Thailand Flooding Bulletin

December 2011

A Message from Mazars Thailand’s Managing Partner

After two months underwater we can slowly return to our houses, factories and offices to clean up what the floods have left behind.

The damage for companies ranges from a fall in sales due to disruptions to the supply chain or reduced operations by their customers through to the complete shutdown of a factory with machinery destroyed by the flood waters. Companies insured for flood damage and business interruption will now be preparing their insurance claim. This will need to be done thoroughly as insurance companies will challenge each claim to limit their own exposure.

On the positive side, it will also give companies the opportunity to rethink, redesign and reengineer their operations and supply chains. This may include new factory designs, the purchase of new and improved machinery, reducing vulnerabilities in the supply chain and so on. Now is the time for flood damage recovery planning. We strongly believe that companies should not overlook the impact on their balance sheet, the opportunities for tax planning and the incentives proposed by the Thai government. In this bulletin we summarise those tax, accounting and legal points most applicable for your company. However, the recovery is just beginning and the incentives will likely change over time. Further we expect more initiatives to be announced to get business in Thailand up and running again.

I wish you a lot of strength in your recovery efforts.

Rob Hurenkamp

1 December 2011

Financial Reporting

The current flood crisis has accounting implications for all companies in Thailand. Not only entities directly affected by the loss of assets or business should be concerned by the following accounting matters, but also any entity operating in Thailand whose employees, suppliers or customers have been affected.

Accounting for the effects of floods will require a considerable amount of judgement and estimate. Any key sources of estimation uncertainty should be disclosed in the notes to the financial statements, as they may also significantly impact the carrying amount of assets and liabilities within the next financial year.

Tangible Assets

Which costs incurred as a result of the floods can be capitalised?

Repairs, maintenance and flood prevention costs

Expenditure incurred by an entity to repair assets affected by the floods is recognised in the profit and loss as incurred. The reason why such costs are expensed rather than capitalised is that they do not increase the future economic benefit of the asset. Rather they maintain the asset's potential to deliver the level of future economic benefits that it was expected to provide when it was originally acquired.

Replacement costs

Costs incurred on the replacement part of fixed assets affected by the floods are recognised in the carrying amount of the assets. The carrying amount of what was replaced is derecognised, and the new component is depreciated over its useful life.

How to depreciate tangible assets directly or indirectly affected by the floods?

Non cessation of depreciation

Depreciation does not cease when the asset becomes idle or is temporarily retired from active use (e.g. moving assets away from flood affected areas).

Depreciation of an asset only ceases at the earlier of the date that:

- the asset is classified as held for sale - i.e. it will be recovered through a sale transaction rather than continuing use, and
- the asset is derecognised - on disposal (sale, finance lease, donation...) or when no future economic benefits are expected from its use.

Change in depreciation method

If assets remain unused for a significant period of time, depreciation method may be changed to reflect a new way to measure the economic benefits from using the assets. Notably, under the unit of production method, the cost of the assets is apportioned over their productive life, measured in terms of units produced or machine hours utilised (under this method, the depreciation charge will be *nil* in periods where there is no production).

Financial Reporting (continued)

This change in accounting estimate will be recognised prospectively by including the revised depreciation expense in profit or loss in 2011 and future periods. Specific disclosure is required if the change has significant impact on the financial statements.

Change in useful life of the fixed assets

The current flood crisis may result in a decrease in the estimated useful life of the entity's assets, even if the assets are not determined to be impaired. This change in accounting estimate will result in the un-depreciated cost to be written off to the income statement over the revised remaining useful of the assets.

Specific disclosure is required if the change has significant impact on the financial statements.

Should tangible assets directly or indirectly affected by the floods be impaired?

As a result of the current flood crisis, an entity may:

- not be able to continue some production lines;
- have to significantly decrease its production;
- discontinue or restructure operations; or
- dispose of an asset after the flood relief.

Such situations are indicators of assets impairment. An impairment test must therefore be carried out before the end of the current financial period, and the entity required to make a formal estimate of the recoverable amount of the related assets.

The recoverable amount of the assets is the higher of:

- their fair value less costs to sell: amount obtainable from the sale of the assets, less disposal costs (legal costs, stamp duty, cost of removing the asset...); and
- their value in use: based on the estimation of future cash flows expected from use of the assets. Assessment of future cash flows should take into account the effects of the floods (e.g. decrease in revenue and level of production, increase in production costs)

The carrying amount of the asset shall be written down to its recoverable amount. The reduction is an impairment loss and shall be recognised immediately in the profit or loss.

How to account for insurance compensation to be received for damaged assets?

Insurance compensation received for items of property, plant and equipment that were impaired, damaged, lost or given up shall be recognised in profit or loss when the compensation becomes receivable- generally when the insurance company has formally accepted the claim, not necessarily the amount.

Even if the compensation amount that will be received is uncertain, the entity should make a reliable prudent estimate of the claims receivable. This receivable should not exceed the amount of impairment losses recognised on covered assets. It should be discounted if the time value of money is material.

Financial Reporting (continued)

If the claim is probably, but not virtually certain at balance sheet date, it should be disclosed in the notes to the financial statements.

Compensation from insurance should be accounted for separately from the impairment or derecognition of the covered assets. As a result, while assets will probably be impaired or written off in the current accounting period, the related insurance claims may be recognised in subsequent accounting periods.

Goodwill and Intangible Assets

Why goodwill and intangible assets may be impaired as a result of the floods?

Goodwill and intangible assets with an infinite life should be tested for impairment at balance sheet date. The estimation of the recoverable amount should reflect the change in economic conditions and operations resulting from the floods.

Other intangible assets should be tested for impairment if there is an indication of impairment as a result of the floods. For instance, the recoverable value of a trademark for a mark of products should be assessed at balance sheet date, if the product line has been discontinued or interrupted.

Inventory

Why inventories should be written down?

The entity needs to assess the net realisable value of the inventory at balance sheet date, defined as its estimated selling price less any estimated costs still to be incurred to make the sale.

A decrease in the net realisable value may result from stock damages, increase in production costs or decrease in selling prices. Therefore, the current flood crisis may result in the recognition of write-down not only for damaged inventories, but also for ‘non-damaged’ inventories whose production costs have increased or whose selling price has decreased.

If the net realisable value of inventory is less than its carrying value, the difference is-recognised as an expense in the year and if significant, should also be disclosed in the notes to the financial statements.

Which costs should be included in the cost of inventories?

The cost of inventories shall comprise all costs of purchase, costs of conversion based on the normal capacity of the production facilities and other costs incurred in bringing the inventories to their present location and condition.

Financial Reporting (continued)

The following are examples of costs that should be excluded from the cost of inventories and recognised as expenses when incurred:

- Labour costs that are the result of abnormal idle capacity or repair work resulting from the flood;
- Abnormal amount of wasted materials or other production costs;
- Storage costs, unless the storage is necessary in the production process before a further production stage;
- Selling costs.

Accounts Receivables

Should accounts receivables be impaired as a result of the floods?

As a result of the floods, many cash flows have been delayed as businesses halted production or distribution centres ended up underwater. Further, customers seriously affected by the floods may not be able to settle their outstanding debts.

The entity should assess whether the related receivables should be impaired. Any decrease in the recoverable value should be recognised in profit or loss.

Tax

How can the flood crisis impact the value of deferred tax assets?

Deferred tax assets are recognised for all deductible temporary differences and all unused tax losses and credits, but only to the extent that it is probable that future taxable profit will be available against which they can be utilised.

The carrying amount of the deferred tax assets recognised in the balance sheet should be reviewed at balance sheet date, to ensure that sufficient taxable profit will be available in future.

Provisions

Which flood related costs can be provided for at balance sheet date?

A provision should be recognised only if:

- the entity has a present obligation as a result of the past flooding;
- it is probable that an outflow of resources will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

Financial Reporting (continued)

Future operating losses

A company cannot make provisions for future operating losses, as there is no present obligation. Therefore, the expected costs to clean up or restore a business following flooding that are expected to result in operation losses cannot be recognised until the obligations for such an expense have been incurred.

A business that 'only' intends to fully restore a flood damaged production facility in January 2012 cannot recognise any provision for such expenditure as at 31 December 2011. Once the obligations related to the restoration have been incurred (for example a company is hired to clean the facility) the costs can be accrued.

Onerous contract

An onerous contract is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

For example, a lease agreement on a factory in a flood-affected industrial estate that intends to permanently move its production facility to a new location must recognise the full costs of settling that contract as a provision.

'Force majeure' clauses may excuse the entity from performing its obligations due to the floods. If this is applicable, no obligation exists at balance sheet and therefore no provision should be recognised.

Restructuring

A constructive obligation to restructure arises only when the entity has a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring, either by starting to implement that plan or announcing its main features to those affected by it.

No obligation arises for the sale of an operation until the entity is committed to the sale, i.e. there is a binding sale agreement.

Guarantees

A constructive obligation may result from guarantees given to another entity directly affected by the flood (e.g. guarantee on subsidiary bank loans).

Management must assess whether it is probable that the guarantee will be called upon and if so, a provision should be recognised.

Loans

How can the current flood crisis affect loan presentation?

The current flood crisis may affect the ability of the entity to meet the requirements of loan agreements and may result in a breach of loan covenants. Should this happen, the lender may be entitled to require immediate repayment of the full outstanding balance. The loan should therefore be reclassified as a current liability at balance sheet date.

Financial Reporting (continued)

Government Grants

When shall government grants be recognised in profit or loss?

Government grants shall not be recognised until there is a reasonable assurance that:

- the entity will comply with the conditions attached to them; and
- the grants will be received.

Government grants shall be recognised as income over the periods necessary to match them with the related costs which they are intended to compensate, on a systematic basis.

Going Concern

How to assess whether the going concern assumption is appropriate?

Financial statements are usually prepared on a going concern basis, i.e. that the entity will be able to continue as a going concern. As a result of the floods, not only will there be uncertainty for many businesses with regards to its future operations, but some businesses may not be able to continue trading or may choose not to resume its operations.

Management should therefore make an assessment of the entity's ability to continue as a going concern. In assessing whether going concern is appropriate, management should take into account all information about the future, at least for the twelve months after the balance sheet. If management either intends to liquidate the entity or to cease trading, or has realistic alternative but to do so, financial statements shall not be prepared on a going concern basis.

In such cases, it is required as a minimum to disclose an entity's future uncertainty. Assets should be written to net realisable value and provision recognised for all known obligations, for example employee severance and the costs required to settle contracts which may have become onerous. Non current assets and liabilities may also be reclassified to current items in the balance sheet.

Event after the Balance Sheet Date

Which events occurred after the balance sheet date should impact the financial statements?

Events after the balance sheet date are those events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are authorised for issue.

A distinction is drawn between:

1. Events which require adjustment of the financial statements: they provide evidence of conditions that existed at the balance sheet date. These include:
   - Formal acceptance of a claim from the insurance company;
   - Bankruptcy of a customer confirming a loss that existed at the balance sheet date; and

Financial Reporting (continued)

- Sale of inventories up to their net realisable value at the balance sheet date.

2. Events which require disclosure only: they are indicative of conditions that arose after the balance sheet date:
   - Announcing a plan to discontinue an operation;
   - Announcing a major restructuring;
   - Major purchase of assets; or
   - Entering into significant commitments to restore the site.

Tax

Tax Flood Relief Measures for BOI Promoted Companies

The following tax measures for Board of Investment ('BOI') promoted companies have been approved by Cabinet, but are still to be passed into law:

1. Flood affected companies that wish to establish a temporary production facility or make a new investment in Thailand.

   For companies investing in a province affected by the floods the following incentives are being proposed:

BOI Zone	Industrial Estate	Income Tax Holiday	Income Tax Reduction After Tax Holiday
Zone 1	Inside/ Outside	8 years without cap	-
Zone 2	Inside	8 years without cap	50% reduction of tax for a further 3 years
	Outside	8 years without cap	-
Zone 3	Inside/ Outside and Special	8 years without cap	50% reduction of tax for a further 5 years

   For BOI promoted companies investing in another non-flood affected province, the amount of tax exempted will be capped.

Tax (continued)

2. New investors or any investor not affected by the floods who wishes to undertake a new investment or expand its existing business in Thailand, the following income tax concessions will apply:

BOI Zone	Industrial Estate	Income Tax Holiday	Income Tax Reduction After Tax Holiday
Zone 1	Inside	8 years capped	50% reduction for another 3 years
	Outside	8 years capped	-
Zone 2	Inside	8 years capped	50% reduction for another 5 years
	Outside	8 years capped	-
Zone 3	Inside/ Outside and Special	8 years capped	50% reduction for another 5 years

Approval Process

There are still a few issues that need to be ironed out before the incentives proposed above are passed into law. The Cabinet decision grants generous incentives for existing companies to invest in a province affected by flooding. However, some parts of that province may not have been affected at all whilst other regions will have been inundated with water. Likewise it appears a little inequitable that a new company investing in an industrial estate in Zone 2 for instance will be entitled to a 5 year 50% income tax reduction after the 8 year holiday but an existing company affected by flooding will only be entitled to a 3 year concession.

Legal

BOI's Emergency Measures to Help Flood-Affected Companies

The Board of Investment ('BOI') approved on 7 November 2011 additional emergency measures to help companies and entrepreneurs affected by the flood crisis. The new measures include:

1. Permission for raw materials imported under section 36 (duty-free importation for export manufacturing) that are completely damaged to be recognised as part of waste allowance and therefore relieved of tax burdens;
2. Permission for companies to temporarily outsource some part of their manufacturing processes to other manufacturers in order to avoid business interruptions; and
3. Import duty exemption until 30 June 2012 for imported machinery to replace existing machinery damaged by flooding.

Ministry of Labor Measures

The Ministry of Labor has set up a committee to discuss measures to assist employers who will not lay off employees due to the floods. The website of the Ministry of Labor announces a subsidy of 2,000 Baht per employee per month if certain conditions are met. We note that this proposal hasn't been enacted in the relevant legislation yet.

Immigration

Due to the flooding of the Government Complex at Chaeng Wattana, visa extensions, re-entry permits and 90 days reporting may be submitted at:

1. Immigration Bureau, Soi Suanplu, Building 1; and
2. One Start One Stop Investment Center ('OSOS'), Chamchuri Square. Note that the OSOS can only be used for business visas, 90 days reporting, re-entry permits and official visa.

This temporary change will apply until further notice. The Government Service Centre can be contacted on tel. 1111 for more information.

Compensation for Households Affected by the Floods

On 8 November 2011, the Cabinet agreed to pay compensation of 5,000 Baht to each household affected by flooding. The following conditions apply:

1. The house was hit by a flash flood causing damage to the property; or
2. The house was inundated by flood water for at least seven consecutive days.

Frequently Asked Questions

Employee Compensation and Benefits

As a flood victim, is an employee liable to personal income tax for compensation received from the employer?

An employee that incurs damages from floods is not liable to personal income tax for compensation received not exceeding the actual damage incurred (Royal Decree No. 527 dated 9 June 2011).

As a general rule, personal income tax is exempted if it meets the following conditions:

- the company has a written policy to provide such welfare benefits to the employee;
- the policy applies to all employees; and
- the compensation amount is reasonable.

Insurance Claims

Are insurance claims subject to corporate income tax?

Corporate income tax is exempted for claims received from insurance companies for damages incurred which exceed the cost of the asset damaged or destroyed less accumulated depreciation (Royal Decree No. 527 – see below).

Are insurance claims for business disruption subject to corporate income tax?

The company is liable to corporate income tax on amounts received for insurance claims in respect of business disruption. Receipt from the Insurance claims is considered normal taxable income and there is no specific exemption granted.

Inventory Write Off

What is the process to write off damaged inventory?

Loss from inventory written-off is tax deductible for corporate income tax computation if the company destroys the inventory according to Departmental instruction no. Paw 5/253 and Paw 79/2541. The procedures are summarised as follows:

- For inventory which cannot be kept, e.g. food, medical supplies, chemicals, the procedures are:
  - approval from authorised person in determining that it is damaged goods under conditions prescribed for each business (in case of returned goods, a document indicating receipt of returned goods along with the description and certain other details are required.)
  - investigation for the destruction to be witnessed by at least 3 persons, from the warehouse, accounting, sales or auditing
  - preparing evidence of inventory destruction with the signature of the authorised person and at least 3 witnesses who attend the destruction (Revenue Officer is not required)

Frequently Asked Questions (continued)

- For destruction of inventory which can be kept and held to be destroyed, the company has to inform the Area Revenue Office 30 days prior to the destruction date. It is not necessary for the Officer to attend the destruction. In the case that the company is under supervision of any government agency, the company does not have to inform the Revenue office but only such government agency responsible for its supervision.

The company located in the export industrial zone has to follow the procedures of the industrial estate and invite the auditor to investigate the destruction.

In respect of the company that receives the investment promotion on imported raw materials to be used in the production for export (where the quantity of imported raw materials is controlled by the Board of Investment), the company has to follow the rules and procedures prescribed by the Board of Investment and invite an auditor to be a witness.

Tax Exemptions

The Revenue Department enacted Royal Decree No.527 in July 2011, which exempts income tax payments by those impacted by natural disasters in Thailand since 1 January 2011.

Tax exemptions apply in the following cases:

- Personal income tax and corporate income tax exemptions on compensation received from the Thai Government or donations from others which does not exceed the actual cost of damages.
- Corporate income tax exemption for claims received from insurance companies for damages incurred which exceed the cost of the asset damaged or destroyed less accumulated depreciation.
- Income tax deduction allowances on donations to victims of disasters as follows:
  - Personal income tax – up to 10% of taxable income after deducting any other deductions and allowances.
  - Corporate income tax – Up to 2% of net taxable profit.
- A VAT exemption for businesses donating goods to the victims.

It is important to note that the purpose of issuing Royal Decree No.572 is to reduce the tax liability of victims of disasters and to promote donations which aim to help the victims.

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