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Newsletter

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In this Issue

The Financial and Sustainability Reporting Standards Council (FSRSC) has approved the adoption of Amendments to: PAS 7 and PFRS 7, Supplier Finance Agreements; PAS 12, International Tax Reform - Pillar Two Model Rules; PAS 1, Non-current Liabilities with Covenants; and PFRS 16, Lease Liability in a Sale and Leaseback issued by the International Accounting Standards Board (IASB).

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Contents

ADOPTION OF REVISED ACCOUNTING STANDARDS 3

AMENDMENTS TO PAS 7 AND PFRS 7, SUPPLIER FINANCE AGREEMENTS 3

AMENDMENTS TO PAS 12, INTERNATIONAL TAX REFORM - PILLAR TWO MODEL RULES 4

AMENDMENTS TO PAS 1, NON-CURRENT LIABILITIES WITH COVENANTS 5

AMENDMENTS TO PFRS 16, LEASE LIABILITY IN A SALE AND LEASEBACK 6

Editorial Board 8

ADOPTION OF REVISED ACCOUNTING STANDARDS

The Financial and Sustainability Reporting Standards Council has approved the adoption of the amendments to the following:

- PAS 7 and PFRS 7, Supplier Finance Agreements;
- PAS 12, International Tax Reform - Pillar Two Model Rules;
- PAS 1, Non-current Liabilities with Covenants; and
- PFRS 16, Lease Liability in a Sale and Leaseback.

AMENDMENTS TO PAS 7 AND PFRS 7, SUPPLIER FINANCE AGREEMENTS

Objective

To add disclosure requirements, and ‘signposts’ within existing disclosure requirements, that ask entities to provide qualitative and quantitative information about supplier finance arrangements.

Key changes

A **supplier finance arrangement** often referred to as *supply chain finance*, *payables finance or reverse factoring arrangements* is characterized by one or more finance providers offering to pay amounts an entity owes its suppliers and the entity agreeing to pay the finance providers at the same date as, or a date later than, suppliers are paid. These arrangements provide the entity with extended payment terms, or the entity’s suppliers with early payment terms, compared to the related invoice payment due date.

The amendments to PAS 7 add a disclosure objective that an entity must disclose information regarding its supplier finance arrangements. This disclosure should provide the users of financial statement with the means to evaluate the impact of these arrangements on the entity's liabilities, cash flows, and its vulnerability to liquidity risk. The amendments require a company to disclose:

- The terms and conditions of the supplier finance arrangements;
- For the arrangements, as at the beginning and end of the reporting period;
  - carrying amounts of supplier finance arrangement financial liabilities,
  - carrying amounts of financial liabilities for which the finance providers have already settled, and
  - ranges of payment due dates
- The type and effect of non-cash changes in the carrying amounts of financial liabilities.

In the Application Guidance outlined in PFRS 7; Par 39, entities are mandated to disclose a description of how it manages the liquidity risk resulting from financial liabilities. The amendments introduced an additional factor, whether the entity has accessed, or has access to, supplier finance arrangements which provide extended payment terms for the entity or early payment terms for its suppliers.

Furthermore, the amendments specify that concentrations of liquidity risk and market risk can emerge from supplier finance arrangements resulting for an entity to focus with finance providers, a portion of its financial liabilities that were initially owed to suppliers.

TRANSITION AND EFFECTIVE DATE

An entity shall apply these amendments for annual reporting periods ***beginning on or after January 1, 2024***. Earlier application is permitted.

Note: An entity is required to apply the amendments to PFRS 7 when it applies the amendments to PAS 7.

Our View:

The amendments provide a more comprehensive and transparent picture of an entity's financial position, enabling users of financial statements to make more informed decisions and assessments of an entity's financial performance and risk profile.

AMENDMENTS TO PAS 12, INTERNATIONAL TAX REFORM - PILLAR TWO MODEL RULES

Objective

To provide a temporary exception to the requirements regarding deferred tax assets and liabilities related to pillar two income taxes.

Key changes

The ***Pillar Two Model Rules*** or "Global Anti-Base Erosion" (GloBE) Rules was issued to address the tax challenges of the digitalization of the economy. It was designed to ensure large multinational enterprises (MNEs) pay a minimum level of tax on the income arising in each jurisdiction where they operate.

The amendments in International Tax Reform — Pillar Two Model Rules require an entity to disclose:

1. The entity's application of the exception wherein an entity refrains from recognizing and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes.
2. Its current tax expense (income) separately which are related to pillar two income taxes.
3. A known or reasonably estimable information that helps users of financial statements understand the entity's exposure to pillar two income taxes arising from that legislation for periods in which the pillar two legislation is enacted or substantively enacted, but not yet in effect.

   In adherence to these requirements, an entity is required to disclose qualitative and quantitative information regarding its exposure to Pillar Two income taxes at the end of the reporting period. For instance, an entity could disclose the following information to meet these requirements:

   - Qualitative information such as how an entity is affected by Pillar Two legislation and the main jurisdictions in which exposures to Pillar Two income taxes might exist.
   - Quantitative information such as an indication of an entity's profits that risks being subject to Pillar Two income taxes and the average effective tax rate applicable to those profits; or an indication of how the entity's overall effective tax rate would have changed if Pillar Two legislation had been effective.

TRANSITION AND EFFECTIVE DATE

The amendments come into immediate and retrospective effect upon its issuance, encompassing the temporary exception from recognition and disclosure of information pertaining to deferred taxes and the requirement to disclose the application of the exception.

The requisite disclosure of the prevailing tax expense associated with Pillar Two income taxes, along with disclosures pertaining to periods preceding the legislation's enactment, is mandatory for annual reporting periods ***commencing on or after January 1, 2023***. However, this requirement does not extend to any interim period ending on or before December 31, 2023.

Our View:

Entities should prepare for the additional disclosure requirements introduced by the amendments. These mandates involve divulging known or reasonably estimable information to help financial statements users comprehend an entity's exposure to Pillar Two income taxes. Entities should be informed that it must disclose both qualitative and quantitative information about its Pillar Two income tax exposure at the end of the reporting period. In instances where information is unknown or not estimable, entities must make a statement to that effect and detail their progress in assessing exposure. Entities are advised to engage with advisors to understand the impact on financial statements, audit, and tax filings. It is also recommended that entities assess the adequacy of their processes to obtain the necessary information for timely compliance with the disclosure requirements outlined by the amendments.

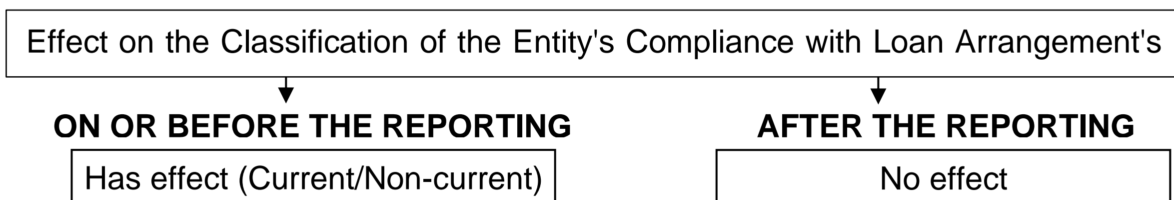
AMENDMENTS TO PAS 1, NON-CURRENT LIABILITIES WITH COVENANTS

Objective

To clarify how conditions with which an entity must comply within twelve months after the reporting period affect the classification of a liability.

Key changes

Right to Defer Settlement of Liability bound by Covenants Exists at the end of the Reporting Period



When an entity classifies a liability arising from a loan arrangement as non-current and the liability is bound by covenants which an entity is required to comply with within twelve (12) months of the reporting date, the entity shall disclose such information in the notes. This information should allow users of financial statements to comprehend the risk associated with the possibility that the liability might become due for repayment and such details should include:

a. carrying amount of the liability;
b. information about the covenants; and
c. facts and circumstances of an entity having difficulty with the compliance of covenants at the end of the reporting period.

TRANSITION AND EFFECTIVE DATE

An entity shall apply these amendments for annual reporting periods ***beginning on or after January 1, 2024,*** retrospectively. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

Our View:

Anticipated changes in the classification of an entity's liabilities as current or non-current, resulting from the 2022 amendments, are not expected to be substantial in comparison to the existing guidance. Nonetheless, in the event that an entity opts for early adoption of the 2020 amendments, the 2022 amendments may yield a significant impact on its classification. Generally, the implementation of the 2022 amendments may likely require additional disclosures.

AMENDMENTS TO PFRS 16, LEASE LIABILITY IN A SALE AND LEASEBACK

Objective

To specify how a seller-lessee should apply the subsequent measurement requirements in PFRS 16 to the lease liability that arises in the sale and leaseback transaction.

Key changes

In a **sale and leaseback** transaction, an entity (the seller-lessee) transfers an asset to another entity (the buyer-lessor) and then leases back the same asset from the buyer-lessor. In this transaction, the seller-lessee has retained its right to use the asset for the duration of leaseback since it has sold only its interest in the value of the underlying asset at the end of the leaseback.

The amendment clarifies the accounting for sale and leaseback transactions under PFRS 16, 'Leases', depends upon whether the asset transfer satisfies the criteria for a sale outlined in PFRS 15, 'Revenue from contracts with customers'. If the buyer-lessor obtains control of the underlying asset, the sale and leaseback transaction qualifies as a sale. In such instances, the seller-lessee recognizes the leaseback by recording a lease liability that reflects the payment terms of the leaseback, along with a right-of-use asset representing the retained right of use. Gains or losses recognized by the seller-lessee are limited to the extent that they relate to the rights transferred to the buyer-lessor. In other words, **fully recognition of gain or loss at the date of sale and leaseback transaction is unacceptable.** This amendment specifically affects the accounting treatment of sale and leaseback transactions for seller-lessees, provided that these transactions involve variable lease payments that do not depend on an index or rate.

Measurement

The seller-lessee may ascertain the portion of the asset's previous carrying amount attributed to the retained right of use by, for instance, making a comparison of:

- the present value of expected payments (inclusive of variable ones) with the fair value at the transaction date;
- the expected term over which the seller-lessee utilizes the asset in the leaseback with the remaining economic life of the asset; or
- the fair value of the asset at the transaction date less the present value of the expected residual value of the asset at the end of the leaseback with the fair value of the asset at the transaction date.

Illustrative example:

ABC Co. (seller-lessee) sells its land to XYZ Co. (buyer-lessor). The land is carried at its cost amounting to ₱1,000,000 before the transaction occurs and has a fair value at the date of sale amounting to ₱1,800,000. Concurrently, ABC Co. entered into a contract with XYZ Co. for the right to use the land for a period of ten (10) years, payable annually. Lease payments comprise fixed and variable payments which do not depend on an index or a rate.

Assume that the seller-lessee estimates the expected payments over the lease term, and it discounts those expected payments using the incremental borrowing rate (since the rate implicit in the lease cannot be readily determined), resulting in a present value of the expected payments for the lease of ₱450,000.

In this example, the proportion of the land that relates to the right of use retained is 25%, calculated as:

Present value of expected payments for the lease	₱450,000
Fair value of the land	₱1,800,000

At the commencement date, the seller-lessee accounts for the transaction as follows:

Cash	1,800,000	
Right-of-use asset (₱1,000,000 × 25%)	250,000	
Land		1,000,000
Lease liability		450,000
Gain on rights transferred ((₱1,800,000 – ₱1,000,000) × 75%)		600,000

TRANSITION AND EFFECTIVE DATE

An entity shall apply these amendments for annual reporting periods ***beginning on or after January 1, 2024,*** retrospectively. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

Our View:

The amendment could signify a substantial shift in accounting policy for entities engaged in sale and leaseback transactions with variable payments independent of an index or rate. Entities will be required to establish an accounting policy, in accordance with PAS 8 for the lease payments in such transactions.

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Comments and suggestions are welcome.

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