ACRA
ACCOUNTING AND CORPORATE REGULATORY AUTHORITY

RAISING THE BAR ON FINANCIAL REPORTING

FINANCIAL REPORTING SURVEILLANCE PROGRAMME INAUGURAL REPORT

Scope / Disclaimer

When perusing the findings set out in this report, the reader should bear in mind the facts and circumstances of the affected companies. The findings should not be read in isolation or interpreted as additional mandatory rules to the prescribed Accounting Standards in Singapore.

Published September 2015

Acronyms

ACRA	Accounting and Corporate Regulatory Authority
FRSP	Financial Reporting Surveillance Programme
FY2013	Financial year ended between 1 January 2013 and 31 December 2013 (both dates inclusive)
FY2014	Financial year ended between 1 January 2014 and 31 December 2014 (both dates inclusive)
FY2015	Financial year ended between 1 January 2015 and 31 December 2015 (both dates inclusive)
FRTAP	Financial Reporting Technical Advisory Panel
ISCA	Institute of Singapore Chartered Accountants
ISCA-FSRC	Financial Statements Review Committee of ISCA
SFRS	Singapore Financial Reporting Standards
SGX	Singapore Exchange
SID	Singapore Institute of Directors

ACRA is the national regulator of companies in Singapore and administers the Companies Act in Singapore. Through the FRSP, ACRA enforces directors' duties under sections 201(2) and 201(5) of the Companies Act to prepare financial statements in accordance with the prescribed Accounting Standards in Singapore. This enforcement is necessary to ensure that the quality of financial reporting in Singapore is on par with global standards and instils greater confidence in investors.

The FRSP commences when ACRA identifies and reviews selected financial statements lodged with ACRA. Directors are then queried on possible non-compliance(s) with the prescribed Accounting Standards in Singapore. Section 31(1) of the ACRA Act (read with section 6(1)(a) of the ACRA Act and the Second Schedule to the ACRA Act) empowers ACRA to require any person to furnish information or produce any book or document in connection with the review. ACRA may call upon an auditor of the company to assist in its queries or investigation.

CONTENTS

1 EXECUTIVE SUMMARY

"High quality financial reporting is part and parcel of good governance and is key to maintaining Singapore's competitive advantage as a trusted environment. We should therefore make a serious effort to raise the bar in a meaningful way."

Mrs Josephine Teo,
then Minister of State for Finance and Transport,
ACRA's Public Accountants Conference, 14 August 2013

In recent years, a growing number of companies have been thrust into the limelight with allegations of accounting irregularities. This has in turn resulted in significant volatility in the share prices of the affected companies. Concurrently, accounting standards are becoming increasingly complex as they evolve in tandem with a challenging and dynamic business environment and complex business models.

A higher level of scrutiny is therefore necessary to uphold and maintain investors' and other stakeholders' confidence in the transparency, integrity and quality of financial reporting in Singapore. With this in mind, **ACRA expanded the scope of its FRSP in July 2014** to include reviews of financial statements with 'clean' audit reports of listed companies. Previously, the FRSP was focused on the (partial) review of accounting issues highlighted in the modified audit reports[1] of listed companies.

The primary objective of the FRSP is to **guide companies to meet the requirements** in the prescribed Accounting Standards[2] in Singapore. Regulatory sanction is taken against company directors only for non-compliance(s) that has a severe impact to the financial statements.

[1] Modified audit reports refer to those other than true and fair audit opinions. They comprise audit opinions that are qualified, with adverse opinions and disclaimer of opinions.
[2] Accounting Standards refers to the accounting standards issued by the Accounting Standards Council for application by companies incorporated in Singapore. They include the SFRS.

This inaugural report encapsulates the **surveillance work of the first review cycle** under the expanded FRSP. The findings are reported on an aggregated, non-attributable basis with the intention of helping directors avoid common pitfalls and take the lead in raising the quality bar on financial reporting.

Regulatory outcomes of listed companies

A total of **49 sets of FY2013 Financial Statements of listed companies were reviewed** in 2014. All reviews were completed, except for two ongoing cases. The regulatory outcomes of the completed cases are summarised in the table below.

	Listed Companies
No. of financial statements reviewed	49
Enquiry letters sent	47
Ongoing cases	2
Regulatory outcomes	
Warning	4
Advisory	29
Closure	12
Total	**45**

No prosecutions were undertaken, nor were composition fines imposed, in this review cycle. The maximum penalty for directors under the Companies Act is imprisonment of three years and/or fine of S$100,000.

Collectively, **4 instances of severe non-compliance, 54 instances of other non-compliance and 74 areas for improvement** were identified. All instances of non-compliance and areas for improvement are incidences where the financial statements were not compliant with the Accounting Standards, differentiated by the nature and extent of the misstatements.

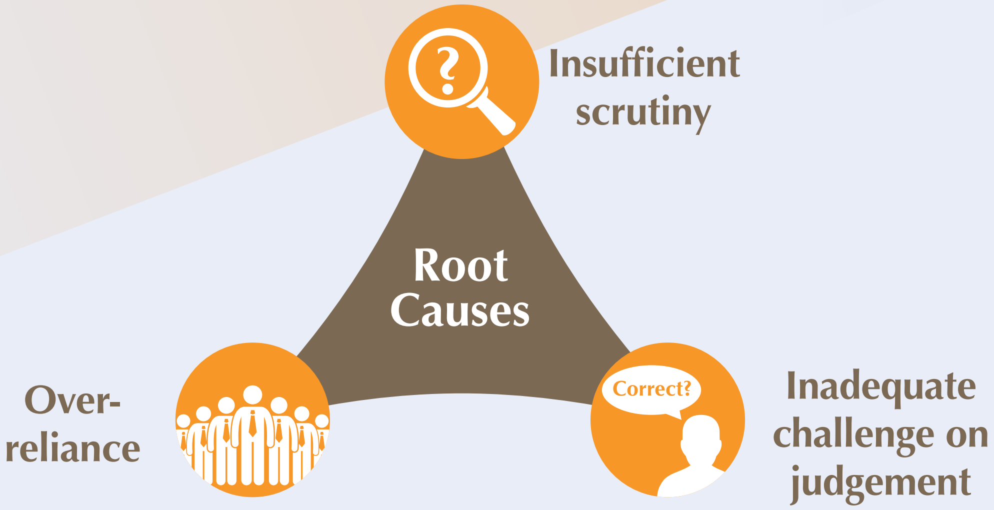
ACRA is encouraged to note that all instances of non-compliance brought to the attention of the directors before the finalisation of the FY2014 Financial Statements have been addressed. A majority (76 percent) of the areas for improvement were also attended to. This ensures that **investors are provided with reliable and meaningful financial statements on a timely manner** for their decision-making.

All instances of non-compliance and areas for improvement are communicated via the **issuance of closure letters, advisory letters and warning letters** (refer to Appendix A for the degree of non-compliance). Closure letters and advisory letters do not carry any regulatory sanction. Directors were interviewed and their statements were taken before the warning letters were issued. Directors of listed companies who received warning letters must disclose this fact at their appointment or re-appointment as a director under the SGX Listing Rule 704(7) and Appendix 7.4.1(k).

Root causes of the non-compliances

The detailed findings and case studies are set out in Section 3 of this report. From the findings and interviews with the directors, the fundamental basis for the non-compliances appeared to be **a lack of ownership by the companies in the financial reporting process**.

Three main root causes of the non-compliances were identified:



Insufficient scrutiny by directors when the reported financials did not accord with their understanding of the business

ACRA observed that some directors did not accord sufficient scrutiny to the financial statements and hence, were **unable to discern** that the reported financials were **inconsistent** with their knowledge and understanding of the business.

In one case, the listed company reported a negative operating cash flow, even though its directors were aware that the business was profitable and generating a positive operating cash flow (Case Study A).

Case Study A Pg 12

In another case, the listed company accounted for the retail component of a mixed-use property as property held for sale, even though its directors were aware of the corporate strategy and business intention to keep the retail component for long-term investment (Case Study B).

Case Study B Pg 14

Over-reliance on accounting team who may lack competence or diligence

ACRA also observed that some directors depended heavily on management, accounting teams and auditors to ensure that there were no accounting breaches. While such reliance is acceptable for basic financial reporting functions, these directors also **deferred unreservedly** to management's judgements on critical accounting issues. They **did not consult further** nor obtain additional accounting advice, even when they were **uncomfortable** with those judgements made by management.

Some directors were also unaware of the instances of non-compliance until highlighted by ACRA. This could be due to a lack of competent and/or adequately-resourced accounting teams.

Independent directors did not adequately challenge management's judgement

There were also instances where management made **judgements that were overly aggressive** and deviated from the generally accepted accounting practices. The accounting positions were not supported by analyses. There was also a lack of documentary evidence to indicate robust discussion(s) on the issues.

In one case, the listed company recognised the entire revenues and profits on its construction contracts, well before the contracts were substantially completed. The listed company also wrongly presented the unbilled amounts as trade receivables (Case Study C).

Case Study C Pg 16

In another case, the listed company consolidated a profitable subsidiary, even though the key decisions relating to that subsidiary remained with the seller. By consolidating prematurely, the listed company wrongly portrayed that it had a profitable ongoing business (Case Study D).

Case Study D Pg 18

The findings and root causes showed that most of the instances of non-compliance **could have been avoided** if the directors, even without the benefit of detailed accounting knowledge or professional support, review the financial statements carefully and with rigour.

Looking ahead

The expanded FRSP, being a nascent programme, will **continue to be fine-tuned**. This includes refining its engagements with a varied range of stakeholders that encompasses directors, financial officers and auditors. ACRA would like to thank the many stakeholders who came forth with candid feedback to improve the review process.

ACRA will publish the FRSP areas of review focus for the FY2015 Financial Statements soon. This will serve as a useful reference for directors and a timely reminder on some possible areas of misstatements in the FY2015 Financial Statements.

2 ABOUT THE FRSP

Demarcating the roles of preparers and auditors

In 2013, a survey[3] by the Association of Chartered Certified Accountants in collaboration with ACRA showed that around 50 percent of the survey respondents, which comprised chief financial officers, financial controllers and accountants, appeared to believe that the primary responsibility over the preparation of financial statements falls on the auditors, rather than on them. Adding to this were views from the survey focus group that some company officers such as **directors were not fully engaged in financial reporting** and that many relied on their auditors to drive the process.

The lack of ownership by preparers was reinforced in a subsequent study[4] in 2014 by the Singapore Management University in collaboration with ACRA. The auditors of 257 Singapore-listed companies proposed 3,222 adjusting entries worth S$33.9 billion for the FY2013 audits. Most of these adjusting entries were derived from factual errors/misstatements, indicating a **lack of quality in the financial statements prepared by the companies** before audit. This hinders the auditors' ability to conduct effective audits, which may in turn impair the reliability of audited financial statements.

[3] Strengthening the Financial Reporting Value Chain in Singapore (2013).
[4] Audit Adjustments Matter: Upholding Financial Reporting Quality (2014).

All stakeholders – directors, management, accounting teams, auditors, investors and regulators – have **joint and inter-dependent roles** to play in strengthening the financial reporting value chain. With this in mind, ACRA expanded the FRSP in July 2014. Targeted at the preparers of financial statements, the expanded FRSP involves full reviews of the financial statements of listed companies.

The expanded FRSP is **aligned with the financial reporting surveillance programmes in other leading financial markets**. It also addresses the concern that financial statements with 'clean' audit reports could still contain instances of non-compliance with the Accounting Standards, as revealed by ACRA's findings from inspecting auditors[5].

This inaugural report encapsulates the surveillance work of the first review cycle under the expanded FRSP.

Enforcing directors' duties over financial reporting

ACRA administers the Companies Act that applies to companies incorporated in Singapore. Their financial statements lodged with ACRA are selected for review using a risk-based approach (refer to Appendix A). Companies incorporated outside of Singapore as well as non-company entities do not come under ACRA's purview.

The FRSP enforces directors' duties in relation to financial reporting under the Companies Act. Specifically, **sections 201(2) and 201(5) of the Companies Act** require the directors of a company to present and lay before the company, at its annual general meeting, financial statements that:
(a) comply with the prescribed Accounting Standards in Singapore; and
(b) give a true and fair view of the profit or loss, and the state of affairs of the company.
The **directors must fulfil both conditions** in the discharge of their responsibilities under the Companies Act.

The FRSP is primarily focused on the compliance with the Accounting Standards. Enquiries are made to directors when a desktop review of the financial statements indicates possible non-compliance(s) with the Accounting Standards. **Section 31(1) of the ACRA Act** (read with section 6(1)(a) of the ACRA Act and the Second Schedule to the ACRA Act) empowers ACRA to require any person to furnish information or produce any book or document in connection with the review. ACRA may call upon an auditor of the company to assist in its queries or investigation.

Focusing on what matters to investors

The ultimate goal of the FRSP is to ensure that investors are provided with reliable and meaningful financial statements for their decision-making. As such, ACRA has focused its review and enquiries on areas that might significantly **impact the key measures used by investors** such as revenue, profit and operating cash flow.

For a holistic assessment, besides the **quantitative amount**, the subjective **qualitative factors are also considered**. For example, emphasis is placed on assessing the classification of properties for a property-developer company, as with the measurement bases of inventories for a manufacturing company. More questions are raised on areas that might impact the income statement if a company appears to face significant pressures to show a trend of increasing earnings, amidst a difficult business environment.

[5] ACRA carries out the Practice Monitoring Programme to inspect the auditors' work for compliance with prescribed auditing standards. The latest annual public report is available at www.acra.gov.sg.

Deep-dive into accounting issues

Due to the focus on key measures used by investors, many enquiries are made in the areas of **accounting recognition and measurement**, particularly in relation to complex or unusual transactions. When accounting issues are identified, ACRA drills into them, requesting for detailed explanations and, where necessary, documentary evidence to support the accounting positions.

With increasingly complex business models and corporate strategies, an appropriate accounting outcome could differ depending on the facts and circumstances of an arrangement. Significant efforts were therefore expended to **raise specific and to-the-point enquiries** so as to solicit a comprehensive response from directors. This enables ACRA to form **its independent and well-informed view**, rather than to accept the directors, management and/or auditors' judgements unreservedly without complete information.

Sometimes, there may be requests for commercially sensitive documents such as agreements and minutes of board meetings. The information obtained will be treated with the strictest confidence in accordance with the law.

These documents are requested to uphold the effectiveness and integrity of the review process. There is an **inherent risk** for companies not to be forthcoming in providing ACRA with information that contradicted their existing accounting treatments. For example, in one case, the listed company omitted the provision of clauses in the agreement that contradicted its existing accounting treatment in the response to ACRA enquiry. When ACRA identified and highlighted the omitted clauses following the review of the agreement, the listed company re-assessed its accounting treatment and restated its financial statements to recognise a profit of S$8 million in the prior year.

First expert opinion from the ISCA-FSRC

To **benchmark** enquiries and findings of the FRSP to **expert views and market practices**, ACRA collaborated with the ISCA-FSRC to review most of the financial statements.

Established more than 30 years ago, the ISCA-FSRC comprises more than 30 experienced audit partners from the various audit firms in Singapore, with a majority from the Big-Four[6] audit firms. They bring a wealth of accounting knowledge and experience to the FRSP.

Measures were put in place to **safeguard the confidentiality and independence** of the review and deliberation processes, such as setting up small groups for discussion. More than 50 small group discussions were held in 2014 to deliberate on the enquiries and findings.

ACRA **retains the sole discretion** in deciding the regulatory outcome, after considering the expert opinion from the ISCA-FSRC and the FRTAP.

[6] Big-Four audit firms comprise Deloitte & Touche, Ernst & Young, KPMG and PwC.

Second expert opinion from the FRTAP

When non-compliances leading to regulatory sanctions are considered complex and/or judgemental, they are referred to the FRTAP for a second independent expert opinion.

The FRTAP was set up by ACRA to **ensure that any serious enforcement decision is not unduly prejudicial to directors**. The FRTAP comprises senior audit partners, directors, chief financial officers, financial controllers and academia of the broader financial reporting community.

A review group of five members is drawn from the 16-member FRTAP to deliberate on each case. To ensure neutrality, each review group must comprise three senior audit partners from different audit firms with at least one non-auditor representative. Each member must declare their independence in respect of the case before the proceedings.

To date, three review group meetings were held to deliberate on six cases, of which, supports for severe non-compliance were obtained for four cases.

Regulatory outcomes

ACRA applies the following range of regulatory outcomes, depending on the severity and number of non-compliance:

Details on the calibration of the regulatory outcomes are provided in Appendix A.

Closure letters and advisory letters do not carry any regulatory sanction. For regulatory sanctions such as warning, composition and prosecution, ACRA interviews directors and takes their statements before imposing the sanctions.

Directors of listed companies who have received the regulatory sanctions should also consider the **implications from the SGX Listing Rules**. In particular, under Rule 704(7) and Appendix 7.4.1(k), a director who receives a warning letter from a regulatory authority must announce that fact at his future appointment(s) or re-appointment(s) as a director of any company listed on the SGX. Under the SGX Listing Manual Rule 703(1), the directors of a listed company must also consider whether the regulatory sanction constitutes 'material information' in relation to the company and, if so, an announcement should be made by the listed company.

It should also be noted that ACRA has the right to take regulatory action against auditors in respect of an inappropriate audit opinion, under section 207 of the Companies Act.

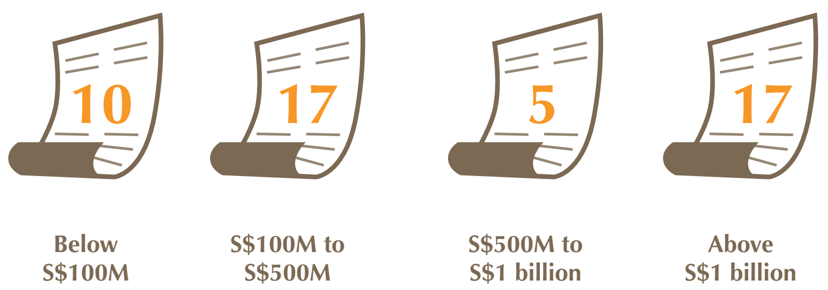
[7] Under section 204(1) of the Companies Act, any director who fails to comply with section 201(2) or 201(5) shall be guilty of an offence and shall be liable on conviction to a fine not exceeding S$50,000.
[8] Under section 204(3) of the Companies Act, if the offence is committed with intent to defraud creditors or for fraudulent purpose, the offender shall be liable on conviction to a fine not exceeding S$100,000 or to imprisonment for a term not exceeding three years or to both.

3 FINDINGS FROM THE FY2013 FINANCIAL STATEMENTS

Listed Companies

Out of 49 sets of FY2013 Financial Statements of listed companies reviewed, enquiry letters were sent to the directors of 47 listed companies. All reviews were completed, except for two ongoing cases. Their market capitalisation is depicted below.

Number of listed companies reviewed (by market capitalisation as at 31 December 2013)



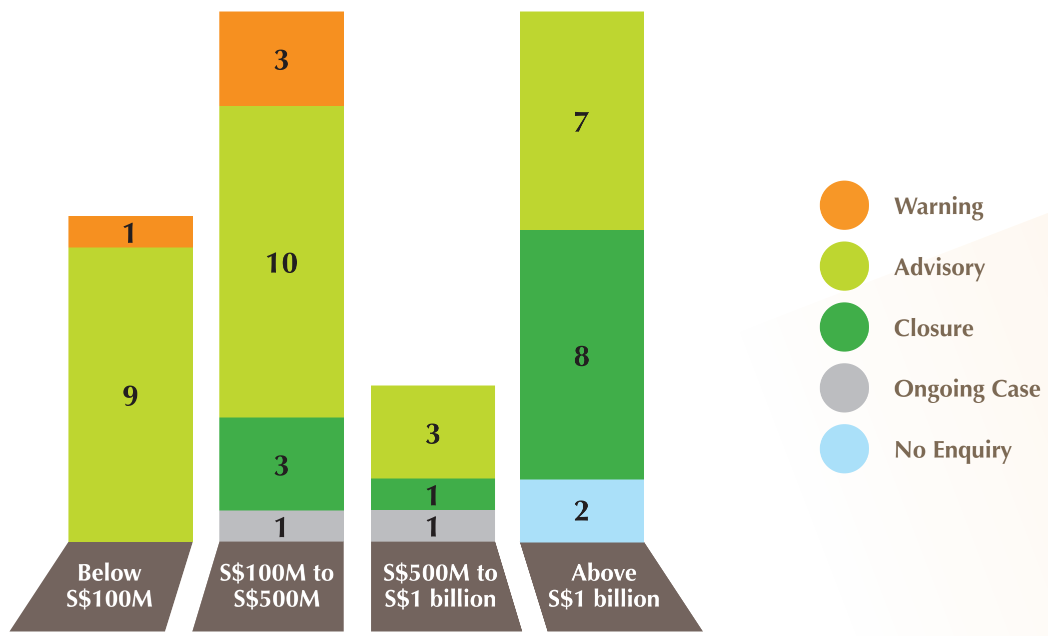
Good reporting from larger-cap listed companies

The 17 listed companies with market capitalisation above S$1 billion reviewed demonstrated a good level of financial reporting quality. There were no instances of severe non-compliance with regards to the material complex arrangements and transactions such as business acquisitions, service concession arrangements and investee classifications in their FY2013 Financial Statements.

In contrast, there was **room for improvement** among the 27 listed companies with market capitalisation below S$500 million, which formed more than half of the review population. There were four instances of severe non-compliance that significantly affected the reported profits or operating cash flows. **40 out of 54** instances of other non-compliance were also attributable to these companies. The higher proportion of non-compliance could be due in part to **the increased complexity in accounting when these companies scale up and expand operations overseas**. It could also be due to their audit committees not spending sufficient time on financial reporting.

In particular, the **audit committees** of the 27 smaller-cap listed companies **met less often**. While a majority (74 percent) met four times, two audit committees met only once and another two audit committees met only twice for FY2013. In contrast, 51 percent of the audit committees of the 17 larger-cap listed companies met four times while the remaining 49 percent met more than four times for FY2013.

Regulatory outcomes of listed companies (by market capitalisation as at 31 December 2013)



At the date of this report, for listed companies, **4 instances of severe non-compliance, 54 instances of other non-compliance and 74 areas for improvement** were identified and communicated to the directors.

The instances of non-compliance are elaborated below. Case studies have been included to illustrate how directors can identify some instances of non-compliance. These case studies do not comprise solely or all instances of severe non-compliance. The information in the case studies has also been adjusted to mask the identities of the companies.

Errors distorted true operating cash flows

The statement of cash flows is an important source of information for investors to evaluate the company's ability to:

(a) convert profits into cash to fund its operations and investments, and repay its debts; and
(b) adapt to changing circumstances and seize business opportunities.

It is critical to report the cash flows accurately and present them correctly.

Six listed companies made **straightforward errors** in their consolidated statements of cash flows. These errors could be easily detected by directors during their desktop reviews of the financial statements. The errors indicated a lack of care and diligence by the finance teams, finance controllers, chief financial officers and directors when preparing the financial statements.

In particular, two listed companies **wrongly presented non-cash currency translation differences as cash flow items** in the consolidated statements of cash flows. For one listed company, the net cash flow positions from all three types of activities were reversed.

Case Study A

Background
The functional currency of the major subsidiaries of the Group was the Indonesian Rupiah (IDR) while the presentation currency for the FY2013 Financial Statements was the United States Dollar (US$).

To present the consolidated financial statements in the US$, the Group converted the financial statements of those major subsidiaries reported in the IDR to the US$. The conversion resulted in unrealised foreign exchange differences being recognised in the Group's equity (Currency Translation Differences).

The Group included the Currency Translation Differences that are non-cash items within its operating, investing and financing cash flows in the Consolidated Statement of Cash Flows.

Directors' Explanation
The Directors explained that such presentation better reflected the operating capacity of the Group, and provided a better picture of the impact from the significant depreciation of the IDR against the US$ in FY2013.

Following ACRA's enquiry, the Directors restated the FY2013 figures in the FY2014 Financial Statements as follows:

All in US$	Actual in FY2013 Financial Statements	Restated in FY2014 Financial Statements
Net operating cash **(outflow)**/inflow	**($25 million)**	$40 million
Net investing cash **inflow**/(outflow)	**$40 million**	($50 million)
Net financing cash **(outflow)**/inflow	**($10 million)**	$15 million

ACRA's Analysis and Conclusion
The Currency Translation Differences did not involve cash flows and should not be presented as cash flow items in the Consolidated Statement of Cash Flows.

By including non-cash items, the trends and positions of the Group's **true cash flows became distorted**. For example, the Group should have reported that it generated an operating cash **inflow** of US$40 million, and not that it had used an operating cash **outflow** of US$25 million. The operating cash outflow reported was not consistent with the Directors' understanding that the business had been profitable and was generating positive cash flows, making it obvious to detect.

(Technical reference: Paragraph 28 of SFRS 7 Statement of Cash Flows)

Learning Point

Besides balance sheets and income statements, directors should review statements of cash flows, and raise **questions when the trend and/or position of the reported cash flows appear inconsistent** with their knowledge of the companies' business operations and performance.

In view of the current volatile foreign currency markets, directors should also **understand how the significant foreign currency exposures are managed and reported** in the financial statements.

Other related findings

Four other listed companies **misclassified certain cash flows within operating activities** when those cash flows should be presented within investing activities. As a result, their true operating cash flows were misstated.

In one case, the listed company wrongly classified the progress payment received for the disposal of a subsidiary within operating activities, when it should be reported within investing activities. As a result, its net cash inflow from operating activities was overstated five-fold.

In another case, the listed company wrongly classified the refunded deposit for an aborted business acquisition within operating activities, when it should be reported within investing activities. As a result, it reported a net cash inflow from operating activities of S$4 million, instead of the true net cash outflow from operating activities of S$1 million.

Operating cash flow is an important indicator to investors when assessing the ability of a business to generate cash from its operations. Blending operating cash flows with other cash flows gives an inaccurate picture of the sustainability of cash flows from the revenue-generating activities.

Accounting did not follow business intention for mixed-use property

Mixed-use property developments with various components such as residential, retail and office are becoming popular. When a property developer has different business intentions (i.e. sell or keep for future rental) for different components or portions of a component in a mixed-use development, those components/ portions should be separately **accounted for** based on **the developer's business intentions**. Such classification could have a significant impact to the income statement, particularly when the developer uses the fair value model to account for its investment properties.

Two listed companies **wrongly accounted** for the entire development projects as properties held for sale during their construction. Both companies had intended to keep the retail components of the development projects for long-term investment when they acquired the land parcels. However, they transferred the retail components to investment properties only upon the completion of construction.

As both companies adopted the fair value model to account for their investment properties, this resulted in a **lump-sum fair value uplift** recognised **in the year of completion**. As such, the companies' profits in the year of completion were significantly overstated. Their profits/ losses in each financial year during the period from the acquisition of the land parcels to the completion of construction also did not reflect the changes in the market prices of the retail components.

Case Study B

Background
In FY1999, the Group acquired a land parcel via Subsidiary A for the development of a mixed-use residential and retail property. The Group intended to sell the residential component and hold the retail component for long-term investment. Subsidiary A could strata-subdivide the property only when the construction was completed.

In FY2013, when construction was completed, Subsidiary A distributed the retail component in-specie to a fellow subsidiary. The Group then transferred the cost of the retail component of S$5 million to investment properties, and recognised a lump-sum fair value gain of S$10 million on that component in FY2013.

Directors' Explanation
The Directors were of the impression that the retail component could not be separately accounted for as an investment property during the construction period, because:

(a) Subsidiary A could not strata-subdivide the mixed-use property until the construction was completed;
(b) the costs attributable to the retail component could not be reliably estimated; and
(c) the fair value of the ground floor attributable to the retail component could not be reliably measured during the construction period.

ACRA's Analysis and Conclusion
The Group had intended to wind up Subsidiary A when the residential component was fully sold and have Subsidiary A distribute the retail component in-specie to a fellow subsidiary, which would then hold it as an investment property. **From the Group's perspective**, the retail component was constructed for future use as an investment property and **those portions could be sold separately**, since the acquisition of the land in FY1999.

It was not plausible that the costs and fair value attributable to the retail component could not be reliably estimated during the construction period. The Group had used the percentage-of-completion method to account for the revenue and profit from the residential component (i.e. excluding the retail component) during the construction period and should therefore be able to estimate the costs separately for each component. The retail component was not designed to be highly specialised in nature and there are **established techniques to value such retail component** in Singapore.

Had the retail component been accounted for as an investment property at fair value, it will be re-measured to its fair value in each financial year between FY1999 and FY2013. Based on the movement of a relevant property index, the Group could be reporting a fair value gain of S$1 million, rather than S$10 million, in FY2013.

(Technical reference: Paragraphs 5, 8 and 10 of SFRS 40 Investment Property)

Learning Point

Directors should understand the company's business model and intention for the various components in each mixed-use property development and **raise questions when the accounting does not follow the business model and intention**.

Learning Point

Any transfer between property held for sale and investment property should be **supported by evidence of the change in use** to prevent arbitrary transfer and earnings manipulation.

Method to measure stage of completion did not reflect work performed

Revenue and profits from construction contracts on which the percentage-of-completion method is applied, are **susceptible to misrepresentation**. These revenue and profits are recognised, prior to the completion and delivery of the construction contracts and when estimates of construction costs and measures of work performed are often subjective and discretionary. Yet, due to the size and prevalence of construction contracts, the resulting revenue and profits are usually key measures of the Group's growth, profitability and to some extent, liquidity.

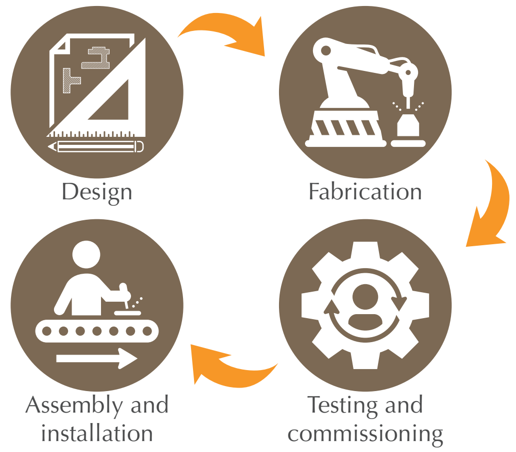
One listed company failed to use a measure that reflected the work performed to determine the stage of completion of its construction contracts. This resulted in a **premature recognition of revenue and profits during the construction period**.

The listed company also **wrongly presented** the unbilled amounts from its construction contracts as trade receivables. As a result, trade receivables accounted for almost the entire Group's revenue for that financial year.

Case Study C

Background
The Group applied the percentage-of-completion method to recognise revenue and profits on its contracts for constructing environmental systems. It measured the stage of completion of these contracts using the 'percentage of actual steel tonnage used divided by the total budgeted steel tonnage' (the Steel Tonnage Percentage).

There were four phases in the construction cycle:



Steel, which contributed to 48 percent of the Group's costs of sales in FY2013, was used mainly in the second phase (i.e. Fabrication phase). The remaining 52 percent of the costs were incurred in the first phase and the last two phases of the construction.

The Group had a nil balance for its construction contracts, even though it had several on-going contracts at both year-ends. The Group's trade receivables were also unusually high, representing almost the entire Group's revenue in FY2013.

Directors' Explanation
The Directors were of the view that steel was a key component and therefore, considered the Steel Tonnage Percentage a reliable proxy to measure the work performed.

There was no construction-in-progress balance because the Group had recognised all unbilled amounts as trade receivables, which was correspondingly recognised as revenue. The unbilled amounts represented about one third of the Group's trade receivables. A large portion of the unbilled amounts arose due to the Group acceding to customers' requests to defer billing.

ACRA's Analysis and Conclusion
The **Steel Tonnage Percentage was not reflective of the work performed**. With steel being used mainly in the second phase, the Group would have recognised 100 percent of the revenue and profits associated with the contracts by the end of the second phase, even though the remaining work and costs had not been performed and incurred, respectively.

The unbilled amounts should not be presented as trade receivables because they have not been billed. This **artificially inflated the amount of trade receivables**. Coupled with the fact that the unbilled amounts were classified as 'not past due', the ageing analysis of trade receivables was also artificially improved.

(Technical reference: Paragraphs 22 and 23 of SFRS 11 Construction Contracts)

Learning Point

Where the revenue, profit and construction work-in-progress of a project are **not reflective of the extent of work performed**, directors should question management accordingly.

Learning Point

Directors should also **challenge when the trade receivables are unusually high** as compared to the annual revenue.

Subsidiary consolidated before control was obtained

At times, management could make judgements that may be overly aggressive. Independent directors should be **alert to management bias** in financial reporting, by taking into account the economic and business situations of the companies and the management's motivations for taking those accounting positions.

One listed company failed to determine the correct date when it obtained the control of a subsidiary (i.e. the acquisition date). As a result, it consolidated the subsidiary's results and financial position prematurely and therefore, **wrongly portrayed that it had an ongoing profitable business**, separate from the loss-making existing business that it intended to dispose.

Otherwise, the Group might also be exposed to trading suspension risk under Rule 1303 of the SGX Listing Manual.

Case Study D

Background
On 31 December 2013, the Group entered into a sale and purchase agreement (SPA) to acquire 51 percent of Company B, **a one-man consultancy company**. The SPA gave the Group the rights to:

(a) appoint at least one director in Company B, in addition to one existing director of Company B;
(b) direct Company B to enter into any arrangements for the benefit of the Group and Company B; and
(c) establish the annual operating budget and be involved in the funding decisions of Company B.

Under the SPA, the entire purchase consideration was payable by the Group after 31 December 2013. The purchase consideration remained unpaid in 2014.

In October 2014, the acquisition was terminated, shortly after the Group aborted its plan to dispose its only other business (i.e. the loss-making business).

Directors' Explanation
The Group appointed its Chairman to be the Chairman of Company B on **31 December 2013**, which was also considered the acquisition date of Company B.

However, the Group consolidated the results and financial position of Company B from **1 November 2013**. This was due to a clause in the SPA stating that the Group was entitled to "all risks and rewards associated with 51 percent of Company B from 1 November 2013", even though the SPA was signed on 31 December 2013.

ACRA's Analysis and Conclusion
The Group should not consolidate Company B from 1 November 2013.

The acquisition date of Company B should be later than 31 December 2013 because as of 31 December 2013:

(a) there were **pre-completion undertakings** in the SPA overriding the Group's rights in the decision-making of Company B. Specifically, the seller was required to consult the Group but retained a full discretion in making the key decisions of Company B until the completion of the SPA;
(b) even though the Group had appointed its Chairman to be the Chairman of Company B, there was no formal meeting of directors held between 1 November 2013 and the date when the FY2013 Financial Statements were authorised. **All key decisions of Company B continued to be made by the seller** during this period; and
(c) the Group **did not make any payment of the purchase consideration**. Although not conclusive, this brings into question as to why the seller would give up its rights over Company B that was profitable with a healthy balance sheet, before receiving any purchase consideration.

By consolidating Company B prematurely, the Group had wrongly portrayed that it had an ongoing profitable business, separate from the loss-making existing business that it intended to dispose. Otherwise, the Group might also be exposed to trading suspension risk under Rule 1303 of the SGX Listing Manual.

(Technical reference: Paragraph 8 of SFRS 103 Business Combinations)

Learning Point

Directors should **consider all specific facts and circumstances**, including the pre-completion undertakings to establish that the Group has control (i.e. the power to direct the activities of a subsidiary) before consolidating the subsidiary.

Learning Point

Independent directors should be **alert to management's motivations** to present the financial statements to achieve certain objectives, which may not be compliant with the Accounting Standards and/or the SGX Listing Manual.

Specific intangibles not recognised separately from goodwill

Intangible assets are increasingly a key reason for companies to enter into business acquisitions. In many business acquisitions, the payment for specific intangible assets matches or exceeds the payment for traditional capital assets such as machinery, equipment and buildings.

Companies **should not absorb the entire difference** between the amount paid for the acquisition and the fair value of the acquired tangible assets **under goodwill**. Given the significant payments made for specific intangible assets, companies should identify these assets (such as customer lists, order backlogs, technology know-how, usage rights, licensing permits and trade secrets) and attribute a fair value to each of these assets separately.

Doing so not only meets the requirements of SFRS 103 *Business Combinations*, but more importantly, it allows directors to communicate the real value of the acquired business. Investors can then assess if the company had **paid fairly or overpaid** for the acquired business.

Three listed companies failed to recognise significant amounts of specific intangible assets from their material business acquisitions. Their management commentary and/or announcements related to those acquisitions indicated a range of specific intangible assets, for which a significant premium was paid, but none was recognised in their FY2013 Financial Statements.

Case Study E

Background

The Group acquired 100 percent of Subsidiary C for a cash consideration of S$10 million. In the announcement, the Group disclosed that one key reason for acquiring Subsidiary C at a premium was due to **licensing deals worth S$2.7 million** recently secured by Subsidiary C.

As part of the purchase price allocation (PPA), the Group determined the fair value of Subsidiary C's net identifiable assets to be S$2.0 million, comprising:

- cash and trade receivables of S$0.2 million;
- operating rights of S$0.3 million; and
- a leasehold building of S$1.5 million.

This resulted in goodwill of S$8.0 million (i.e. 80 percent of the purchase consideration).

Directors' Explanation

The Directors did not engage a professional valuer to perform the PPA of Subsidiary C because other than the leasehold building, the remaining assets of Subsidiary C were considered monetary and short-term in nature. A separate property valuation was obtained to support the fair value of the leasehold building.

The Directors were also of the view that the operating rights of S$0.3 million, which were derived from their carrying amounts in Subsidiary C's separate financial statements, represented their fair values at the acquisition date.

ACRA's Analysis and Conclusion

Specific intangible assets are typically not recognised in the acquiree's financial statements. As such, instead of relying on Subsidiary C's separate financial statements, the Group should consider its **reasons for paying a premium** to acquire Subsidiary C, such as for the licensing deals worth S$2.7 million when identifying the specific intangible assets.

By valuing only the leasehold building and not the business of Subsidiary C as a whole, the Group failed to identify and separately recognise the fair values of the licensing deals and other intangible assets acquired. The Group had also **not recorded the operating rights at their fair values**, which could differ from the historical cost amount recorded in Subsidiary C's separate financial statements.

It is important to **differentiate goodwill from the specific intangible assets**. Goodwill is tested for impairment annually, whereas specific intangible assets are typically amortised. Had the licensing deals and other intangible assets been recognised separately, their fair values would be amortised over the useful lives of those assets. This would **better match the cost with the revenue** derived from those assets in the future.

(Technical reference: Paragraphs 18, and B31 to B34 of SFRS 103 Business Combinations. See also paragraphs IE16 to IE44 of SFRS 103 which list 28 classes of intangible assets potentially acquired in a business acquisition.)

Learning Point

When a business acquisition results in a large amount of goodwill, directors should **ensure that the premium paid is reflected** by recognising specific intangible assets.

Learning Point

When there is no in-house expertise, directors should engage a professional valuer to identify and value those specific intangible assets separately. **Such valuation often requires specialist knowledge and skills.**

Impairment loss not recognised for a significant or prolonged decline

Given the continuing economic uncertainties and market volatility globally, the quoted prices of some equity investments may have fallen below their acquisition costs for some time. When faced with a potentially significant or prolonged decline in fair value below cost, directors should critically **assess management's basis for deferring the recognition of impairment loss** in the income statement.

A decline in line with the overall decline in the relevant markets does not mean that the investment is not impaired. The impairment loss should not be reversed when the share price subsequently recovers. **The decline should also be assessed based on the time period that has passed**, and not based on whether the value will recover within the company's investment horizon.

One listed company did not recognise impairment loss for its listed equity investment in the income statement, even though that investment's quoted share price slipped more than 30 percent below its acquisition cost for more than three years. Although the quoted share price was trending upwards, the highest share price for the past year remained 37 percent below its acquisition cost.

Case Study F

Background
The Group accounted for its equity interest in another listed company as an available-for-sale investment.

	Decrease in quoted share price below the acquisition cost %
At September 2010 (acquisition date)	-
At 31 December 2010	-7%
At 31 December 2011	-50%
At 31 December 2012	-44%
At 31 December 2013	-38%
Highest price between 1 January 2013 and 31 December 2013	-37%

Directors' Explanation
The Directors were of the view that the decline in fair value below cost was neither significant nor prolonged. This was because:

(a) there were no quantitative thresholds in the SFRS prescribing the extent when a decline was considered significant and the length of time when a decline was considered prolonged;
(b) given the business model of the investee, the Group required a longer time horizon to evaluate its investment in the investee; and
(c) the Group's share of the investee's net assets exceeded its cost of investment.

The Group disclosed that it had made a critical judgement that the decline in fair value below its cost was not significant or prolonged because of the short-term duration of the decline, the magnitude by which the fair value of the investment declined below cost and the positive financial health and short-term business outlook of the investee.

ACRA's Analysis and Conclusion
The **principle-based SFRS** would typically not set quantitative thresholds. Therefore, directors should apply their judgement in deciding whether the decline is significant or prolonged. The judgement should be reasonable, able to withstand a third party's scrutiny, and aligned with market practice.

Based on the Group's circumstances, the decline in fair value below cost was in excess of 30 percent (i.e. significant). In addition, the decline in fair value below cost had persisted for more than three years (i.e. prolonged). At no time during the past three years had the share price exceeded the acquisition cost. In fact, the highest share price during the past three years remained 25 percent below cost while the highest share price during the past one year was 37 percent below cost.

It was irrelevant whether the Group expected to hold the investment for a longer time horizon, or that it had forecasted a recovery of the value during that investment horizon. The **assessment of 'prolonged' should be based on the time period that has passed**.

The fact that the net assets of the investee exceeded the Group's cost of investment was also not pertinent given that this assessment must be performed using quoted share prices.

Had the decline been considered significant or prolonged, the Group would have recorded an impairment loss, which would reduce its pre-tax profit in FY2013 by more than 30 percent. It was not sufficient to make only disclosures in this regard. **Disclosure does not compensate for wrong accounting**.

(Technical reference: Paragraph 67 of SFRS 39 Financial Instruments: Recognition and Measurement)

Learning Point

Directors should critically assess management's basis for the judgement made to **ensure that it is not overly aggressive or is an outlier from the market practice**.

Where the management's judgement appears to be out of the norm, directors should consider **consulting** independent parties or obtaining additional accounting advice to ensure that the management's judgement is sound, able to withstand a third party's scrutiny and aligned with market practice.

Presentation did not accord with substance of transaction

The income statement is typically the most important statement in the financial statements, providing information on the sustainability of earnings and how changes in market conditions have affected the business.

The trends and performance presented in the income statement **should portray an objective view**, particularly in respect of non-recurring transactions.

One company did not properly present the gain on disposal of a subsidiary in the income statement in accordance with the substance of the transaction. As a result, it wrongly portrayed that the decline in the Group's profit was due to a one-off disposal of a subsidiary, when it was actually due to a general decline in its business operations.

Case Study G

Background

The Group disposed a subsidiary to a third party for US$13 million. The Group presented its income statement as follows:

	FY2013 US$'million	FY2012 US$'million
Gross profit	20	24
Other income (Note (a))	10	10
Expenses	(19)	(25)
Reclassification of fair value loss on disposal of subsidiary	(10)	-
Profit before tax	1	9

Note (a): Included gain on disposal of a subsidiary of US$8 million.

The nature of 'Reclassification of fair value loss on disposal of subsidiary' of US$10 million was not disclosed. It was also unknown whether it was related to the gain on disposal of a subsidiary of US$8 million included in 'Other income'.

Directors' Explanation

The Directors confirmed that **both amounts arose from the same transaction**. The Group disposed a subsidiary, which in turn held an available-for-sale investment.

Upon the de-consolidation of the disposed subsidiary, the fair value reserve of the available-for-sale investment was reclassified from equity to 'Other income' in the income statement.

ACRA's Analysis and Conclusion

The 'Reclassification of fair value loss on disposal of subsidiary' of US$10 million and the gain on disposal of a subsidiary included in 'Other income' of US$8 million were related to the same transaction (i.e. disposal of the subsidiary). The effect should be presented together in the income statement as a **net loss on disposal of subsidiary** of US$2 million.

Otherwise, investors could misinterpret that the Group's decline in profit before tax by 89 percent from US$9 million to US$1 million was largely due to a non-recurring loss on disposal of the subsidiary of US$10 million, when the decline was in fact due to the lower gross profits from its business operations and lower other income.

(Technical reference: Paragraphs 34(a) and 34(f) of SFRS 27 (consolidated and separate Financial Statements))

Learning Point

Directors should **apply their knowledge** of significant transactions and ensure that the trends and performance presented in the income statement **portray an objective view, particularly in respect of non-recurring transactions**.

Other findings
- Insufficient knowledge and diligence in preparing financial statements

Several instances of non-compliance indicated an insufficient knowledge of the Accounting Standards and/or a lack of diligence in preparing and reviewing the FY2013 Financial Statements.

In one case, the company **wrongly reversed the revaluation surplus** on the disposal of its property, plant and equipment to the income statement. Such revaluation surplus should be reclassified directly within equity and not recognised through the income statement. As a result, it overstated its net profit by 35 percent.

In another case, the company **wrongly presented 52 percent of its revenue** as rendering of services, when they were sales of goods. The directors attributed the error as clerical in nature but this could be misinterpreted by investors as a significant change in the company's business activities.

4 RESOURCES AVAILABLE

Good practices in responding to enquiries

Given directors' unfamiliarity with the expanded FRSP in 2014 and the initial approach of keeping the questions brief, the **quality of the first round of directors' responses varied significantly**. Some cited wholesale provisions from the Accounting Standards without explaining how it applied to the Group's circumstances. Some provided incomplete and sometimes, conflicting explanations. Consequently, close to 40 percent of the listed cases were followed-up with a second round of enquiries. This has delayed the conclusion of those cases and corrections could not be effected by the next financial year.

Directors are therefore **encouraged to consider the following good practices** when responding to ACRA's enquiries:

ADDRESS each and every question in the sequence provided

EXPLAIN the Group's circumstances and commercial substance of transactions

PROVIDE insights into the basis for management's and directors' judgements

REFLECT the willingness to consider alternative viewpoints

MAINTAIN consistent fact pattern and explanations

Director Financial Reporting Essentials Course

Recognising that some directors may need to strengthen their financial reporting competencies, ACRA worked with SID and ISCA to develop the **Director Financial Reporting Essentials Course**. This course was launched in December 2014.

Pitched at the directors' level, the course provides **practical tips on how directors could apply rigour in their reviews of financial statements and how directors could query management on** judgements and estimates. To encourage attendance, ACRA provides a **subsidy of S$300 per individual** to the first 3,000 eligible company directors who attend the course before 31 March 2016.

More details are available at *www.sid.org.sg*

First 3,000 eligible company directors who attend before 31 March 2016 will enjoy a subsidy of S$300 each.

Raising awareness through seminars and talks

ACRA has engaged over 1,400 directors and company management at various seminars and talks on the expanded FRSP in the past year. They include the Singapore Corporate Awards Seminar 2014, the Singapore Business Federation's ACRA Seminar on Companies' Compliance Programmes, the Singapore Association of the Institute of Chartered Secretaries and Administrators' Corporate Legislations and Regulations Update Forum 2014, and the ISCA-CPA Australia Joint Dinner Talk.

To engage audit committees, ACRA collaborated with SGX and SID to organise the 'ACRA-SGX-SID Audit Committee Seminar' in January 2015. Attended by over 150 audit committee members, the seminar saw ACRA sharing its initial observations from the review of the FY2013 Financial Statements. A similar event will be held in January 2016.

More details are available at: *www.acra.gov.sg*

Sharing review focus in advance

ACRA publishes the FRSP areas of review focus in advance through its Practice Guidance.

The areas of review focus are updated yearly to take into consideration key findings from recent reviews, changes in Accounting Standards, as well as emerging issues under the current market conditions.

The Practice Guidance is available at: *www.acra.gov.sg*

APPENDIX A
ACRA'S PROCESS ON THE FRSP

Select financial statements for review

Financial statements lodged with ACRA are selected for review using a risk-based approach. Emphasis is placed on the financial statements of listed companies with:
(a) modified audit reports indicating potential non-compliance with the Accounting Standards and other requirements of the Companies Act;
(b) significant public interest risks based on criteria such as market capitalisation, revenue and asset size, as well as multiple employees, creditors, customers and other stakeholders;
(c) operations that require significant judgement in accounting for their transactions, hence increasing the risk of misstatement; and
(d) change in listing or trading status (e.g. newly listed, suspended or delisted) or in key stakeholders, including controlling shareholders, directors, management and auditors.

Make enquiries

Enquiry letters are issued to the Board of Directors to request for explanations and, where necessary, supporting documents. Directors are given up to 21 calendar days to respond with a written reply for the first enquiry.

All explanations are received in writing. Directors' requests for physical meetings to clarify enquiries are usually acceded to. Measures are taken to ensure strict confidentiality for all information provided to ACRA.

Decide regulatory outcome

The prescribed Accounting Standards in Singapore is a set of principle-based accounting standards, which requires judgement. It is important that preparers, auditors, investors and regulators make the judgement faithfully. If two methods are appropriate to achieve the outcome, both methods are accepted by ACRA.

The judgements made should be documented in support of an honest and fair attempt to meet the principle(s). It should be noted that disclosure does not compensate for wrong accounting.

The findings are grouped initially into three categories, namely:
(a) Instance of severe non-compliance;
(b) Instance of other non-compliance; or
(c) Area for improvement.

All instances of non-compliance and areas for improvement are incidences where the financial statements were not compliant with the Accounting Standards, differentiated by the nature and extent of the misstatements, which are assessed using both quantitative and qualitative factors.

Depending on the severity and number of non-compliance, the following range of regulatory outcomes are applied:
(a) Closure;
(b) Advisory;
(c) Warning;
(d) Fine by offer of composition; or
(e) Prosecution leading to fines and/or imprisonment.

A closure letter is issued when ACRA is satisfied with the explanations provided by the directors. There may be suggested areas for improvement to be considered in the preparation of the future year's financial statements.

An advisory letter is issued when there is one or more instances of other non-compliance. It does not represent a regulatory sanction. Directors are required to rectify the non-compliance(s) in the future year's financial statements.

A warning letter is issued when there is one or more instances of severe non-compliance. Directors may be requested to restate, re-audit and re-lodge the corrected financial statements with ACRA.

Composition and prosecution will be levied on cases with instance(s) of non-compliance that has an adverse impact to the financial statements and/or non-rectification of previous instance(s) of non-compliance.

For regulatory sanctions such as warning, composition and prosecution, ACRA interviews directors and takes their statements before imposing the sanctions. It should also be noted that ACRA has the right to take regulatory action against auditors in respect of an inappropriate audit opinion, under section 207 of the Companies Act.

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