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## Editors' Page

Happy New Year to our readers! We wish you a fruitful and prosperous Year 2011!

There will be several major changes to Financial Reporting Standards (FRSs) and Clarified International Standards on Auditing (ISAs) for financial statements with financial period beginning on or after 1 January 2010. In practice, the majority of entities affected will be those with financial period ended on 31 December 2010 (financial period beginning on 1 January 2010), unless there has been a change in the financial period-end. Are you ready to 'welcome' these massive changes?

AXP focuses on '2-T'. Thus, we are developing tools and programmes, and providing technical updates to assist our clients and other audit practitioners to keep abreast of the latest changes in the accounting industry. Please contact us should you require any such assistance.

ISAs do not distinguish the audit approach required for a one-person entity from that required for an entity employing thousands of employees. **An audit is an audit. Thus, the basic approach to an audit does not change just because the entity is small, and there are no 'exceptions' for not complying with all the relevant ISAs.**

If you are uncertain of how to adopt the Clarified ISAs, turn to our **Breaking News**, in which we illustrate how you can adopt the Clarified ISAs with ease, while improving the quality of the audit engagements and reducing the costs of compliance!!

In our **Tips on using Audit Express**, we continue to highlight how our core product, **Audit Express**, helps to improve the efficiency and effectiveness in performing audit engagements. In this issue, we illustrate how **Audit Express**

can help to generate bank confirmation letters in batch with ease, even if there are hundreds or even thousands to be generated.

Look into our **Technical News Update** to focus your attention on those aspects which affect you, your practice and your clients immediately and those which involve longer-term convergence issues.

In **Reviewing Disclosure Requirements**, we review the frequently-omitted disclosure requirements for two Standards: borrowing costs and non-current assets held for sale and discontinued operations!

In **Experts' Corner**, we shall continue with Part IX of preparing group accounts, particularly, the implications of account balances, trading with an 'associate', and recognition of an impairment loss in respect of an 'associate', and Part III of intangible assets.

In the third topic of the **System of Quality Control for Audit Practitioners** series, we shall zoom into the requirements of the second element – relevant ethical requirements. We have also developed practical tools in complying with this element of ISQC 1.

**AXP Updates** highlights the milestones achieved by AXP during the past four months. We have also highlighted the top scorers from our Audit Express Certification, attended by students from colleges and universities. You may wish to consider recruiting them when they are graduated.

We will continuously revise the contents of our e-Newsletter to better suit your needs, thus, we welcome your feedback or suggestions on **AXP e-Newsletter**. Happy reading!

**Editorial Team**

# Preparing Bank Confirmation Letters in Batch

Tips on

**Audit**

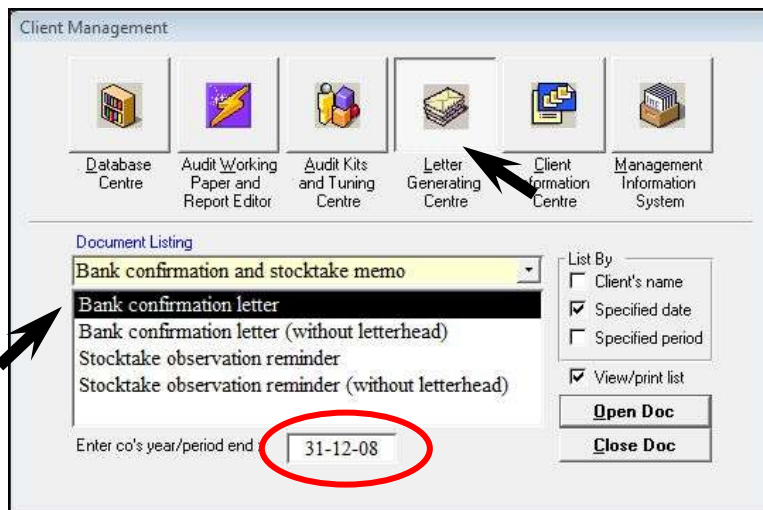
*Express*

With a complete listing of clients' bankers and bank accounts kept in the database, **Audit Express** allows users to generate bank confirmation letters in batch in just a few seconds.

Many auditors have unpleasant experiences when attempting to obtain bank confirmation letters as audit evidence. Sometimes the bank confirmation letters received are incomplete and often they are not received on time, especially when the auditors' reports need to be issued urgently. To meet the filing deadlines, auditors have been accepting alternative audit procedures such as checking to the bank statements as well as unrepresented cheques and uncredited deposits in the bank reconciliations. However, **in accordance with ISA 505 – External Confirmations as revised and redrafted by the International Auditing and Assurance Standards Board (IAASB), such alternative audit procedure is no longer acceptable.** In future, auditors may be challenged on whether they have obtained sufficient appropriate audit evidence if they have relied on such 'weak' alternative evidence rather than direct bank confirmation letters.

One way to mitigate this problem is to prepare and send out the bank confirmation letters earlier so as to allow ample time for follow up and rectification. With a complete listing of clients' bankers and bank accounts kept in the database, **Audit Express** allows users to generate bank confirmation letters for every yearend in batch and a bank confirmation control summary as follows:-

Step 1 – select the Bank Confirmation Letter from the Letter Generating Centre.



Step 2 – key in the year/period end (as circled).

**Tips on Audit Express – Preparing Bank Confirmation Letters in Batch**

Note that the system pulls out all the bank records of clients who are under the specified year/period end and generates a bank confirmation control summary:-

**Bank Confirmation**  
For clients of the financial year or period ended **31 Dec 2008**  
**567 records**

Auditor : AXP Solutions Sdn Bhd

155 A Good Man Sdn Bhd  
\* Dresdner Bank (A/c no. : 048-008730-2)  
\* Far Eastern Bank Limited (A/c no. : 011-40767-06(SGD) / 501-01735-03(USD))  
\* Hong Kong Bank (A/c no. : 009-011-774-1; Fixed deposits)  
\* Royal Bank of Canada (A/c no. : 0001-000595-02-6)

267 Adhorne Realty Sdn Bhd  
\* Malaysian Banking Berhad (A/c no. : 520409282)  
\* Malayan Banking Berhad (A/c no. : 3430-333665-251 (USD); 3430-333665-201 (USD))  
\* The Agricultural Bank of China (A/c no. : 32-70202-3; 32-70201-7; Fixed deposit account)  
\* The Agricultural Bank of China (A/c no. : Current A/c No. 143-300-010-8; Fixed Deposit A/c No. 143-400-399-2)  
\* The Asahi Bank, Ltd (A/c no. : 128-308-593-2)  
\* The Bank of Tokyo - Mitsubishi, Limited (A/c no. : 021-0-009244-7)

176 Almedia Marketing Sdn Bhd  
\* Bank Central Asia (A/c no. : 411-303-661-8)  
\* Industrial & Commercial Bank Limited (A/c no. : 700-131288)  
\* Overseas-Chinese Banking Corporation Limited (A/c no. : BN-802-03581-R-USD)  
\* The Asahi Bank, Ltd (A/c no. : 101-327-382-6)  
\* The Bank of Tokyo - Mitsubishi, Limited (A/c no. : 104-310-842-0)

246 Anderson Shipping Sdn Bhd  
\* Banque Nationale De Paris (A/c no. : 65-01447-5)  
\* Far Eastern Bank Limited (A/c no. : 213-304-208-5)  
\* Hongkong Bank Malaysia Berhad (A/c no. : 0018104-2150-000-SGD / 0018104-2150-000-USD)  
\* The Asahi Bank, Ltd (A/c no. : 119-308-380-9)  
\* The Tokai Bank Limited (A/c no. : 23-1-001164-3)

042 Andre Creative Talent Studio  
\* Bank Central Asia (A/c no. : 28-42107-5)  
\* Chung Khaiw Bank Limited (A/c no. : 304-505-111-1)

When the bank records in the database are maintained properly by designated personnel, auditors can ensure completeness of bank confirmation letters being generated for a particular year end/period.

Auditors can record the dates of sending out the bank confirmation letters in the control summary and set timing for follow up if the bank confirmation letter is not received within reasonable time.

This enables auditors to closely monitor the process and increase the chances of receiving the bank confirmation letters in time.

At the same time, a set of bank confirmation letters are generated in MS Word format as follows:-

**AXP SOLUTIONS SDN BHD**  
Chartered Accountants  
83 A, Jalan Emas Satu,  
Taman Sri Skudai,  
81300 Johor Bahru,  
Johor, Malaysia  
Tel: +607 557 5722 Fax: +607 557 7697

Date: 15 December 2008

**THE HONGKONG AND SHANGHAI BANKING CORPORATION LTD**  
OCBC CENTRE BRANCH,  
65 CHULIA STREET,  
SINGAPORE 049513,

Dear Sirs / Madams,

**ZAP COPY CENTRE SDN BHD**  
CURRENT ACCOUNT : 04200150535 AND OTHERS

We are presently engaged upon the audit of the financial statements of our above-named client, and shall be obliged if you would advise us, direct to the above address, of the following particulars at the close of business on **31 December 2008**.

(a) the balances of all accounts open between you and our client during the year ended on the above date :-  
(i) current accounts  
(ii) deposit accounts  
(iii) savings accounts  
(iv) loan accounts

Note that a large number of bank confirmation letters have been generated within a few seconds and the preparer can print and send them out right away! This reduces the preparation time substantially, which means lesser time cost too!

**Audit Express** is also flexible by allowing users to amend the bank confirmation letters template as and when changes are necessary.

Tips on Audit Express – Preparing Bank Confirmation Letters in Batch

Auditors can incorporate all kinds of standard letters in the Letter Generating Centre and assign these time consuming, administrative tasks to a non-professional member of staff. Examples of letters that can be included are, but not limited to:-

- (1) Stock-take observation reminder letters;
- (2) Audit reminder letters;
- (3) Annual Return filing reminder letters and etc.

For more details on how you can exploit **Audit Express** to cope with the revised and/or redrafted ISAs, kindly contact our Customer Service at [support@myaxp.com](mailto:support@myaxp.com).

**AXP**™  
Knowledge · Create · Value

**MSC**  
MALAYSIA  
Status Company

# Audit Express

Now compliant with the Clarified International Standards on Auditing (ISAs)!

a software that improves both the speed and quality of undertaking an audit engagement.

It also updates you technically with local support.

visit our website for more detail. [www.myAXP.com](http://www.myAXP.com)

To arrange for a demonstration, kindly contact us at 1300 882 297 or [marketing@myAXP.com](mailto:marketing@myAXP.com)

To ease your cash flows, you can opt for the 0% interest installment plan for up to 24 months with EON Bank and Hong Leong Bank credit cards.

**AXP Solutions Sdn Bhd**  
is proud to be one of the winners of

**Enterprise**  
2010  
Malaysia's  
Entrepreneur Spirit

# Breaking News

## Adopting Clarified ISAs - Quality of Audit *VS* Cost-Benefit

Small and medium practitioners may find it difficult to switch from the 'traditional' audit approach to a 'risk-based' audit approach and a common reason for not adopting the 'risk-based' audit approach is the cost-benefit issue! Nevertheless, it is generally believed that adopting the 'risk-based' audit approach will improve the quality of the audit.

### What is Clarified ISAs?

As we are aware, the International Auditing and Assurance Standards Board (IAASB) (one of the standard setting boards under the IFAC) has completed its programme of enhancing the clarity of its International Standards on Auditing (ISAs), which is commonly referred to as '**Clarity Project**'. This programme involved the application of new drafting conventions to all ISAs to reflect the new conventions and matters of clarity generally.

The Clarified ISAs have the following common structure:

- **Introduction** – explanation of the purpose, scope and subject matter.
- **Objectives** – objective to be achieved as a result of complying with the requirements of the ISA.
- **Definitions** – description of the meanings attributed to certain terms in the ISA.
- **Requirements** – specific auditor requirements, each requirement contain the word '**SHALL**'.
- **Application and other explanatory material** – provides further explanation of the requirements, and guidance for carrying them out.
- **Appendices** – form part of the application and other explanatory material.

The Malaysian Institute of Accountants (MIA) has adopted Clarified ISAs in its entirety and these Clarified ISAs are effective for the audit of financial statements for **financial period beginning on or after 1 January 2010**, which is also the effective date for the adoption of several revised and new financial reporting standards, for instance, **FRS 101 (revised)** Presentation of financial Statements, **FRS 7** Financial Instruments: Disclosures, and **FRS 8** Operating Segments.

**Overview of the ‘Risk-Based’ Audit**

The objective of the audit is to reduce the audit risk to an acceptably low level. Audit risk is the risk of expressing an inappropriate audit opinion on financial statements that are materially misstated. Audit risk has two key elements, i.e., *inherent and control risks*, and *detection risk*. Inherent risks may include business and fraud risks. (Note: Further explanation of these risks is not included here as these are not within the scope of this topic).

The ‘risk-based’ audit approach can be divided into three key phases:

1. **Risk assessment** – to identify and assess the risks (*stated above*) of material misstatement in the financial statements.
2. **Risk response** – design and perform further audit procedures that respond to identified and assessed risks of material misstatement, at both the financial statement and assertion levels.
3. **Reporting** – form an opinion based on the audit evidence obtained, and prepare and issue a report that is appropriate to the conclusions reached.

**Exhibit I – Procedures for Risk Assessment**

RISK ASSESSMENT PROCEDURES		
Activities	Purpose of the activities	Some of the documents in <i>Audit Express</i>
Preliminary engagement activities	Decide whether to accept or continue engagement	1. Client acceptance and retention 2. Establish terms of the engagement
Plan the audit	Develop overall audit strategy and audit plan	1. Establish overall audit strategy 2. Preliminary analytical review 3. Determine planning materiality
Perform risk assessment procedures	Identify and assess risks of material misstatement	1. Understand the entity and its environment 2. Assessing risks of material misstatement 3. Assessing risks relating to fraud 4. Time cost budget and budgeted audit fee 5. Trial balance, general ledger and opening balances 6. Determination of functional currency

**Exhibit II – Procedures for Risk Response**

RISK RESPONSE PROCEDURES		
Activities	Purpose of the activities	Some of the documents in <i>Audit Express</i>
Design overall responses	Develop appropriate responses to the assessed risks of material misstatement	<ol style="list-style-type: none"> <li>1. Responses to assessed risks</li> <li>2. Update audit strategy / audit plan</li> <li>3. Update planning materiality</li> </ol>
Implement responses to assessed risks of material misstatement	Reduce audit risk to an acceptably low level	<ol style="list-style-type: none"> <li>1. Assessment of control risk and tests of control</li> <li>2. Substantive tests for accounts balances and class of transactions</li> <li>3. Various presentation and disclosure checklists</li> </ol>

**Exhibit III – Procedures for Reporting**

REPORTING PROCEDURES		
Activities	Purpose of the activities	Some of the documents in <i>Audit Express</i>
Evaluate the audit evidence obtained	Determine what additional audit work is required, if any	<ol style="list-style-type: none"> <li>1. Summary of audit differences</li> <li>2. Review of subsequent events</li> <li>3. Contingent liabilities, operating lease and capital commitments</li> </ol>
Prepare the auditor’s report	Form an opinion based on audit findings	<ol style="list-style-type: none"> <li>1. Audit completion report</li> <li>2. Going concern checklist</li> </ol>

**Why ‘risk-based’ audit?**

Small and medium practitioners may find it difficult to switch from the ‘traditional’ audit approach to a ‘risk-based’ audit approach and a common reason for not adopting the ‘risk-based’ audit approach is the cost-benefit issue! Nevertheless, it is generally believed that adopting the ‘risk-based’ audit approach will improve the quality of the audit.

Thus, do the benefits override the costs, or do the costs override the benefits? We shall summarise some of the [key benefits](#) of adopting a ‘risk-based’ audit approach:

**1. Time flexibility to perform the audit**

Risk assessment procedures can often be performed before the commencement of an audit engagement, hence, an audit client may also have time to respond to identified weaknesses in internal control and respond to other requests for audit purposes before the commencement of the year-end audit fieldwork.

**Breaking News – Adopting Clarified ISAs – Quality of Audit vs Cost-Benefit****2. Focus on key areas**

The audit team can focus on high-risk areas and, perhaps, reduce work in lower-risk areas, which will improve the overall effectiveness in performing the audit engagement.

**3. Focus on specific risks**

Further audit procedures are designed to respond to assessed risks, and tests of details that address risks in general may be significantly reduced or eliminated.

**4. Benefit of understanding the internal control**

When an auditor decides to test the operating effectiveness of internal controls, such tests of controls (which may be required to be tested every three years if the conditions are met) will often result in less work being required in performing extensive tests of substantive procedures.

**5. Value-added services to clients**

When an auditor has obtained a full understanding of an entity's internal control systems, the auditor may identify weaknesses in internal control that were not previously known to the management. Communicating these weaknesses to management will enable them to take appropriate action, which may result in reducing the entity's business and fraud risks!

In a nutshell, the benefits of a 'risk-based' audit may override the associated costs, and practitioners will experience significant improvements in the quality of the audit engagement.

**Moving Forward**

ISAs do not distinguish the audit approach required for a one-person entity from that required from an entity employing thousands of employees. **An audit is an audit.** Thus, the basic approach to an audit does not change just because the entity is small, and there is **no 'exceptions' for not complying with all the relevant ISAs.**

ISAs focus on matters the auditor needs to address, and not on the details of specific procedures. The design of further audit procedures depends on the auditor's risk assessment and perhaps, the size of the entities. In tailoring the procedures to respond appropriately to the assessed risks, appropriate exercise of professional judgement is essential. However, professional judgement cannot be used to avoid compliance with any ISA requirements, except in exceptional circumstances allowed under the ISAs.

Reading and understanding all the Clarified ISAs and training all the staff to possess sufficient knowledge and capabilities to apply ISAs are not simple tasks.

Thus, to provide complimentary value-added services to our clients, AXP has embarked on several projects relating to both understanding and ensure compliance with ISQC 1 and Clarified ISAs. As a result, we have developed various audit programmes and tools to assist audit practitioners in complying with the latest developments in professional standards. Audit documentation for the audit of small and medium-sized entities has also been developed to cater for the needs of auditing smaller entities while complying with the Clarified ISAs.

**If you are interested to find out more about the Clarified ISAs-compliant audit documentation, please feel free to contact our Technical Support Team at [support@myAXP.com](mailto:support@myAXP.com) or [1300 882 297](tel:1300882297).**



# Technical News Update

In response to comments and views received, we have divided our Technical News Update into 3 sections. Section 1 is of particular interest to SMEs and SMPs. Section 2 focuses on FRS and convergence with IFRS. Section 3 includes other technical news and updates.

## **Section 1 – Special Interests for SMEs and SMPs**

### *Update of IFRS for SMEs*

The trend towards globalisation is inevitably, including the adoption of IFRS, and most likely, IFRS for SMEs. Are you ready to adopt IFRS for SMEs? The International Accounting Standards Board (IASB) provides 'IFRS for SMEs Update' for subscription, which is a staff update about news relating to the IFRS for SMEs.

The public may also subscribe for free to the 'IFRS for SMEs alert', and you can sit back, relax and read the update sent directly to your email accounts. If you have not yet subscribed to IFRS for SMEs alert, you may do so by visiting the following web-page: <http://www.ifrs.org/IFRS+for+SMEs/Update.htm>

## **Section 2 – Development of FRS and Convergence with IFRS**

### ***Technical News from the International Accounting Standards Board ('IASB')***

From **1 November 2010** to **31 December 2010**, the IASB and the IFRS Interpretations Committees have published the following:

- ✓ IASB publishes IFRS Practice Statement on Management Commentary
- ✓ IASB proposes improvements to hedge accounting
- ✓ ISAB issues amendments to IAS 12 Income Taxes
- ✓ IASB issues narrow amendments to IFRS 1

For more information on the above technical news, please visit [www.ifrs.org/Home.htm](http://www.ifrs.org/Home.htm).

### ***Technical News from the Malaysian Accounting Standards Board ('MASB')***

Since **1 November 2010** to **31 December 2010**, the MASB has published the following:

- ✓ FRS 124 *Related Party Disclosures*
- ✓ Amendments to FRSs contained in the document entitled '*Improvements to FRSs (2010)*'
- ✓ IC Interpretation 19 *Extinguishing Financial Liabilities with Equity Instruments*
- ✓ *Prepayments of a Minimum Funding Requirement* (Amendments to IC Interpretation 14)

The issuance of these pronouncements is part of MASB's roadmap towards achieving full convergence with the IFRS in 2012, which is aimed at reducing the gap between the IFRSs and FRSs.

## **Section 3 – Other Technical News and Updates**

### ***Technical News from the Investor Resources section of the IASB***

The IASB recognises that investors and other users of financial statements have an important stake in the development of IFRSs, and hence, has set up a new section in its web page – 'Investor Perspectives', to provide regular updates for investors. It is written by former analysts who are now IASB members.

On **10 December 2010**, Mr. Paul Pacter considers the need for IFRS for SMEs and the support available from the IASB on IFRS for SMEs in his article: '**Capital providers need good small business reporting, too**'. If you are interested to find out more and provide your feedback on this topic, please visit the following web page:

<http://www.ifrs.org/Investor+resources/2010+perspectives/December+2010+Perspectives/IFRSfor+SMEs.htm>

*Note: the above URL is provided with the consent and agreement of IASB's Investor Liaison unit.*

# Reviewing Disclosure Requirements



*As a value-added service, AXP provides a complimentary service to assist in reviewing annual financial statements audited by our clients during the implementation and customisation stage of **Audit Express**. Any recommendations for improvements in disclosure requirements will be issued for their considerations.*

*In this section, we shall highlight common disclosure “faults” which have been observed during our review, and hope that it will help our client practitioners to better understand the disclosure requirements of prevailing reporting standards.*

In this issue, we shall focus on **MASB 27 / FRS 123 Borrowing Costs** and **MASB 28 Discontinuing Operations / FRS 5 Non-current Assets Held for Sale and Discontinued Operations**.

<u>Reference</u>		<u>Observations</u>	<u>Recommendations or sample disclosures</u>
<u>PERS</u>	<u>FRS</u>		
27.29 (a)	123.8 123.17 123.20 123.22	Accounting policies for borrowing costs are omitted.	<p><b>Example:</b></p> <p><b>Where borrowing costs are capitalised:</b></p> <div style="border: 1px solid black; padding: 10px;"> <p><i>Borrowing Costs</i></p> <p>123.8 123.17 Borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets are capitalised as part of the cost of the assets when the Group and the Company incur the expenditure for the assets, incurs borrowing costs and undertakes activities that are necessary to prepare the assets for the intended use or sale.</p> <p>123.20 123.22 Capitalisation of borrowing costs is suspended during extended periods in which active development is suspended and ceased when substantially all the activities necessary to prepare the qualifying assets for the</p> </div> <p>For details, please refer to AXP’s <b>Model Financial Statements for FRS 2010</b>, page 44, or AXP’s <b>Model Financial Statements for PERS 2009</b>, page 25.</p>

<u>Reference</u>		<u>Observations</u>	<u>Recommendations or sample disclosures</u>																																																																																																																												
<u>PERS</u>	<u>FRS</u>																																																																																																																														
			<p><b><u>Where there is no capitalisation of borrowing costs:</u></b></p> <p>All borrowing costs are expensed in profit or loss when they are incurred.</p>																																																																																																																												
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N/A	5.28	<p>Non-current assets classified as held for sale and the assets of a disposal group classified as held for sale are <b><u>NOT</u></b> presented separate from other assets.</p> <p>The liabilities of a disposal group classified as held for sale are <b><u>NOT</u></b> presented separate from other liabilities.</p>	<p><b>Example:</b></p> <p>FRS Ref. 101.51(a) MODEL GROUP BERHAD (Company No. 12345678-A) (Incorporated in Malaysia) 101.51(b) AND ITS SUBSIDIARIES</p> <p>101.10(e) NOTES TO THE FINANCIAL STATEMENTS 101.51(c) FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2010</p> <p>5.28 The assets held for sale and liabilities directly associated with assets held for sale are as follows:</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 80%;"></td> <td style="text-align: right; border-left: 1px solid black;"><b>The Group</b></td> </tr> <tr> <td></td> <td style="text-align: right; border-left: 1px solid black;"><b>31.12.10</b></td> </tr> <tr> <td></td> <td style="text-align: right; border-left: 1px solid black;"><b>RM'000</b></td> </tr> <tr> <td><b>Assets classified as held for sale:</b></td> <td></td> </tr> <tr> <td>Investment property (Note 6)</td> <td style="text-align: right; border-left: 1px solid black;">543,924</td> </tr> <tr> <td>Trade and other receivables</td> <td style="text-align: right; border-left: 1px solid black; border-bottom: 1px solid black;">10,396</td> </tr> <tr> <td></td> <td style="text-align: right; border-left: 1px solid black; border-bottom: 3px double black;"><b>554,320</b></td> </tr> <tr> <td><b>Liabilities directly associated with assets classified as held for sale:</b></td> <td></td> </tr> <tr> <td>Trade and other payables</td> <td style="text-align: right; border-left: 1px solid black; border-bottom: 1px solid black;">9,596</td> </tr> </table> <p>For details, please refer to AXP's <b>Model Financial Statements for FRS 2010</b>, page 71.</p>		<b>The Group</b>		<b>31.12.10</b>		<b>RM'000</b>	<b>Assets classified as held for sale:</b>		Investment property (Note 6)	543,924	Trade and other receivables	10,396		<b>554,320</b>	<b>Liabilities directly associated with assets classified as held for sale:</b>		Trade and other payables	9,596
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28.31	5.33 (b)	<p>No analysis of the single amount of the:</p> <p>(i) post-tax profit or loss of discontinued operations, and</p> <p>(ii) post-tax gain or loss recognised on the measurement to fair value less costs to sell or on disposal of the assets or disposal group(s) constituting the discontinued operation,</p> <p>into revenue, expenses and the resultant pre-tax profit or loss arising from discontinued operations.</p>	<p><b>Example:</b></p> <p>5.33, 5.34 The results of the discontinued operations are as follows:</p> <table border="1"> <thead> <tr> <th></th> <th colspan="2">The Group</th> </tr> <tr> <th></th> <th>31.12.10</th> <th>31.12.09</th> </tr> <tr> <th></th> <th>RM'000</th> <th>RM'000</th> </tr> </thead> <tbody> <tr> <td>5.33(b)(i) Revenue (Note 50)</td> <td>154,302</td> <td>234,168</td> </tr> <tr> <td>5.33(b)(i) Expenses</td> <td>(142,719)</td> <td>(213,324)</td> </tr> <tr> <td>5.33(b)(i) Profit before tax from discontinued operations (Note 42)</td> <td>11,583</td> <td>20,844</td> </tr> <tr> <td>5.33(b)(ii)/112.81(h)(ii) Income tax expense (Note 42, 50)</td> <td>(3,956)</td> <td>(5,048)</td> </tr> <tr> <td>Profit from discontinued operations for the financial year</td> <td>7,627</td> <td>15,796</td> </tr> <tr> <td>5.33(b)(iii), (iv), 112.81(h)(i) Gain on disposal of discontinued operations, net of income tax of RM Nil (2009: RM Nil)</td> <td>1,459</td> <td>-</td> </tr> <tr> <td>Profit for the financial year (Note 43, 50)</td> <td>9,086</td> <td>15,796</td> </tr> </tbody> </table> <p>5.33(c) Net cash flows attributable to discontinued operations are as follows:</p> <table border="1"> <thead> <tr> <th></th> <th colspan="2">The Group</th> </tr> <tr> <th></th> <th>31.12.10</th> <th>31.12.09</th> </tr> <tr> <th></th> <th>RM'000</th> <th>RM'000</th> </tr> </thead> <tbody> <tr> <td>Cash flows from operating activities</td> <td>3,403</td> <td>6,359</td> </tr> </tbody> </table> <p>For details, please refer to AXP's <b>Model Financial Statements for FRS 2010</b>, page 71.</p>		The Group			31.12.10	31.12.09		RM'000	RM'000	5.33(b)(i) Revenue (Note 50)	154,302	234,168	5.33(b)(i) Expenses	(142,719)	(213,324)	5.33(b)(i) Profit before tax from discontinued operations (Note 42)	11,583	20,844	5.33(b)(ii)/112.81(h)(ii) Income tax expense (Note 42, 50)	(3,956)	(5,048)	Profit from discontinued operations for the financial year	7,627	15,796	5.33(b)(iii), (iv), 112.81(h)(i) Gain on disposal of discontinued operations, net of income tax of RM Nil (2009: RM Nil)	1,459	-	Profit for the financial year (Note 43, 50)	9,086	15,796		The Group			31.12.10	31.12.09		RM'000	RM'000	Cash flows from operating activities	3,403	6,359
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# Reviewing Disclosure Requirements

Experts' Corner



**About Experts' Corner**

*Our Technical Adviser, Mr. Keith Farmer, will review and illustrate recognition and measurement issues of prevailing accounting standards in an interesting manner.*

# Preparation of Group Accounts – Consolidation (Part IX)

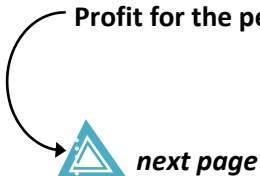
This is the ninth part of a series of articles concerning the preparation of **consolidated** financial statements in accordance with FRS 3: 'Business Combinations' and FRS 127: 'Consolidated and Separate Financial Statements' and FRS 128: 'Investments in Associates'.

In our previous article, we demonstrated the accounting treatment of an associate in the context of an investors' **separate** and **consolidated** financial statements. In this article, we shall illustrate the implications of current account and loan account balances, trading with an associate and recognition of an impairment loss in respect of an associate.


**Example**

The following are the income statement [**I/S**], statement of changes in equity [**SOCE**] and statements of financial position [**SFP**] of '**P**', '**S**' and '**A**' for the year ended 31/12/X7 (RM'000's). '**P**' acquired its interest in '**S**' on 31/12/X1 when the retained earnings of '**S**' were RM680,000 and 180,000 of the ordinary shares in '**A**' on 31/12/X4 when the retained earnings of '**A**' were RM910,000. Consolidated goodwill was impairment tested at 31/12/X7 but no impairment loss was evident.

<b><u>Income Statement (top section of SCI)</u></b>	<b><u>P</u></b>	<b><u>S</u></b>	<b><u>A</u></b>
Revenue	8,000	3,600	2,600
Cost of sales	<u>(4,600)</u>	<u>(1,600)</u>	<u>(900)</u>
Gross profit	3,400	2,000	1,700
Aggregate expenses	<u>(1,300)</u>	<u>(600)</u>	<u>(600)</u>
	2,100	1,400	1,100
Interest and finance costs	<u>(600)</u>	<u>(200)</u>	<u>(200)</u>
PBT	1,500	1,200	900
Tax	<u>(500)</u>	<u>(350)</u>	<u>(350)</u>
<b>Profit for the period [= TCI]</b>	1,000	850	550
	=====	=====	=====



Experts' Corner – Consolidation (Part IX)

<u>Statement of Changes in Equity</u> (extract)	<u>P</u>	<u>S</u>	<u>A</u>
 Retained b/f	7,190	2,380	2,010
Profit for the period [= TCI]	1,000	850	550
Ordinary dividends declared	(300)	(120)	(90)
Transfer to reserves	<u>(110)</u>	<u>(80)</u>	<u>(50)</u>
Retained c/f	7,780	3,030	2,420
	=====	=====	=====
<u>Statement of Financial Position</u>	<u>P</u>	<u>S</u>	<u>A</u>
Sundry net assets	8,318	4,430	3,320
<u>Investments:</u>			
75% OSC of 'S'	1,700		
30% OSC of 'A'	512		
Current accounts (trading) – 'A'	40		(40)
Loan accounts (finance) – 'A'	120		(120)
Declared dividends	(300)	(120)	(90)
	=====	=====	=====
OSC RM1 NV	2,500	1,200	600
Retained earnings	7,780	3,030	2,420
General reserves	110	80	50
	=====	=====	=====

Further information:

- 1) At the respective acquisition dates, book values of the net assets of both 'S' and 'A' were equal to fair values.
- 2) 'P' sold goods to 'A' on 30/11/X7 for RM200,000 at cost + 25%. 'A' still has the goods in inventory at 31/12/X7.
- 3) At 31/12/X7 there was objective evidence that the investment in the associate might be impaired. Hence, in accordance with FRS 136 'P' carried out an impairment test. The test indicated that the recoverable amount of the associate was RM3m in total (it represents a cash generating unit in its own right).
- 4) 'P' does not accrue for dividends.

**Required: Prepare the consolidated financial statements of the P group for the year to 31/12/X7 incorporating the results of A using the equity method.**

*Tutorial Notes:*

- 1) *Since the recoverable amount of the associate is RM3m in total, the recoverable amount of P's investment is 30% x RM3m = **RM900,000** at 31/12/X7.*
- 2) *Since the associate is equity accounted, we cannot cancel the trading and loan account balances, neither do we delete any trading between the parent and the associate. However, we do need to eliminate the **group share (ie. 30%)** of any unrealised profit resulting from the trading activities (see article in the last issue). The elimination is shown below against the 'cost of sales' of the parent, and is commonly referred to as a 'provision for unrealised profit' [**PURP**].*

Answer

**Working schedule for CIS figures**

	<u>P</u>	<u>S</u>	<u>A</u>	<u>☞</u>	Pub. CIS
	(100% x 12/12)	(100% x 12/12)	(30% x 12/12)		
Revenue ( <i>Turnover</i> )	8,000	3,600			11,600
Cost of sales	(4,600)	(1,600)			
<b>PURP: 25/125 x 200 x 30%</b>	<b>(12)</b>				<b>(6,212)</b>
Gross profit	3,388	2,000			5,388
Aggregate expenses	(1,300)	(600)			(1,900)
Profit before finance cost and tax	2,088	1,400			3,488
<b>1) Share of P/L of 'A': 30% x 550</b>			<b>165</b>		165
<b>Impairment loss recognised [Wk 5]</b>				<b>(68)</b>	<b>(68)</b>
Interest payable	(600)	(200)			(800)
<b>PBT</b>	1,488	1,200			2,785
Tax	(500)	(350)			(850)
<b>P/L for the period [= 'TCI']</b>	988	850			1,935
<b>Equity preference dividends of 'S'</b>		n/a			
		850			
Minority interest [25% x 850]		(212.5)			(212.5)
		637.5			
I. G. <b>ordinary</b> dividends:					
S to P: 75% x 120	90	(90)			
<b>A to P: 30% x 90</b>	27		(27)		
	<b>1,105</b>	<b>547.5</b>	<b>138</b>	<b>(68)</b>	<b>1,722.5</b>
	=====	=====	=====	=====	=====

**Consolidated Income Statement of the P group for the year ended 31/12/X7 (RM'000's)**

(Based on the figures in the 'published' column above.)

Revenue	11,600
Cost of sales	(6,212)
Gross profit	5,388
Aggregate expenses	(1,900)
	3,488
<b>Share of P/L of associate</b>	<b>165</b>
<b>IMPAIRMENT LOSS RECOGNISED</b>	<b>(68)</b>
Interest payable	(800)
PBT	2,785
Tax	(850)
Profit for the period [= 'TCI']	1,935
	=====
Attributable to:	
Minority interest	212.5
	=====
Owners of the parent	1,722.5
	=====

**Consolidated Statement of Changes in Equity of the P group for the year ended 31/12/X7 (RM'000's)**

Attributable to the owners of the parent:

	OSC	Wk. schedule for RE				RE	GR	Total	MI	Total Equity
		P	S	A	⊘					
B/f	2,500	7,190	1,275	330		8,795	nil	11,295	895 ①	12,190
P/L [= 'TCI']		1,105	547.5	138	(68)	1,722.5		1,722.5	212.5 ②	1,935
<b>Appropriations:</b>										
Dividend – ordinary		(300)				(300)		(300)	(30) ③	(330)
Trf. to reserves		(110)	(60)	(15)		(185)	185	-	n/a ④	-
C/f	2,500	7,885	1,762.5	453	(68)	10,032.5	185	12,717.5	1,077.5 ⑤	13,795
	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====

① MI balance at 1/1/X7:

OSC of 'S'	1,200
RE B/f (see S's SOCE)	2,380
	3,580 x 25% = 895
	=====

② The MI share of the 'TCI' is RM212,500 (seen in the CIS). Insert this figure into the MI column.

③ The MI share of the ordinary dividend of 'S' is 120 x 25% = 30

④ Transfer to reserves do not affect the net assets – ignored in respect of MI share of 'S'.

⑤ MI balance at 31/12/X7:

OSC of 'S'	1,200
RE C/f (see S's SOCE)	3,030
GR C/f (see S's SFP)	80
	4,310 x 25% = 1,077.5
	=====

**CSFP of the 'P' group as at 31/12/X7 ('000's)**

Statement of Financial Position	P	S	A	CSFP
Sundry net assets	8,318	4,430	<del>3,320</del>	Sundry net assets 12,748
<b>Investments:</b>				
75% OSC of 'S'	1,700			G'will (Wk 1) 290
30% OSC of 'A'	512			Associate (Wk 5) 900
<b>PURP ['P' sold to 'A']</b>	<b>- 12</b>			
Current accounts (trading) – 'A'	40		(40)	Curr. A/c – 'A' 40
Loan accounts (finance) – 'A'	120		(120)	Loan A/c – 'A' 120
Div. receivable – 'S' (75% x 120)	90 ①			<b>Div. due 'A'</b> 27
Div. receivable – 'A' (30% x 90)	27			Declared div. (300)
Dividends declared	(300)	(120) ①	(90)	MI share of div. (30)
	=====	=====	=====	=====
		= 30		

<u>Statement of Financial Position</u> (cont'd)	<u>P</u>	<u>S</u>	<u>A</u>		<u>CSFP</u>
OSC RM1 NV	2,500	1,200	<del>600</del>	OSC	2,500
Retained earnings	7,780	3,030	<b>2,420</b>		
Div. receivable – 'S' (75% x 120)	90	}		GRE (Wk 3)	10,032.5
Div. receivable – 'A' (30% x 90)	27				
<b>PURP ['P' sold to 'A']</b>	<b>- 12</b>				
General reserves	110	80	<b>50</b>	GGR (Wk 4)	<u>185</u>
	=====	=====	=====		2,717.5
				MI (Wk 2)	1,077.5
					=====

*Tutorial Notes:*

- 1) ① Do not forget to accrue for the dividends receivable in the parent's **SFP** and then delete the intra-group balance in respect of 'S'. Since 'A' is not consolidated, there is no 'intra-group' balance to delete !!
- 2) The trading and loan account balances cannot be cancelled. They simply cross-cast onto the **CSFP**.
- 3) The 'provision for unrealised profit' [**PURP**] is deducted – in a **group** context – from the carrying value of the associate and P's component of the **group** retained earnings. [See workings 3) and 5) below.]

**WK 1: GOODWILL RECOGNISED ON CONSOLIDATION**

Cost to 'P' of investment in 'S'	[75%]	1,700	
<u>Less: ADFV of the net assets of 'S':</u>			
OSC of 'S'		1,200	
RE of 'S'		<u>680</u>	
= 100% net assets of 'S'	x 75%	(1,410)	
		=====	
<b>Original goodwill on consol.</b>		<u>290</u>	
		=====	

**WK 2: MINORITY INTEREST AT REPORTING DATE**

<u>Net assets of 'S' at the current reporting date:</u>			
OSC of 'S'		1,200	
Reserves of 'S' at the reporting date ( <u>all</u> of them):			
Retained earnings		3,030	
General reserves		<u>80</u>	
= Net assets at reporting date		4,310	
		=====	
	x 25% =		
<b>MI per CSFP (separate component of equity)</b>			<b>1,077.5</b>
			=====

**WK 3: GROUP RETAINED EARNINGS**

(Prepare this working *separately* for each reserve)

Retained earnings of 'P' (as a <i>separate</i> entity)	Per question	7,780	
	Dividend receivable: 'S'	90	
	Dividend receivable: 'A'	<u>27</u>	
		7,897	
<b>Consolidation adjustment: PURP in respect of sale to an associate: 30% x 40k</b>		<b><u>(12)</u></b>	
		7,885	
'Post' acquisition RE of 'S':	75% x (3,030 – 680)	<u>1,762.5</u>	
		9,647.5	
<b>Post in associate: RE: 30% x (2,420 – 910)...see below</b>	<b>453 Cr.</b>		
<b>LESS: IMPAIRMENT LOSS RECOGNISED</b>	<b><u>68 Dr.</u></b>		<b><u>385 Cr.</u></b>
<b>Group RE per CSFP</b>			<b>10.032.5</b>
			=====

**WK 4: GROUP GENERAL RESERVES**

(Prepare this working *separately* for each reserve)

General reserves of 'P' (as a <i>separate</i> entity)	Per question	110	
'Post' acquisition GR of 'S':	75% x (80 – nil)	<u>60</u>	
		170	
<b>Post in associate: GR: 30% x (50 – nil)...see below</b>		<b><u>15 Cr.</u></b>	
<b>Group GR per CSFP</b>			<b>185</b>
			=====

**WK 5: EQUITY BASED ACCOUNTING**

Cost of 'A'	512	
<b>Consolidation adjustment: PURP in respect of sale to an associate: 30% x 40k</b>	<b><u>(12)</u></b>	<b>500</b>
Add: Post acquisition reserves (ALL of them):		
<b>Retained earnings: 30% x (2,420 – 910)...see above</b>		<b>453 Dr.</b>
<b>General reserves: 30% x (50 – nil)...see above</b>		<b><u>15 Dr.</u></b>
		<b>968</b>
<b>LESS: IMPAIRMENT LOSS RECOGNISED</b>		<b><u>(68) Cr.</u></b>
<b>CV of the investment in the associate in the CSFP (equity based at 'RA')</b>		<b>900</b>
		===

*Tutorial Note: The equity based CV of the investment in the associate is RM968k (see above), however the impairment test indicates that the RA is only RM900k, hence an impairment loss of RM68k needs to be recognised.*

We have one last topic to consider: how to account for **Joint Ventures** (which represent separate entities) in the context of the investors **SFP** and the **CSFP**. We shall turn our attention to this in the next issue.

# Intangible Assets (Part III)

This is the third part of a series of articles concerning the 'recognition' and 'measurement' aspects of **intangible assets [IA]** subject to FRS 138: 'Intangible Assets'. In this article, we shall only consider how to determine the **initial 'cost'** of '**internally generated**' intangible assets since this is a 'big' topic in its own right. Thereafter, we shall consider '**exchanged**' intangible assets, **subsequent** measurement principles and the '**revaluation**' rules.

## INITIAL MEASUREMENT ('COST'):

### If 'INTERNALLY GENERATED'

This is perhaps one of the most contentious areas as far as the recognition of intangible assets are concerned, however, let's first of all be clear about what the Standard requires.

- 1) Firstly - as a **general principle** - any expenditure (incurred either **internally** or **externally**) which does **NOT** satisfy both the '**definition**' and '**recognition tests**' **shall be recognised in P/L as an expense in the period in which it is incurred**, (unless it relates to a business combination accounted for as an acquisition, in which case it forms part of the goodwill figure recognised at the date of acquisition). We need to relate this requirement to points 3) and 4) below.
- 2) Secondly – it further states that “any expenditure **initially** expensed **CANNOT** be reinstated”. Once it's gone; it's gone !
- 3) The Standard **BANS** capitalisation of any **initial** costs associated with the development of **internally generated** goodwill, brands, mastheads, publishing titles, customer lists and items *similar* in substance. It goes further: it also **BANS** capitalisation of any **subsequent expenditure** in respect of the same items. Such costs are **always** recognised in P/L as an expense **as incurred**.
- 4) The Standard **BANS** capitalisation of start-up costs, training costs, advertising costs, promotional costs, relocation costs and reorganisation costs.

Does this leave us with **any** 'internally generated' intangible assets which can be 'recognised' (ie. capitalised rather expensed) ? The answer is 'yes', but it is limited to costs associated with 'research and development' activities.

So, before we consider the requirement of the Standard, let's take a 'step-back' and consider **what type** of '**costs**' we are dealing with and **why** they are incurred.

Typical costs include (*amongst others*) wages, salaries, rent, power, light, heat, any materials used, legal fees, depreciation on non-current assets used for R&D purposes, borrowing costs (subject to satisfying the conditions)... .....*and so the list goes on !!*

Experts' Corner – Intangible Assets (Part III)

At first sight, these costs are **'revenue'** in nature and hence should be **expensed as incurred** (*in the normal way !*).

However, we have to think – **why** does an entity incur such costs ? Presumably the answer **must be** that they are incurred in the 'hope' that they will lead to the introduction or improvement of new products, processes, systems – **something** that will generate revenue **in the future !!** At the very least, they should enhance the 'knowledge base' of the entity and hence its fundamental worth as a business.

If so, then we need to consider whether they should be treated as an **'asset'** and capitalised rather than an **'expense'** and simply written off.

Unfortunately, the answer is not *quite* that simple !! Clearly, **some** of the activities undertaken – what we traditionally refer to as **'research'** – cannot by definition have any identifiable future benefit **at this moment in time**. Other activities – what we traditionally refer to as **'development'** – are undertaken **specifically** on the basis of identifiable future cash flows. I suppose in **simple** terms the answer would be to **expense** the **former** and **capitalise** the **latter**, but once again the answer is not *quite* that simple !!

If we were to **capitalise ALL 'development'** costs, we **might** find that the entity runs out of funds before the project is actually completed, and hence **no** future benefits will be recognised (*indeed, the entity may end up in liquidation instead – it has happened before !!*).

Conversely, whilst we **are** required to **expense ALL 'research'** costs, we should not forget that the knowledge gained as a result of incurring the costs may well represent a valuable 'asset' which **another party** would be prepared to pay to acquire.

**Hence we need some 'rules' !!**

In the **past**, Standards focused on **INTERNAL** costs, and *generally* required **research** costs to be expensed and **development** cost (*subject to satisfying certain criteria*) to be capitalised. Whilst this area (ie. **internal** costs) **is** obviously important, there was no reference to **PURCHASED** costs, and hence these were generally **not** recognised, (*particularly in the case of business combinations*) **even though** there is no doubt that valuable consideration **was** paid to acquire them.

The **revised Standard** now covers **this** area also. Hence we now need to consider **both**:

- **'internally generated R&D'** costs, and,
- (*what the Standard calls*) **'in-process (or 'purchased) R&D'** costs.

Whilst the rules for **'internally generated'** costs have **NOT** changed, there are **NEW** rules for **'in-process R&D'** costs.

We shall consider them both (*in this article, only the rules for **internally generated** R&D costs*).

**INTERNALLY GENERATED:**

FRS 138 replaced FRS 109<sub>2004</sub>: 'Research and Development Costs', which was withdrawn. Such costs are now dealt with under the rules applicable to **'internally generated intangible assets'**. FRS 138 states that 'it is sometimes difficult to assess whether **internally** generated intangible assets qualify for recognition because of problems in identifying future benefits and measuring the costs reliably'.

Hence, **in addition** to complying with the **general** requirements (*ie. satisfy the 'definition' and 'recognition tests'*) such costs **also** have to satisfy **FURTHER** conditions.

Firstly, start by splitting *all* the costs incurred into two 'phases':

**'Research' phase** 'original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding' – ***these costs are written-off in the period in which they are incurred since their nature is that they have no 'clearly identifiable future benefits' (ie. they do not satisfy the definition of an asset nor satisfy the 'probable inflow' test).***

**'Development' phase** 'application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use' – ***these costs shall be recognised as an expense as incurred UNLESS they satisfy 6 further conditions.....in which case they shall be capitalised:***

1) Technical ***feasibility*** of completion (*to sell or use !!*)

Whether the intention is to sell or use the knowledge (to generate income) the simple fact is that we have to assess whether it is technically feasible to achieve the desired end result within the foreseeable future. If not, then whilst the project may be continued, any expenditure incurred to date and likely to be incurred in the future will be expensed as incurred ***until (or if !)*** it satisfies this condition.

2) ***Intention*** to complete (*and sell or use !!*)

Simply because a project might be assessed to be 'technically feasible', this does not guarantee that an entity actually intends to complete the project. Without an entity demonstrating its intention to complete the project, there will be no future income stream !

3) ***Ability*** to use/ sell.

Let's consider the marketing plan, the target audience, the ability to differentiate, the ability to communicate. Many seemingly good inventions have never seen the light of day !

4) ***How*** it will generate future economic benefits (*existence of market ?*)

Is the end result targeted at an existing market, or aiming to create an entirely new market ? Given the nature of much current research and development activity, it aims to create entirely new markets which never existed before. Apple seems to have mastered this technique, others might not be so lucky !!

5) ***Availability*** of adequate technical, financial and other resources complete and use/ sell.

An obvious point I guess !! But, if the availability of any of these resources are in question, the project will never be completed anyway !! Rolls Royce suffered a similar fate many years back.

6) ***Ability*** to measure expenditure ***reliably***.

We are accountants after all !!

IF **ALL** the '6' conditions above are satisfied, an entity is **required** to **capitalise** all costs that are **directly attributable** to creating/ producing/ preparing the intangible asset such that it is '**capable of operating in a manner intended by management**' (I suggest you learn this phrase – by now you should know that it is frequently used !!) – including: materials and services, salaries and wages and legal fees. **As usual, do not capitalise selling/ administration/ general overheads, inefficiencies, or staff training costs.**

**Note, and always remember (as we said above):**

- a) Whatever the arguments may be, the Standard specifically **bans** recognition of **INTERNALLY** generated brands, mastheads (ie. newspaper titles), publishing titles, customer lists and items 'similar in substance'.
- b) **All** costs that do **not** meet the definition **and** recognition tests **shall be expensed as incurred.**
- c) Costs expensed as '**incurred**' .....**CANNOT** subsequently be capitalised.

**Example**

The following is an extract from the trial balance of PQ for the year ended 31/12/X6 together with relevant information.

Extract from the trial balance ('000's):	Dr.	Cr.
Research and development costs (note 1)	4,245	
	=====	=====

Extract from the notes:

1) Research and development costs relate to various projects currently being carried out by PQ. These are detailed below:

	<u>Project number:</u>			
	<u>1</u>	<u>2</u>	<u>3</u>	<u>others</u>
<u>Costs (RM'000's)</u>				
<u>Year to 31/12/X5:</u>				
Research	369	405		1,342 }
Development			745	} 2,861
<u>Year to 31/12/X6:</u>				
Research	453	392		1,920 }
Development		150	585	} 3,500

The following information is available:

Project 1

This is still in the research stage, but the directors are confident that it will prove successful and provide a substantial proportion of the company's income in about 5 years time.

Project 2

During the course of X6, the technical feasibility and commercial viability of this project was established and it was redesignated as development work on the 30th September.

Project 3

This project was expected to be completed during X6, but has run into technical problems, and it is now anticipated that it will not be completed until early X7. The delay in commercial application is not likely to affect consumer demand, and it represents a substantial advance over currently marketed products. Income projections have been revised to allow for the additional costs and delayed revenue, but they still indicate a substantial net present value.

Others

These are other projects that are currently being undertaken by PQ, but have not yet identified any areas where a commercial application is foreseeable.

As a result of the success of project 2, the directors proposed to redesignate all previous research costs as development costs. Income projections indicate that future revenue will exceed all costs incurred to date and further costs to completion.

As yet, none of the projects have generated any revenue, but the auditors are in agreement with the directors on all aspects of commercial marketability.

**Required:**

- a) **Discuss how the expenditure incurred in relation to each project should be accounted for in the financial statements prepared for the year ended 31/12/X6.**
- b) **Prepare an extract from both the published I/S and SFP of PQ for the year ended 31/12/X6 relating to research and development expenditure,**

**Answer**

- a) Firstly, we need to know where the amount of RM4,245,000 as seen on the trial balance comes from. By looking at the analysis of the expenditure given in the note, RM745,000 relates to project 3 which was classified as 'development expenditure' in X5 and hence capitalised. The remainder, ie. RM3,500,000 relates to **all** the expenditure incurred in respect of X6.

Let's take these projects one at a time.

**Project 1:** This is still in the '**research**' phase. Whilst the directors are confident of the final outcome, at the moment the expenditure does **not** meet the definition of an intangible asset. The expenditure incurred in X5 was expensed in X5, and similarly the expenditure in X6 will be expensed in X6.

**Project 2:** The expenditure incurred in X5 was expensed in X5 which was correct for the same reason as project 1 above. The expenditure in X6 has been split into two phases: '**research**' (RM392,000) and '**development**' (RM150,000). Assuming **all '6' conditions are satisfied** the '**development**' costs will be capitalised, but the '**research**' costs have to be expensed. Two points should be noted:

- 1) The directors propose to redesignate **previously expensed** research costs as development costs and (*presumably*) reinstate them. This is **not** allowable. Previously incurred costs which were **expensed as incurred** can **never** be reinstated.

**Experts' Corner – Intangible Assets (Part III)**

2) Since the project does not **yet** generate income, the capitalised costs need to be tested **ANNUALLY** for impairment, and any impairment loss recognised **immediately**. You should note that the impairment loss will be reversed in a subsequent period **if** the requirements for a reversal of an impairment loss in FRS 136 are met.

**Project 3:** Despite the setback, it appears that the '6' conditions are **still** satisfied, and hence the expenditure in X6 will be capitalised. Once again, until the project starts to generate income, the **accumulated** capitalised costs need to be tested **ANNUALLY** for impairment, and any impairment loss recognised **immediately**.

**Others:** These are still in the 'research' phase and all expenditure incurred in X6 will be expensed.

b) Extracts from the F/S of PQ for the year ended 31/12/X6 ('000's)

**Income Statement (top section of Statement of Comprehensive Income)**

Research costs expensed (453 + 392 + 1,920)	<b>(2,765)</b>
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**Statement of Financial Position**

Intangible NCA	<u>Cost</u>	<u>Amortisation</u>	<u>RM</u>
Project 2	150	n/a	150
Project 3	1,330	n/a	<u>1,330</u>
	====	==	<b>1,480</b>

Tutorial note: Once each project is 'capable of operating as intended by management' any **further** expenditure will **cease** to be capitalised. Assuming the resultant intangible assets are assessed to have a '**finite**' life, amortisation will **start** from this date, **irrespective** of whether they are **actually** generating income or not.

There is a lot here to digest, who says accountancy is boring !! In our next article, we shall consider '**in-process**' (or '**purchased**') R&D costs.



# *System of Quality Control for Audit Practitioners*

## *— Relevant Ethical Requirements*

In this series of [System of Quality Control for Audit Practitioners](#), we shall illustrate the steps that audit practitioners can take to ensure compliance with ISQC 1.

### Introduction

In our previous Issue, we discussed the first element of a quality control system as required by ISQC 1. In this Issue, we will consider how a Firm shall implement the second element – **relevant ethical requirements**.

In accordance with Paragraph 20 of the ISQC 1, the Firm shall establish policies and procedures designed to provide it with reasonable assurance that the Firm and its personnel comply with relevant ethical requirements. The fundamental principles of professional ethics established in the Part A of the IFAC Code include:

1. Integrity;
2. Objectivity;
3. Professional competence and due care;
4. Confidentiality; and
5. Professional behaviour.

In Part B of the IFAC Code, it illustrates how the conceptual framework in Part A shall be applied, and provides examples of safeguards that may be appropriate to address threats to compliance with the fundamental principles and situations where safeguards are not available to address the threats. The threats illustrated fall into the following categories:

1. Self-interest threat;
2. Self-review threat;
3. Advocacy threat;
4. Familiarity threat; and
5. Intimidation threat.

### Independence Requirements

Irrespective of whether staff members hold a professional designation in the Firm, all members of the engagement team must maintain independence in both mind and appearance of their assurance clients. Independence requirements shall be maintained throughout the engagement period for all assurance engagements. If there are threats to independence, it shall be eliminated or reduced to an acceptable level by applying appropriate safeguards.

**System of Quality Control for Audit Practitioners  
– Relevant Ethical Requirements**

We shall illustrate two of the common non-assurance services provided by the Firm below:

**Can a Firm prepare tax return for an assurance client?**

It is not uncommon for a Firm to provide assurance and taxation services to a client, such as the preparation of a tax return. **Self-review and advocacy threats** may be created for the preparation of tax return for an assurance client. However, if the client's management takes responsibility for the returns, including any significant judgements made, a threat to independence will not generally be created.

**Can a Firm calculate current and deferred tax for an assurance client?**

Another common example is where a Firm helps the assurance client to prepare the current and deferred tax calculations, particularly for small and medium-sized entities which do not have qualified personnel to prepare such calculations. Since the current and deferred tax calculations will subsequently be audited by the Firm, it creates a **self-review threat**. The significant of the threats depends upon several factors, and safeguards shall be applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of safeguards include:

- Use **professionals** who are **not members of the audit team** to **perform the service** of calculating current and deferred taxes;
- If such services are performed by a member of the audit team, use a **partner or senior staff member** with appropriate expertise who is **not a member of the audit team** to **review the tax calculations**; or
- Obtain advice on the service from an external tax professional.

If the threats to independence cannot be eliminated or reduced to an acceptable level by applying appropriate safeguards, the Firm shall eliminate the activity, interests, or relationship that is creating the threat, or refuse to accept or continue the engagement.

**Policies and procedures of the Firm in respect of independence requirements**

The following summarises the policies and procedures that shall be established by the Firm in accordance with the ISQC 1:

**The Firm**

- The Firm, its personnel and others subject to independence requirements, shall maintain independence where required by relevant ethical requirements.
  - Communicate its independence requirements to its personnel and others subject to independence requirements.
  - Identify and evaluate circumstances and relationships that create threats to independence, and take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or to withdraw from the engagement.
  - Maintain and update its records relating to independence and take appropriate action regarding identified threats to independence that are not at an acceptable level.

**System of Quality Control for Audit Practitioners  
– Relevant Ethical Requirements**

- The Firm is notified of breaches of independence requirements and needs to take appropriate actions to resolve such situations.
  - The Firm is required to promptly communicate identified independence breaches to the engagement partner, other relevant personnel in the Firm and the Network or others subject to the independence requirements.
- Set out criteria for determining the need for safeguards to reduce the **familiarity threat** to an acceptable low level when using the same senior personnel on an assurance engagement over a long period of time.

**Engagement Partners and Staff Members**

- Engagement partners are to provide the Firm with relevant information about client engagement to enable the Firm to evaluate the overall impact on independence requirements.
- Personnel to promptly notify the Firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken.
- Personnel to promptly notify the Firm of independence breaches of which they become aware.
- Prompt communication to the Firm by the engagement partners or others of the actions taken to resolve the independence breaches, so that the Firm can determine whether it should take further action.
- **Written confirmation**, either in paper or electronic form, of compliance with policies and procedures on independence from all Firm personnel who are required to be independent by relevant ethical requirements.
- To reduce the **familiarity threat**, for **audits of financial statements of listed entities**, rotation of the engagement partner and the individuals responsible for engagement quality control review, and others subject to rotation requirements after a specified period. In particular, the IFAC Code requires the rotation of the key audit partner after a pre-defined period, normally no more than seven years. However, national requirements may establish shorter rotation periods.

**Excerpt I – ISQC 1 Compliance Checklist on ‘Relevant ethical requirements’ developed by AXP for its customers**

OBJECTIVES OF THIS ELEMENT:					
To ascertain whether the Firm establishes policies and procedures designed to provide it with reasonable assurance that the Firm and its personnel comply with the relevant ethical requirements of the By-Laws.					
COMPLIANCE CHECKLISTS:					
No.	Procedures and Checklists	X-Ref	Yes	No	N/A
<b>1</b>	<b>Compliance with Relevant Ethical Requirements<sup>1</sup></b>		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1.1	Do the Firm and its personnel comply with the By-Laws, including integrity, objectivity, professional competence and due care, confidentiality and professional behaviour?		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<b>2</b>	<b>Independence</b>		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2.1	Are the policies and procedures designed to provide it with reasonable assurance that the Firm, its personnel and others subject to independence requirements maintain independence when required by relevant ethical requirements? Consider the points below.		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**System of Quality Control for Audit Practitioners  
– Relevant Ethical Requirements**

*Excerpt II – Sample annual written confirmation of compliance with the independence requirements in Audit Express*

**TO:**  
«Auditor»  
Chartered Accountants  
«OurAddress1»  
«OurAddress2»  
«OurAddress3»  
«OurAddress4»

Dear Sirs / Madam,

**INDEPENDENCE DECLARATION**

In connection with the performance of my duties as the [position], I am not aware of any relationships between the «Auditor»'s clients and me that, in my professional judgment, may create any threat from the beginning of the calendar year to «YPERDate», including:

- a) **Self-interest threats**, which may occur as a result of the financial or other interests of me or of my immediate or close family member;
- b) **Self-review threats**, which may occur when a previous judgment needs to be re-evaluated by me who is responsible for that judgment;



**Moving Forward**





In order to achieve the objective of this element, the Firm shall evaluate compliance with the relevant ethical requirements as part of the decision to accept a new client or assurance engagement, and continue an assurance engagement. We shall consider the requirements for accepting and continuing client relationships and engagements in next issue!



***Relevant Ethical  
Requirements  
of ISQC 1***


# AXP UPDATES

Milestones achieved, and events participated and sponsored by AXP, since 1 September 2010, are as follows:

<u>Date</u>	<u>Events / Milestones</u>	<u>Organisers / Details</u>
31/12/2010	<b>Audit Express</b> is now compliant with <b>Clarified International Standards on Auditing (ISAs)</b>	AXP focuses on 2-T's. In order to assist Audit Practitioners to resolve contemporary issues, AXP's Technical Support Team has just completed its ' <b>Clarity Project</b> ' to ensure that all audit documentation in <b>Audit Express</b> complies with the Clarified ISAs! If you are an AXP client and have not yet been updated for these latest developments, kindly contact <b>1300 882 297</b> or <a href="mailto:support@myAXP.com">support@myAXP.com</a> for more information.
28/12/2010	New customer from Myanmar 	AXP is successfully expanding into Myanmar, another South-East Asian country, following Malaysia, Singapore and Indonesia.
17/12/2010	Enterprise 50 Award - 2010 	Once again, AXP has been awarded Enterprise 50, an annual award organised by SME Corporation Malaysia and Deloitte Malaysia. AXP has improved substantially since we were awarded with Enterprise 50 in 2008.  For more information, please visit: <a href="http://www.e50.com.my">www.e50.com.my</a>

<u>Date</u>	<u>Events / Milestones</u>	<u>Organisers / Details</u>
10-12/12/2010	2 <sup>nd</sup> global launch of McMillan Woods Global, and global meeting	Our Chief Executive Officer and Chief Marketing Officer were invited to participate in McMillan Woods Global meeting in Phnom Penh, Cambodia. As a result, AXP has obtained valuable exposure into another regional arena.
1-3/11/2010	<p>Audit Express Workshop &amp; Certification – Universiti Terengganu Malaysia (UMT)</p>  <p>Tu Chai Yieng</p>  <p>Tang Chou Leong</p>  <p>Tan Kim Lee</p>  <p>Rosansusilawati Binti Mohammad Ropi</p>	<p>The workshop conducted in UMT was attended by final year accounting undergraduates. The <b>top 5 scorers</b> of Audit Express Certification in UMT are:</p> <ol style="list-style-type: none"> <li>1. Tu Chai Yieng</li> <li>2. Tang Chou Leong</li> <li>3. Tan Kim Lee</li> <li>4. Rosansusilawati Binti Mohammad Ropi</li> <li>5. Wan Ahnaf Ruzaini Bin Wan Hassan</li> </ol> <p>Some of the students are attached to AXP clients for their 6 months practical training.</p>

<u>Date</u>	<u>Events / Milestones</u>	<u>Organisers / Details</u>
28/10/2010	<p>First <b>Audit Express</b> Refresher Course at <b>AXP Training Centre</b></p> 	<p>This was the first <b>Audit Express</b> refresher course conducted in AXP's brand new training centre attended by 30 trainees.</p>
20/10/2010	<p>Table display at CTIM Budget Talk</p> 	<p>Organised by Chartered Tax Institute of Malaysia (CTIM).</p> <p>The annual CTIM Budget Talk analysed and highlighted its implications for the business community.</p> <p>The event was held on 20 October 2010 at Berjaya Time Square, Kuala Lumpur. It was also held in other states in Malaysia at various dates in October.</p>
8 & 15/10/2010	<p>Audit Express Workshop &amp; Certification – International Islamic University Malaysia (IIUM)</p>  <p>Mohammed Abdullah Ali Al-Dailami</p>	<p>The <b>top 2 scorers</b> of Audit Express Certification in IIUM are:</p> <ol style="list-style-type: none"> <li>1. Mohammed Abdullah Ali Al-Dailami</li> <li>2. Syuhaidah Bt Soaib</li> </ol> <p>AXP clients may contact us if you wish to recruit the above students; we shall contact the students on your behalf.</p>

<u>Date</u>	<u>Events / Milestones</u>	<u>Organisers / Details</u>
	 <p>Syuhaidah Bt Soaib</p>	
<p>6/10/2010</p>	<p>Evening Talk on IT for Audit Firms</p> 	<p>This event was organised by Malaysian Institute of Accountants (MIA), Kuching branch, with the aims to create awareness among members of MIA the importance of IT investment, and showcase IT software programmes available in the market for audit practitioners.</p> <p>AXP, as one of the leading audit software providers, is proud to have been invited to showcase our core products, <b>Audit Express</b>, to the participants.</p>
<p>30/9/2010</p>	<p>Audit Express Workshop &amp; Certification – TAR College Kuala Lumpur</p>  <p>Timothy Ng Han Lin</p>  <p>See Gee Kit</p>	<p>The workshop and certification was attended by Advanced Diploma –Year 2 students. The <b>top scorers</b> of Audit Express Certification are:</p> <ol style="list-style-type: none"> <li>1. Yeap Kok Hoe</li> <li>2. Timothy Ng Han Lin</li> <li>3. See Gee Kit</li> <li>4. Chin Jung Wei</li> </ol> <p>The name of other students who obtained <b>Grade A</b> are:</p> <ol style="list-style-type: none"> <li>1. Foo Kwong Long</li> <li>2. Tan Eng Hui</li> <li>3. Tan Kar Mun</li> <li>4. Tang Yuh Ching</li> <li>5. Wong Siao Men</li> <li>6. Yap Tse Syum</li> <li>7. Yvonne Tan Pik Jin</li> </ol> <p>AXP clients may contact us if you wish to recruit the above students; we shall contact the students on your behalf.</p>

<u>Date</u>	<u>Events / Milestones</u>	<u>Organisers / Details</u>
	<p>Audit Express Workshop &amp; Certification –</p>  <p>Chin Jung Wei</p>	
<p>22/9/2010</p>	<p>AXP New Office!</p>  	<p>In view of our business expansion and the setting up of AXP Training Centre to serve our customers better, we have relocated our office in Cyberjaya to <b>A-3-03 &amp; A-3-05, SME Technopreneur Centre 2 Cyberjaya, 2260, Jalan Usahawan 1, 63000 Cyberjaya, Selangor Darul Ehsan.</b></p> <p>Our new offices incorporate a brand new training centre. With a spacious and comfortable training room, trainees can <b>focus on learning without any disturbance and distraction</b> from daily office tasks.</p> <p>Cyberjaya provides a perfect location, with ample parking space (parking is free of charge!) and no heavy city traffic!! It is indeed an ideal venue for <b>quality training.</b></p>
<p>14/9/2010</p>	<p><b>Publication of ISQC 1 Compliance Checklists.</b></p> 	<p>In response to our customers' needs, AXP Technical Support Team embarked on a project to develop ISQC 1 compliance checklists with the aim of assisting our customers to better understand and implement ISQC 1. These checklists have been distributed to our customers.</p>
<p>6/9/2010</p>	<p>Publication of 4 books by our Technical Adviser, <b>Mr. Keith Farmer.</b></p>	<p><b>Mr. Keith Farmer</b> has finished 4 books and they are marketed under the brand of <b>'MingPieMa' Accounting Series.</b> These books are distributed in Malaysia through AXP Solutions Sdn. Bhd. for AXP customers. Furthermore, AXP customers have the privilege to own these books at 10% discount from normal price.</p>

For more information on the above events, kindly visit AXP's web page [www.myAXP.com](http://www.myAXP.com).

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**Contributions & Comments**

AXP e-Newsletter welcomes your contributions on contemporary issues encountered by the profession. We also wish to hear from you on how this e-Newsletter can be improved for more timely and useful information.