Existing MASB included definition for “close members of family”.</td>
<td>No such provision.</td>
</tr>
<tr>
<td>Incorporated.</td>
<td>[124.11(b)]</td>
<td>No such provision.</td>
</tr>
</tbody>
</table>
### 4. Disclosure

Added a paragraph on the disclosure requirements for key management personnel compensation.

Other new disclosures required:
- the amounts of transactions and outstanding balances with respect to related parties. Disclosure of proportions of transactions and outstanding balances is no longer sufficient;
- the expense recognised during the period in respect of bad or doubtful debts due from related parties;
- sub-classification of amounts payable to, and receivable from, related parties into different categories of related parties;
- the name of the entity’s parent and, if different, the ultimate controlling party. If neither of these two parties produces FS available for public use, the name of the next most senior parent that does so is required.

Added a provision to clarify that: “Disclosures that related party transactions were made on terms equivalent to those that prevail in arms’s length transactions are made only if such terms can be substantiated”.

<table>
<thead>
<tr>
<th>Revised IAS 24</th>
<th>FRS 124</th>
<th>FRS 124_{2004}</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Disclosure</strong></td>
<td>Incorporated. [124.16]</td>
<td>No such provision.</td>
</tr>
<tr>
<td>Other new disclosures required:</td>
<td>No change as this disclosure is required under FRS 124_{2004}, but requirement is reworded. [124.17(a)-(b)]</td>
<td>Existing requirement. [8.26(a)-(c)]</td>
</tr>
<tr>
<td>– the amounts of transactions and outstanding balances with respect to related parties. Disclosure of proportions of transactions and outstanding balances is no longer sufficient;</td>
<td>Incorporated. [124.17(d)]</td>
<td>Existing requirement. [8.26(d)]</td>
</tr>
<tr>
<td>– the expense recognised during the period in respect of bad or doubtful debts due from related parties;</td>
<td>Incorporated. [124.18]</td>
<td>No such provision.</td>
</tr>
<tr>
<td>– sub-classification of amounts payable to, and receivable from, related parties into different categories of related parties;</td>
<td>Incorporated. [124.12]</td>
<td>Required disclosure of related party relationships where control exists irrespective of whether there have been transactions between the related parties. [8.23]</td>
</tr>
<tr>
<td>– the name of the entity’s parent and, if different, the ultimate controlling party. If neither of these two parties produces FS available for public use, the name of the next most senior parent that does so is required.</td>
<td>Incorporated. [124.21]</td>
<td>No such provision.</td>
</tr>
</tbody>
</table>
Appendix 1: Example notes of key sources of estimation uncertainty

(a) Recoverability of development costs
The carrying amount of an intangible asset representing a development project for a new process in one of the factories in Rawang is RM1,400,000. An impairment test was triggered in the year because the regulation that would require this new process was delayed, and this would mean that the benefit of the new process would not be realised as soon as expected. The Group carried out an impairment test based on a variety of assumptions of the date when the regulation is in force and concluded that no impairment was required. Should this regulation be delayed beyond July 20X7, then an impairment might arise and this could have a significant effect in 20X6 on the carrying amount of the intangible asset for this new process. Currently the Group is confident that the regulation will be passed during the second half of 20X6 and that this impairment will not arise.

(b) Excess inventory
The Company must determine as of each balance sheet date how much, if any of its inventory may ultimately prove to be unsaleable or unsaleable at its carrying cost. Allowances are established to effectively adjust inventory to net realisable value. To determine the appropriate level of allowances, the Company evaluates current stock levels in relation to historical and expected patterns of demand for all its products and components. The basis for the determination is generally the same for all inventory categories except for work-in-progress inventory, which is recorded at cost. Obsolete or discontinued items are generally destroyed and completely written off. Management evaluates the need for changes to valuation allowances based on market conditions, competitive offerings and other factors on a regular basis.

(c) Inventory net realisable value
Two shipments of pharmaceutical products costing RM2 million arrived at the Malaysian port of call in March but were subsequently put under quarantine due to a virus outbreak in the country of origin and the fear that the shipments may be contaminated. Management is confident that the shipments are not contaminated and that the quarantine issue will be resolved with the relevant authorities in the next quarter. If the shipments are found to be contaminated, management is confident that a refund can be obtained from the supplier.

(d) Allowance for doubtful accounts
The main collectibility risk of trade and other receivables is customer insolvencies. The Company maintains an allowance for doubtful accounts representing management's estimate of the amount of asset impairment in the trade and other receivables portfolio. The Company determines the allowance for doubtful accounts based on a systematic, on-going review and evaluation performed as part of the credit-risk evaluation process, historical loss experience, the size and composition of the portfolios, current economic events and conditions, and other pertinent factors. This evaluation is inherently judgemental and requires material estimates, including the amounts and timing of future cash flows expected to be received, which may be susceptible to significant change. Although management considers the allowance for doubtful accounts to be adequate based on information currently available, additional provisions may be necessary due to (i) change in management estimates and assumptions about asset impairment, (ii) information that indicates changes in the expected future cash flows or (iii) changes in economic and other events and conditions.

(e) Recoverability of overdue receivables
At balance sheet date, RM8 million representing 30% of total trade receivables is 12 months overdue and the customer has explained that the overdue receivables are in respect of a contract where they are completing rectification work. Management is of the opinion that the debt is not doubtful on the basis of the long standing (over 10 years) relationship with the customer and their payment history and compliance with the current cash on delivery terms for new sales.

(f) Impairment of long-lived assets
The Company periodically reviews the carrying value of its long-lived assets held and used and assets to be disposed of, including goodwill and other intangible assets, when events and circumstances warrant such a review. This review is performed using estimates of future cash flows. If the carrying value of a long-lived asset is considered impaired, an impairment charge is recorded for the amount by which the carrying value of the long-lived asset exceeds its recoverable amount. Management believes that the estimates of future cash flows and recoverable amount are reasonable; however, changes in estimates of such cash flows and recoverable amount would affect the evaluations and negatively affect future operating results.
Appendix 1: Example notes of key sources of estimation uncertainty (cont’d)

(g) Deferred tax assets
Deferred tax assets in respect of unutilised tax losses amounting to RM200 million have not been recognised because it is not probable that future taxable profit will be available against which the Company can utilise the benefits since this is the first year the Company has recorded profit since it started operations.

(h) Product warranty
The Company warrants its product for specific periods of time. Product warranties vary depending upon the nature of the product, the geographic location of its sales and other factors. The warranty expense provisions are costs for general warranties on products we sell, product recalls and services action outside the general warranties. Estimated warranty expenses are provided at the time products are sold to customers or new warranty programmes are initiated based on historical warranty claim experience with consideration given to the expected level of future warranty costs, including current sales trends, the expected number of units to be affected and the estimated average repair cost per unit of warranty claims. The Company’s products contain certain parts manufactured by third party suppliers. As the manufacturing suppliers typically warrant these parts, expected receivables from warranties of these suppliers are deducted from our estimates of warranty expense provisions.

The Company believes that the accounting estimate related to warranty expense provisions is a "key source of estimation uncertainty" because changes in it can materially affect net income, and it is necessary to estimate the frequency and amounts of future claims, which are inherently uncertain.

The Company's policy is to continuously monitor warranty expense provisions to determine their adequacy. Therefore, warranty expense provisions are maintained at an amount the Company deems adequate to cover estimated warranty expense.

Actual claims incurred in the future may differ from the original estimates, which may result in material revisions to the warranty expense provisions.
Appendix 2: Example notes on judgements made in applying accounting policies

(a) **Investment property**
The Group has sublet a vacated warehouse but has decided not to treat this property as an investment property because it is not the Group’s intention to hold this for the long-term or for capital appreciation or rental. Accordingly, this is still treated as a lease of property, plant and equipment.

(b) **Finance and operating leases**
The inception of the warehouse and factory leases of the Group took place many years ago. They are combined leases of land and buildings. It is not possible to obtain a reliable estimate of the split of the fair values of the lease interest between land and buildings at inception. Therefore, in determining lease classification, the Group evaluated whether both parts are clearly operating leases or finance leases. Firstly, land title does not pass. Secondly, because the rent paid to the landlord for the building is increased to market rent at regular intervals, and the Group does not participate in the residual value of the building, it is judged that substantially all the risks and rewards of the building are with the landlord. Based on these qualitative factors it is concluded that the leases are operating leases.
This Appendix sets out examples of the disclosures required by FRS 101. These may assist you in drafting your own disclosures. However, amendments to the suggested wordings may be necessary in order to match your own circumstances.

## Consolidated balance sheet as at 31 December 20X8

<table>
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<th>Reference</th>
<th>In thousands of RM</th>
<th>Note</th>
<th>20X8</th>
<th>20X7</th>
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<td><strong>Non-current assets</strong></td>
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<td>101.68(c)</td>
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## Appendix 3: Illustrative financial statement disclosures (cont’d)

### Consolidated income statement for the year ended 31 December 20X8

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<td><strong>Discontinued operations</strong></td>
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**Attributable to:**

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**Earnings per share (sen):**

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### Consolidated statement of changes in equity for the year ended 31 December 20X8

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<th>Share premium</th>
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<th>Hedging reserve</th>
<th>Fair value reserve</th>
<th>Revaluation reserve</th>
<th>Reserve for treasury shares</th>
<th>Retained earnings</th>
<th>Total</th>
<th>Minority interests</th>
<th>Total equity</th>
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<td>[101.96(a)] Total recognised income and expense - profit for the year</td>
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Appendix 4: Financial Reporting Standards and accounting pronouncements

The 21 new/revised Financial Reporting Standards

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<td>Non-current Assets Held for Sale and Discontinued Operations</td>
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The IC Interpretations

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Appendix 4: Financial Reporting Standards and accounting pronouncements (cont’d)

Other existing Financial Reporting Standards

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Note: The subscript “2004” attached to the names of Financial Reporting Standards refers to standards issued by MASB prior to 1 January 2005. These standards will remain in force until they are revised as approved accounting standards.

When the standards are revised, the subscript “2004” would be removed. For example the Exposure Draft on the proposed improvement to FRS 101,2004, Presentation of Financial Statements, when finalised would be called FRS 101, Presentation of Financial Statements.
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