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FAQs on the accounting implications of the unusually severe flooding in parts of Thailand

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FAQs on the accounting implications of the unusually severe flooding in parts of Thailand



The current unusually severe flooding in parts of Thailand has caused, and is continuing to cause, disruption and damage to many businesses. The following is a series of Questions and Answers on the accounting implications of the flooding and other natural disasters.

Q: Are there specific Thai Financial Reporting Standards ('TFRS') covering accounting for natural disasters such as severe flooding?

A: No. There are no specific TFRS dedicated to accounting for natural disasters such as severe flooding. 'Normal' TFRS should be applied as required by the specific situation under consideration.

Q: What are the specific characteristics of natural disasters such as severe flooding that affect the manner in which they are accounted for?

A: Natural disasters such as severe flooding are unexpected; sudden; and can have significant impact on an entity's operations. Accordingly, all estimates; assumptions; forecasts; projections; etc. made by management prior to the flooding will need to be reconsidered in the light of the impact of the flooding on the entity.

Q: Which entities should be considered in assessment of the impact of the flooding?

A: Entities may be directly impacted through flood damage to their own operations and/or indirectly impacted through flood damage to the operations of their suppliers and/or customers. All these entities will need to be taken into consideration in assessment of the impact of the flooding on the entity.

Q: Assessment of the impact of the flooding on the entity involves significant estimation and judgment. How should the associated risks be disclosed in the accounts?

A: TAS 1 Presentation of Financial Statements requires that the principal assumptions and major sources of estimation uncertainty should be disclosed in the accounts, including their nature and the carrying amount of the relevant assets and liabilities at the end of the reporting period. (TAS 1.125)

Q: Does the timing of the impact of the flooding in relation to the entity's financial reporting date affect the manner in which the flooding is accounted for?

A: Yes. The timing of the impact of the flooding affects the manner in which the flooding is accounted for.

Entities that were impacted by the flooding during the period prior to the reporting date will need to recognize the impact in the statement of comprehensive income (SOI) and statement of financial position (SOFI) as at that reporting date.

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Entities that were impacted by the flooding subsequent to the reporting date will not need to recognize the impact in the SOCI and SOFP but will only need to disclose information on the impact on their business as a non-adjusting event in accordance with TAS 10 *Events after the Reporting Period*. TAS 10 requires entities to disclose the following information on material non-adjusting events: The nature of the event; and an estimate of the financial effect, or a statement that such an estimate cannot be made.

The above timing distinction may not be obvious in all cases, e.g. Floodwaters upstream may have caused some damage during the reporting period but the full impact may not have occurred until after the end of that period. In such cases, the accounts should be prepared based on what was known at the reporting date with disclosures of all relevant factors, including non-adjusting events that impacted the entity after the reporting date.

Q: Property, plant and equipment ('PPE') has been damaged by the flooding. Will there be any impact on the carrying value of the PPE at the reporting date?

A: This depends on the timing of the damage.

If the damage occurred after the reporting date: No adjustment needs to be made to the carrying value at the reporting date. However, appropriate disclosure is required to be made. (See FAQ on general considerations - timing of the impact)

If the damage occurred during the reporting period: Yes, there is likely to be an impact on the carrying value at the reporting date.

TAS 16 *Property, Plant and Equipment* states that items of PPE are derecognized (i.e. removed from the accounts) when there are no future economic benefits expected from their use or disposal (TAS 16.67(b)). Therefore, if an item of PPE has been damaged to the extent that it can no longer be used and is irreparable, the item of PPE should be derecognized immediately.

When only part of an item of PPE is irretrievably damaged, the damaged part should be derecognized regardless of whether the damaged party had been carried and depreciated as a separate asset in the accounts (TAS 16.70). The replacement cost of the damaged part is recognized in the carrying amount of the item of PPE when incurred.

TAS 36 *Impairment of Assets* includes physical damage of an asset as an indication of impairment (TAS 36.12(e)). Therefore, impairment testing is required at the time that there has been physical damage to an asset as a result of the flooding. An asset, or a cash generating unit, is impaired when its carrying amount exceeds its recoverable amount. The recoverable amount is the higher of its fair value less costs to sell and its value in use. The impairment loss is the amount by which the carrying amount of the asset or cash generating unit exceeds its recoverable amount.

Determination of the value in use of an asset requires management to estimate future cash flows derived from the asset over its remaining life. In making this estimation, management should take into account the impact of the flooding, including repair and clean-up costs and reduced revenues, on such cash flows.

Q: Inventories have been damaged and/or require to be cleaned-up in order to return them to a saleable condition. Do the related costs impact the carrying amount of the inventory at the reporting date?

A: If the damage occurred after the reporting date: No, there is no impact on the carrying amount of the inventory at the reporting date. However, appropriate disclosure is required to be made. (See FAQ on general considerations - timing of the impact)

If the damage occurred during the reporting period: The answer depends on whether or not consideration of the additional costs would result in the inventory being carried at higher than net realisable value ('NRV').

TAS 2 *Inventories* requires that inventories shall be measured at the lower of cost and NRV. NRV is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Accordingly, if the NRV, after taking into account the additional costs, is higher than the carrying amount, a write-down of the carrying amount is not required. However if NRV is lower than the carrying amount, a write-down of the carrying amount to NRV is required. If the damage is such that it is not possible to bring the inventory into a saleable condition then the carrying amount should be written-off.

Q: Can a provision be recognized for the expected costs, resulting from the flooding, of repairing damage and cleaning-up PPE and inventory?

A: Provisions for repair and clean-up costs can only be made if there was a legal and constructive obligation as a result of a past event as at the reporting date (TAS 37).

If the damage occurred after the reporting date: No provision is recognized at the reporting date. However, appropriate disclosure is required to be made. (See FAQ on general considerations - timing of the impact)

If the damage occurred during the reporting period: It depends on whether or not there was a legal and constructive obligation as a result of a past event as at the reporting date. Ordinarily there will be no such obligation and, therefore, repair and clean-up costs should be expensed when incurred. However consideration should be given to contractual requirements to restore leased assets to their original condition, which constitutes a present obligation as a result of a past event, when the entity should recognize a provision for the associated costs. See also the FAQ on lease and supply contracts.

Q: Insured assets have been damaged by flooding. Can the insurance recoveries be recognized at the reporting date?

A: If the insured event occurred after the reporting date: No, insurance recoveries cannot be recognized at the reporting date. However, appropriate disclosure is required to be made. (See FAQ on general considerations - timing of the impact)

If the insured event occurred during the reporting period: It depends.

Insurance recoveries should only be recognized when the insured entity has an unconditional contractual right to the compensation and it is virtually certain that the compensation will be received (e.g. the insurance company has confirmed in writing that it has accepted the claim and agreed the amount of compensation).

If the insured event occurred, and the related impairment and other insured losses have been recognized, during the reporting period; and the related insurance recoveries become virtually certain after the reporting period but before the financial statements are approved and signed then recognition of the recoveries at the reporting date to the extent of the insured losses recognized would be appropriate as this would be an adjusting event after the reporting period under TAS 10. Assets relating to recoveries in excess of the insured losses recognized should only be booked in the period in which the recoveries become virtually certain (TAS 37.31-35).

Note that application of the above principles may have the result that the timing of the recognition of insurance recoveries may not be in the same accounting period as the recognition of the related insured losses.

Upon recognition, the insurance recoveries must be accounted for as a separate asset. (IAS 32.49(e))

Q: Some customers have been affected by the floods. Does this affect the assessment of the allowance for doubtful receivables at the reporting date?

A: If the customer was affected after the reporting date: No, there is no impact on the allowance for doubtful receivables at the reporting date. However, appropriate disclosure is required to be made. (See FAQ on timing of the impact)

If the customer was affected during the reporting period: Yes, events that occurred during the reporting period are an indicator of impairment and management should take into account the effect of the flooding at the reporting date on customers' ability to pay debts outstanding at the reporting date when assessing the recoverability of receivables. For finance companies, this assessment should include the value of collateral assets that may have been damaged by the flooding.

In practice, management may only become aware after the reporting date that a customer's ability to pay its debts has been affected by the floods. However, if the flooding that caused this inability to pay occurred during the reporting period then the carrying amount of the receivable from the customer must be adjusted accordingly at the reporting date (as the loss existed at the reporting date).

Q: Some investments have been affected by the flooding. Does this affect the assessment of impairment in value of investments at the reporting date?

The answer is similar to that for the assessment of doubtful receivables at the reporting date. If the investments are in entities affected by the flooding after the reporting date: No, there is no impact on the assessment of impairment in value of the investments at the reporting date. However, appropriate disclosure is required to be made. (See FAQ on general considerations - timing of the impact)

If the investments are in entities affected by the flooding during the reporting period: Yes, events that occurred during the reporting period are an indicator of impairment and management should take into account the effect of the floods on the investee entities at the reporting date when assessing impairment in value of the investments.

In practice, management may only become aware after the reporting date that an investee has been affected by the floods. However, if the impact of the floods on the investee entities was during the reporting period then the carrying amount of the investment in those entities must be adjusted accordingly at the reporting date (as the loss existed at the reporting date).

Q: Does the flooding affect the assessment of impairment in value of intangible assets, including goodwill, and deferred tax assets?

A: This depends on the timing of the impact of the flooding.

If the impact of the flooding was after the reporting date: No, the flooding does not affect the assessment of impairment in value of intangible assets, including goodwill, and deferred tax assets at the reporting date. However, appropriate disclosure is required to be made. (See FAQ on general considerations - timing of the impact)

If the impact of the flooding was during the reporting period: Yes, it is likely that the flooding will affect the assessment of impairment in value of intangible assets, including goodwill, and deferred tax assets at the reporting date.

TAS 38 *Intangible Assets* states that an intangible asset shall be derecognized (i.e. removed from the accounts) when no future economic benefits are expected from its use or disposal (TAS 38.112(b)). Therefore, if the intangible asset relates to an investment or business that has been affected or damaged to the extent that it has no economic future, the intangible asset should be derecognized immediately.

Goodwill and intangible assets with an indefinite useful life require to be tested for impairment at least annually and all intangible assets require to be tested for impairment whenever there is an indication of impairment. TAS 36 *Impairment of Assets* includes as an indication of impairment evidence that indicates that the economic performance of an asset is, or will be, worse than expected (TAS 36.12(g)). Therefore, impairment testing is required at the time that the impact of the flooding is such that this evidence exists. An asset is impaired when its carrying amount exceeds its recoverable amount. The recoverable amount is the higher of its fair value less costs to sell and its value in use. The impairment loss is the amount by which the carrying amount of the asset exceeds its recoverable amount.

Determination of the value in use of an asset requires management to estimate future cash flows derived from the asset over its remaining life. In making this estimation, management should take into account the impact of the flooding, including repair and clean-up costs and reduced revenues, on such cash flows.

TAS 12 *Income Taxation* defines deferred tax assets as the amounts of income taxes recoverable in future periods in respect of deductible temporary differences and the carryforward of unused tax losses and unused tax credits (TAS 12.5). Deferred tax assets should be measured at the amount expected to be recovered from the taxation authorities (TAS 12.46). Accordingly, management should consider the impact of the flooding during the reporting period on any deferred tax assets associated with temporary differences and tax losses at the reporting date. E.g. the flooding may impact future profitability of the entity and, therefore, the ability of the entity to recover tax losses against future profits.

Q: The entity has lease and supply contracts which may be affected by the flooding. What are the accounting considerations?

A: Management should review all lease and supply contracts to determine whether they include 'force majeure'/'Act of God' clauses that have the effect of relieving the entity from certain obligations under the contract. Management should then review the contracts in the context of the impact of the flooding to ascertain whether or not they have become 'onerous contracts' as defined in *TAS 37 Provisions, Contingent Liabilities and Contingent Assets*. TAS 37 defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it (TAS 37.68). The unavoidable costs under a contract reflect the net costs of exiting the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it.

Provision should be recognized at the reporting date for the net present obligation under all onerous contracts at the reporting date after first recognizing any impairment loss that has occurred on assets dedicated to that contract (TAS 37.66-69).

Q: The entity presently uses hedge accounting. Are there any accounting implications that should be considered in this respect resulting from the impact of the flooding?

A: If the impact of the flooding occurred after the reporting date: No, there are no accounting implications at the reporting date. However, appropriate disclosure is required to be made. (See FAQ on general considerations - timing of the impact) and management will need to reassess its hedging arrangements and strategy.

If the impact of the flooding occurred during the reporting period: There may be accounting implications depending on the type of instrument being hedged. The impact of the flooding may result in existing hedging arrangements becoming ineffective or hedged future cash flows becoming no longer highly probable. In such case, hedge accounting should be discontinued immediately and cumulative gains or losses previously recognized in other comprehensive income should be transferred to profit or loss.

Q: The impact of the flooding has resulted in the entity being in breach of certain loan covenants. Are there any accounting implications that should be considered?

A: If the impact of the flooding occurred after the reporting date: Yes, there are accounting implications. The classification of the loan (i.e. current/non-current) at the reporting date is not affected but significant appropriate disclosure is required to be made. (See FAQ on general considerations - timing of the impact). The breach of loan covenants should also be considered in the overall assessment of the entity's ability to continue as a going concern.

If the impact of the flooding occurred during the reporting period: Yes, there are accounting implications. The classification of the loan (i.e. current/non-current) at the reporting date may be affected. The breach of a loan covenant may entitle the lender to demand immediate repayment in full of the loan. In such case, unless a waiver of this right is obtained from the lender before the reporting date, the loan should be reclassified from non-current to current at the reporting date and appropriate disclosures should also be made. Note that if the waiver of the right is not obtained from the lender until after the end of the reporting period then this is a non-adjusting event after the reporting period under TAS 10 and the loan should be reclassified from non-current to current at the reporting date and appropriate disclosures made. The breach of loan covenants should also be considered in the overall assessment of the entity's ability to continue as a going concern (see FAQ on going concern considerations).

Q: Should the impact of the flooding on the entity be considered in the assessment of the entity's ability to continue as a going concern?

A: Yes. The flooding can impact the entity's assets, liabilities and operations, directly and/or indirectly (See FAQ on the entities to be considered in the assessment of the impact of the flooding). This impact should be considered in the assessment of the entity's ability to continue as a going concern. The assessment should be made taking into account all factors present at the date that the accounts are approved and signed. Accordingly, even if the impact of the flooding on the entity was after the reporting date, the impact should still be considered in the going concern assessment. If the assessment indicates that use of the going concern basis is not appropriate, the accounts may have to be prepared on a different basis, e.g. the liquidation or break-up basis.



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Q : If a company incurs a loss of assets from flooding, can the company write off the entire residual value and treat it as a deductible expense in its corporate income tax computation?

A : There are two scenarios for this situation

1) In the case where the company has insurance

If an asset is lost and a company is in the process of claiming compensation from an insurance company, that loss cannot be immediately claimed as a deductible expense in the corporate income tax computation pursuant to Section 65 ter (12) of the Thai Revenue Code. The company will be entitled to a deduction in the year that the company receives the compensation from the insurance company.

2) In the case where the company does not have insurance

The company can treat the total residual value of the asset as a deductible expense in the year that the loss of the asset occurs but the company is required to possess reliable records as proof of the loss (i.e. fixed assets register, notification to the police to obtain their report, purchase invoice, etc.) We are expecting further guidance from the Revenue Department for circumstances where the company's financial records are also destroyed.

Q : If the company receives compensation from an insurance company, is the company required to include the compensation received in its corporate income tax computation?

A : In principle, if the damages exceed the compensation, the difference can be treated as a deductible expense for corporate income tax purposes. Conversely, if the compensation exceeds the damages, the difference shall be treated as follows.

For the income received from the insurance company as compensation for damages from floods, storms, fires, or other natural disasters occurring in Thailand after 1 January 2011, such income, specifically the amount exceeding the residual value of the property after the deduction of wear and tear and depreciation,

shall be exempted from the corporate income tax computation in the accounting period that the company receives the compensation from the insurance company.

However, compensation for business interruption (other than the compensation for damages from floods, storms, fires, or other natural disasters) would not fall within the scope of Royal Decree No. 527. Therefore, companies will be required to include such compensation in the corporate income tax computation.

For an individual taxpayer, the individual can obtain an exemption for the total amount derived from the insurance company in accordance with the terms and conditions under Section 42 (13) of the Revenue Code of Thailand.

Q : Is the compensation received from an insurance company subject to VAT?

A : No. The compensation received from the insurance company would not be considered to be income from the sale of goods or provision of services. Consequently, such compensation would not be subject to VAT.

Similarly, the compensation for business interruption (other than the compensation for damages from floods, storms, fires, or other natural disasters) is not considered to be income from the sale of goods or provision of services. Hence, such compensation for business interruption would not be subject to VAT.

Q : What is the VAT treatment for the donation of property?

A : The donation of property is treated as the sale of goods for VAT purposes. To assist the donor company, Royal Decree No. 527 provides an exemption for the company in respect of the donation of property through another entity.

Where the company incurs Input VAT on the purchase of property for the purpose of making a donation, the company is not allowed to deduct that Input VAT against Output VAT in the computation of the company's VAT. This is on the basis that the Input VAT is in relation to property purchased to be used or intended to be used in a business not liable to VAT.

Q : What is the donation period when the company can obtain a tax deduction for any donations made to flood victims?

A : There is no limitation on the donation period. As long as the donation is made after January 1, 2011 and other conditions are met, i.e., the donation is made through an entity acting as an agent for aiding the victim of floods, then the company can obtain a tax deduction for the donation in calculating its corporate income tax.

Q : What are the documents and the processes required to make an insurance claim on the loss or damaged assets?

A : The documents and processes required to make an insurance claim will be based on the terms and conditions contained in the policy agreement with insurance company. In addition, the Company will need to have the relevant evidence to claim in accordance with the policy.

Q : Will the Revenue Department announce any rules or regulations to assist an insurance company with large losses carries forward who are unable to utilize those losses within the next five accounting periods, as happened in the Tom Yum Kung crisis?

A : Currently, there is no such announcement.

Q : Will the loss of goods be treated as sales of goods for the purposes of VAT?

A : It appears that the loss of goods will be treated as a sale and therefore VAT will be payable. The VAT payable will be the market price of the goods on the date the loss occurs.

Q : Will the company be penalized if the company cannot submit tax return on time?

A : The Revenue Department have extended the deadline for filing all tax returns to 30 December 2011 for taxpayers suffering from the flooding. Taxpayers who are able to benefit from this extension must be located in the areas stipulated in the announcement which include, Ayutthaya, Uthai Thani, Pathumthani, Nonthaburi, Saraburi, Nakhon Pathom, Nakhon Sawan, Chiang Mai, Ubon Ratchathani, and Bangkok province, etc.

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The tax returns eligible for extension include all types of tax returns that must be filed under Revenue Code during the period July 2011-November 2011 (except for the specific business tax return for selling immovable property). Please note that for the July 2011 tax return, only some parts of Sukhothai, Nakornsawan, Phitsanulok, Pichit provinces are eligible for the extension.

For other areas which are not stated in this announcement but are affected by the flooding, the Revenue Department is requesting the approval of Minister of Finance for the same extension. Full details of the extension announcement can be found through the following link [*insert link here*].

Apart from the above, it should be noted that at current situation, the Ministry of Finance and Excise Department has concerned to assist the victims from flood by having issued the Ministry of Finance Notification on the date of 2 November 2011 extending the excise tax filing for tax due from 1 September 2011 to 30 November 2011 to be filed by 15 December 2011. This is applicable to the company suffering from flood and located in Nonthaburi, Patum Thani, Ayutthaya, Sing Buri, Nakorn Sawan, Phichit, Uthai Thani, and Bangkok only district of Bang Bon, Bangphlat, Don Mueang, Bang Khen, Bueng Kum, Min Buri, Sai Mai, Lat Krabang and Nong Chok respectively.

Q : If the company gives money to its employees who suffer from the flooding, can the company obtain a deduction for income tax purposes?

A : Yes, the company can obtain a deduction for income tax purposes for the amount given to its employees for the purpose of providing assistance to employees suffering from the flooding.

In order to do so, the company should have rules, regulations or announcements approved by its board of directors and they should be notified to all staff affected by the flooding prior to giving money. In addition, the company should have the relevant evidence to support the payment directly to such employees affected from flooding; i.e. photo, housing certificate showing that their home affected by flooding or other documents showing that they reside in flooding area or similar evidence that they notify to the government agency for flood affected.

Q : If the employees who suffer from the flooding receive money from the employers; will the money be included as assessable income of those employees?

A : No. The money employees receive from their employers to compensate for the flood damage would be exempt for the purpose of the personal income tax calculation on the condition that such money does not exceed the value of damages sustained in accordance with the Section 3 (2) of the Royal Decree No. 527.

Q : What happen if the business has jointly filed the value added tax or specific business tax, and its branch got affected by the disaster?

A : In case where business operator whose branch is affected by the flood and has jointly filed the value added tax returns or jointly filed specific business tax returns, the filing can be made only for the headquarter or branch which is unaffected area. For the branch located in the affected area, the period for additional filing is extended to December 30, 2011 without incurring any penalties and surcharges.

Q : Do the tax return filing and payment of tax have to be made at local Area Revenue Branch Office where place of business is located?

A : No, the tax return filing and payment of tax filed and paid **at different** other Area Revenue Branch Office.

Q : If an enterprise's tax documents are damaged or lost. What procedures should the enterprise follow?

A : In the case where an enterprise's tax documents are damaged or lost, the enterprise shall officially notify to a local police official for detailed list of damaged or lost documents. Should there be any problem in practice, please consult the in-charge the Area Revenue Branch Officer or Bureau of Large Business Tax Administration for obtaining duplicate documents.

Ref : Revenue Department News dated 3 November 2011

Q : the company is a victim of flooding, how should the company record the rental expense for the substitute operating office?

A : It should be recorded as selling and administrative expenses.

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Thank you

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