FINANCIAL REPORTING PRACTICE GUIDANCE NO. 2 of 2020
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AREAS OF REVIEW FOCUS FOR FY2020 FINANCIAL STATEMENTS UNDER ACRA'S FINANCIAL REPORTING SURVEILLANCE PROGRAMME

Under the Financial Reporting Surveillance Programme (FRSP), ACRA reviews financial statements (FS) of Singapore-incorporated companies for compliance with the prescribed accounting standards in Singapore.

To guide directors in reviewing and approving the upcoming FS, ACRA is publishing the areas of FRSP review focus for FY2020 FS.

FRSP's areas of review focus for FY2020 FS

More than 11 months after the first reported human case of the COVID-19 virus, economies around the world are still grasping with the economic and financial effects of the COVID-19 pandemic.

On 14 October 2020, the Ministry of Trade and Industry announced[1] that on a year-on-year basis, the Singapore economy had contracted by 7.0% in the third quarter of 2020.

On 28 October 2020, the Monetary Authority of Singapore (MAS) announced[2] that the economic rebound in Quarter 3, 2020 was underpinned by the resumption of business activities post-circuit breaker. With most industries reopened in Singapore, the growth momentum was expected to slow in Q4 and remain modest in 2021.

MAS also cautioned that some pockets of the Singapore economy might not recover to pre-COVID-19 levels, even by the end of 2021; in particular, travel-related and some contact-intensive domestic services.

MAS further highlighted that without effective vaccination programmes globally, the threat of repeated outbreaks of COVID-19 would remain. Hence, the economic recovery might be more prolonged than in previous recessions.

Against this backdrop, our review on FY2020 FS will focus on:

- Judgements or estimates made in the areas impacted by COVID-19 pandemic;
- Assessment of the going concern assumption;
- Adequacy of impairment charge and assumptions made in the assessment; and
- Valuation of investment properties and financial instruments.

[1] *Refer to https://www.mti.gov.sg/Newsroom/Press-Releases/2020/10/Singapore-GDP-Contracted-by-7_0-Per-Cent-in-the-Third-Quarter-of-2020*
[2] *Refer to https://www.mas.gov.sg/-/media/MAS/EPG/MR/2020/Oct/MROct20.pdf*

The overall objective of the FS is to provide financial information that is comparable and useful to a wide range of users in making economic decisions. In the current climate, directors are expected to deal with more uncertainties, particularly when making estimates or assessing cash flows/financial position. Directors are also encouraged to disclose beyond the requirements in the accounting standards, to inform the users of FS of the areas significantly impacted by COVID-19 pandemic.

Here are some questions that can help directors identify accounting issues and deal with them:

1. Judgements or estimates made in the areas impacted by COVID-19 pandemic

- **Has any operating segment experienced a significant drop in revenue? Any major customer contract(s) cancelled or modified recently?** The answers will help directors identify the changing consumption patterns of customers, as well as changes in contractual terms to 'sweeten' the deal to keep customers. Such changes will impact revenue recognition policies and estimates, and provisions (including provision for onerous contract).

- **Has any revenue been earned through variable consideration?** Due to the circuit breaker measures, some construction works may be halted or delayed. These can affect the estimated performance bonuses and/or attract penalties provided in the customer contracts. On the other hand, many airlines and hospitality chains are relaxing the terms of their loyalty programmes and rolling out promotions. These activities may impact the amount and timing of revenue recognised in the profit or loss.

- **Has any loan been re-financed this year?** Some companies may choose to ride on the opportunity of the low interest rate environment to re-finance their loans while some are forced by circumstances to do so. To ascertain whether the old debt can be de-recognised (with the difference taken to the profit or loss), companies need to satisfy at least one of the two tests below:

  i. *Quantitative test:* whether the net present value of the cash flows under the new debt discounted at the original effective interest rate is at least 10% different from the carrying amount of the original debt

  ii. *Qualitative test:* whether there is a significant change in the terms and conditions so fundamental to the debt (e.g. new debt having a different currency, equity instrument embedded the new debt)

- **Has any complex instrument been issued or entered into to raise funds, or hedge currency and other financial risks?** Complex instruments with embedded derivatives may be used to manage the financial risks. Both their accounting and valuation can be complex; directors are strongly encouraged to seek assistance from experts.

- **Has any invoice discounting, factoring or reverse factoring arrangements been obtained?** To gain access to more liquidity, some companies may use trade financing facilities. However, there is often little disclosure of the related terms and risks in the FS although such disclosure is required by the accounting standards. If factoring of receivables is used, directors are also expected to review the terms of the factoring arrangements e.g. is the company obliged to bear the loss if the receivables were unpaid by the debtors. The terms will determine the time when the receivables are de-recognised from the balance sheet.

- **Are 'exceptional' or 'one-off' costs** (e.g. restructuring costs, costs that must be recognised despite no associated sale made, incremental health and safety costs) **presented on the face of income statement?** If yes, directors should rigorously challenge management's basis for presenting it this way. Recurring costs should not be described as 'exceptional' or 'one-off'. All profit or loss items should be categorised based on the chosen presentation format (i.e. nature or function). Non-GAAP performance measures or splitting of items between COVID-19 and non-COVID-19 that is not in accordance with the chosen presentation format should be avoided, as the adjustments are highly subjective.

- **Are the credits from government reliefs and assistance separately presented as grant income or deducted against the related costs?** If the latter and the amounts are material, directors are reminded to disclose the amount in the notes, together with explanations on their nature, so that users of FS are informed.

2. Assessment of going concern

- **Has the aging of receivables deteriorated? Any major customer(s) been paying past the credit terms? Any major customer(s) based in an industry and/or geographical area with challenging business environment?** If yes to any of the questions, directors should ensure expected loss allowance is not determined solely using historical loss data, which may not represent current year credit risks. If the bulk of receivables was owing from a few customers, directors should disclose the actions taken to monitor and address the risks arising, beyond what is required in the accounting standard. Users of FS will need this information to have a good understanding of the reporting entity's cash flows.

- **Has any major supplier(s) been denying the usual trade or credit terms?** Difficulties in recovering debts from customers, coupled with a denial of usual credit term by suppliers, can spiral the Group into a liquidity crunch. Directors should monitor this closely and ensure cash flow forecasts are prepared in sufficient granularity (e.g. by month) to reflect the current business conditions and the latest business model.

- **Has any bank withdrawn the current loan/credit facilities or rejected re-financing requests?** If management encounters difficulties in obtaining re-financing and/or securing alternative financing, cash flow forecasts used for liquidity and going concern assessments should be updated to reflect the worst case scenario for stress testing. If there is significant doubt on the Group's ability to service debt obligations for at least the next 12 months, directors should disclose the material uncertainty.

- **Has any loan covenant(s) been breached? If yes, did it trigger other borrowings to become immediately payable?** Breaches of loan covenants can reduce liquidity rapidly, triggering other borrowings to become immediately payable as well. Directors are reminded that borrowings with breaches at year-end should continue to be presented as current liabilities, even though a waiver from the loan covenants have been obtained from the banks after the year-end.

- **Has any other events or conditions cast significant doubt on the Group's ability to continue as a going concern?** If yes, directors should disclose the existence of the material uncertainty. If a critical judgement has been made to arrive at the conclusion that there is no material uncertainty, that judgment together with bases and associated uncertainties must be disclosed. Directors should also assess the impact to the directors' statement accompanying the FS, in respect of the holding company's ability to pay debts as and when they fall due.

3. Adequacy of impairment charge and judgments made

Users of FS are likely to focus on impairment in light of the COVID-19 pandemic.

- **Which cash generating unit(s) (CGU) are performing poorly? Has there been any change(s) in the way CGUs are categorised?** Poor business outlook, changing consumption patterns are some indicators requiring impairment tests to be performed. On the other hand, changing business model may impact the allocation of goodwill to the respective CGUs.

  Any change in the way CGUs are categorised or how goodwill is allocated to the CGUs requires significant judgment, for which directors should ensure that the rationale for doing so is valid and supportable. Directors are also reminded to ascertain that the change is not intended to avoid impairment charge, and to disclose the change together with the reasons for doing so in the FS, to aid users' understanding.

- **How have cash flow forecasts in impairment assessment been adjusted to reflect the current environment?** Cash flow forecasts must be updated to reflect the industry and business outlook, and changes in business model both in the short term and long term (e.g. shifting from brick-and-mortar stores to online sales in the short term, and to a hybrid model in the long term). The devil is in the detail; directors are encouraged to run through the detailed cash flow forecasts with management. On the other hand, directors should also ensure that management is not overly prudent, leading to assets being excessively written down.

- **Can certain assumptions used by management lead to significantly different cash flow forecasts?** Companies in the travel-related sectors are expected to experience prolonged uncertainty, for example, when global travel restrictions will be lifted or when tourists will return to Singapore. To address scenarios that can lead to significantly different outcomes, directors are encouraged to use an expected cash flow approach based on multiple probability-weighted scenarios.

  During this uncertain time, it also becomes more important for directors to disclose detailed information about sensitivities to key assumptions made about the future, and/or ranges of outcome. This will aid users of FS in understanding the practical difficulties encountered by directors when reviewing the assumptions. It is also essential to tailor these disclosures, and not simply repeat the requirements of the accounting standard.

- **Do all CGUs have the same risk profiles? If not, was the same discount rate used across all impairment tests? Was the discount rate used this year higher or lower than the discount rate used last year?** A blanket discount rate is typically not appropriate for the impairment testing across CGUs with different risk profiles. In general, discount rates are also expected to be higher this year, to reflect higher risks due to the economic uncertainty, unless the cash flow forecasts and terminal values have been adjusted for that. Directors are advised to engage professional valuers to perform impairment tests this year; as this area is expected to be very complex and judgmental.

4. Fair value measurement of investment properties and financial instruments

- **Has professional valuers' help been obtained to value significant assets** (e.g. investment properties, financial instruments) **or liabilities** (e.g. derivative instruments) **that are recorded at fair value?** If no professional valuer is engaged, directors should assess and be comfortable with management's competency in handling the complexity of these valuations. If the scope of valuation does not cover the assessment of assumptions made by management, directors are expected to review those assumptions in detail and be comfortable with the assumptions made.

- **Has the valuation multiples approach been used to value certain assets? Does the market prices of those assets fluctuate significantly?** If yes to both questions, the market multiples approach may not reflect the actual value drivers. Other valuation approaches such as the income approach may be more suitable. If the valuation approach has been changed this year, users of FS will find it helpful if this is explained in the FS.

- **Has any caveat or qualifying statement been included in the report issued by the professional valuer?** Due to the unprecedented market volatilities, some valuers may include caveat or qualifying statement in their reports. Directors are advised to understand the valuer's reasons for including the qualification and assess the impact with management and the statutory auditors. If the qualification is useful to aid users' understanding of the fair value, directors should ensure this is disclosed as estimation uncertainty.

- **Has any asset's value declined significantly between the year-end date and the date the FS is authorised for issue?** If yes, directors should ensure the decline in value is appropriately disclosed in the FS. Directors are also encouraged to exercise care when classifying a business to a disposal group held for sale, where the underlying assets are no longer depreciated or amortised. Such disposal group must be available for immediate sale and marketed at a price in which a sale within 12 months is highly probable.

5. Other areas of focus

- **Has any subsidiary been de-consolidated, despite no change in the proportion of shares held?** If yes, directors should assess management's basis for doing so; de-consolidation is allowed only when there was a loss of control over the subsidiary. Failure to obtain management accounts or remove directors may not suffice to evidence a loss of control. Directors are expected to consider aspects such as legal rights under contracts, shareholder rights under the constitution, operational dependencies and local legislations.

- **Has any loans or financial instruments been pegged to InterBank Offered Rates, such as LIBOR or SIBOR, that will be converted to an alternate benchmark? Any hedging done on the interest rate risks?** If yes to both questions, directors should consider Phase 1 amendments to financial instruments standards, in response to the interest rate benchmark reform, and seek accounting advice.

The above factors are provided as a general guideline. They do not exhaustively define the requirements of the prescribed accounting standards in Singapore. When in doubt, directors should seek professional help. ACRA also reserves the right to conduct review of other areas in the FS as deemed necessary.