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Critical tips for foreign & Thai managers

Trade and investment in Chiang Mai

Interview BMS Gemini & Driessen

IFRS in Thailand

By Rob Hurenkamp

In June 2009 the roadmap for the implementation of International Financial Reporting Standards ("IFRS") was discussed in meetings between the Securities and Exchange Commission ("SEC"), the Federation of Accounting Professionals ("FAP") and Chief Financial Officers of the SET 50 companies in Thailand. IFRS is a financial reporting framework for financial statements which uses fair value measurement as a key concept in the preparation of accounts. It was adopted in the European Union in 2005. Compared with the current Thai Accounting Standards (from hereon: "TAS"), the advantage of IFRS is that greater transparency is required when reporting on the financial performance and position of a company. Due to this greater transparency, the financial results of one company can be benchmarked with other companies, even across borders. Cross-border comparisons are becoming more prevalent as the number of countries who are adopting IFRS increases. By introducing IFRS for listed companies, the SEC is of the opinion that more foreign investors will be attracted to invest in the Thai stock market over the mid to long term.

The roadmap advises that SET 50 companies should be fully IFRS compliant by 2011. SET 100 companies should be compliant by 2013, followed by all other listed companies by 2015. As in the EU, non-listed, privately-owned businesses are not included in the roadmap.

The Thai press is already reporting certain reluctance on the part of some listed Thai companies to comply with this requirement. In this article I will highlight some of the reasons for this reluctance.

One of the main differences between IFRS and TAS is that IFRS uses fair value as a method of accounting for assets and liabilities while TAS has traditionally based valuations on historic cost. It should be recognized that after the Asian crisis in 1997, new TAS were issued which clearly reflected an effort to bring Thai standards into greater alignment with IFRS. Nevertheless, besides the valuation issue, a key difference remained, namely that IFRS requires much more disclosure in the financial statements than TAS.

In order to adopt IFRS, companies will need to make some changes to the manner in which figures in, and disclosures to, the financial statements are reported. The basic changes will be in the following areas:

1)Adoption of New Accounting Standards
2)Fair Value
3)Additional Disclosure Requirements
4)Technical Complexity

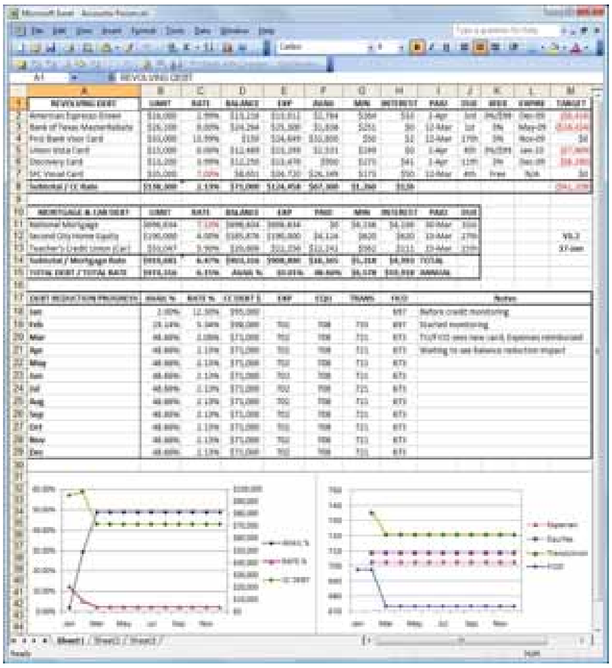
Adoption of New Accounting Standards

In the past few years, TAS has been aligning itself more towards IFRS and many new reporting standards have been introduced. However, some of the more complex standards, such as IFRS 3 (Business Combination), IAS 12 (Income Taxes (including Deferred Income Tax) and IAS 19 (Employee Benefits) have not yet been introduced. The complexity of some of these standards can be illustrated by taking the example of the IFRS requirements when accounting for a new subsidiary, namely that the purchase price will now need to be broken down into the following components: net equity value, intangible asset value and goodwill. Under TAS, a newly acquired subsidiary can simply be booked at its equity value and goodwill. Determining intangible asset value (i.e., the value of the customer base, the brand, patents, etc.) requires specialist knowledge which will either need to be sourced externally or developed internally. The calculations for deferred income tax and the actuarial calculations for pension obligations are similarly complex.

Furthermore, when adopting IFRS, companies will be required to book the differences between the new IFRS valuation and the old TAS valuation directly against equity. In Thailand, differences in the valuation of fixed assets, goodwill, deferred taxation and pension liabilities can be expected to occur when IFRS are adopted for the first time. After adoption of IFRS, the reported equity of a company, combined with the requisite disclosures, should indicate the fair value of the assets and liabilities of that company, a critical measurement for investors.

Adoption of Fair Value

Another aspect of the change from TAS to IFRS involves the switch from historic cost accounting to fair value. This will have an impact on the valuation of fixed assets, financial assets, accounting for subsidiaries, goodwill and some liabilities. The effect will not only be seen on the balance sheet. The reported profit and loss of the company will be similarly impacted. For example, IFRS recommends the revaluation of fixed assets every three to five years. Whilst this policy has largely been adopted by TAS, many companies are yet to actually revalue their assets. Therefore, the first time adoption of the fair value versus historic cost principle might very well lead to substantial differences in valuation. Another illustration of a probable difference in valuation relates to potential severance payments for employees undertaking voluntary retirement. Under voluntary retirement schemes, severance obligations will need to be accounted for. As the severance payments for



retirement can be measured, reporting under IFRS would require an actuarial calculation of these costs. It is worth noting that under TAS no such obligation is required and it is up to each company to determine their own policy as to whether they wish to recognize this balance. Needless to say, most companies choose not to account for this additional liability. The examples above once again show that the asset valuation and the actuarial calculation will require specialist knowledge which is not available yet in many listed companies. .

Additional Disclosure Requirements

One easily noticeable difference when moving to IFRS from TAS is the greater level of disclosure required. Typically the number of pages in the financial statements will easily double due to the additional disclosure requirements. The extra data will need to be recorded within the financial information system and extracted for external reporting purposes. TAS already requires listed companies to provide disclosure for segmental reporting and related party transactions (segmental reporting indicates the revenue and profits generated by different areas of the business, as defined on a company by company basis). However, the more complex disclosure requirement as prescribed by IFRS 7 (Financial Instrument Disclosure) has not been implemented yet. This disclosure requires, amongst other things, that the company reports its quantitative and qualitative exposure to liquidity risk, credit risk and the market risk associated with the financial instruments that are recorded on its books. It is important to realize that, as the disclosure requirements increase, companies will need to adjust and upgrade their internal control and reporting systems in order to keep track of the additional information requirements.

Technical Complexity

From the above it is very clear that the implementation of IFRS is technically complex and will require substantial training of accounting staff and managers within listed companies. Additionally, accounting systems will also need to be upgraded in order to be able to provide all required information.

Conclusion

The SEC has prepared a roadmap for the implementation of IFRS in Thailand in the belief that it will help to attract more investors in the Thai Stock market. In order to comply with SEC requirements, SET 50 companies will need to implement IFRS by 2011 and will need to make changes to their accounting systems, train their staff and account for assets and liabilities following the newly adopted accounting rules. The exercise will be costly, time consuming and a steep learning curve for many listed companies. However I believe this to be a good development, not only as it will improve the transparency of reporting of listed companies, but also because it should improve their internal understanding of the risks to which the company is exposed. In other words, if the information is important enough to be reported to the stakeholders of the Company, including any potential investors, it certainly should be important for Company's management.

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