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Bridging the Expectation Gap in Financial Reporting: Into the Minds of Investors

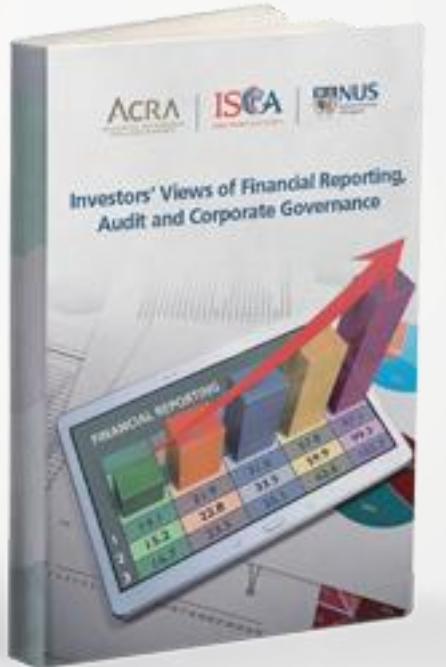
Prof Mak Yuen Teen



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Strengthening Market Confidence

Partners



ACRA

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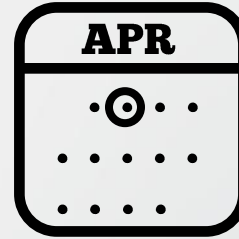
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Objectives of Study



How and When it was Conducted



&



Number of Respondents



33 Institutional
investors



171 Retail
investors



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Profile of Respondents

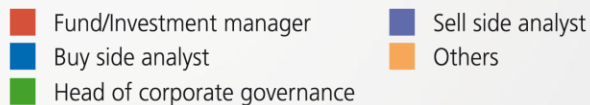
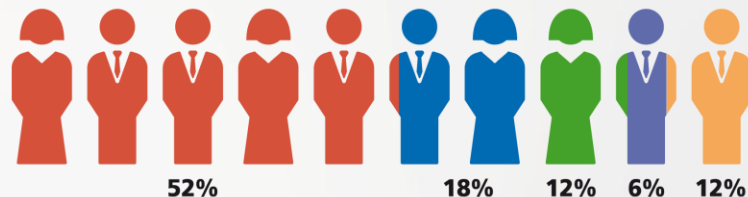


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Institutional Investors

Position of respondents

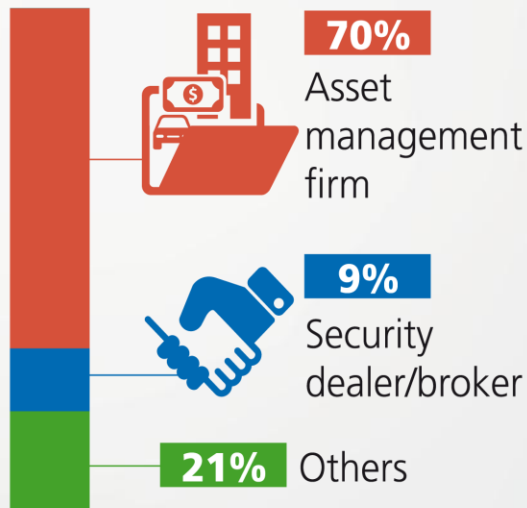


Investment responsibility of respondents

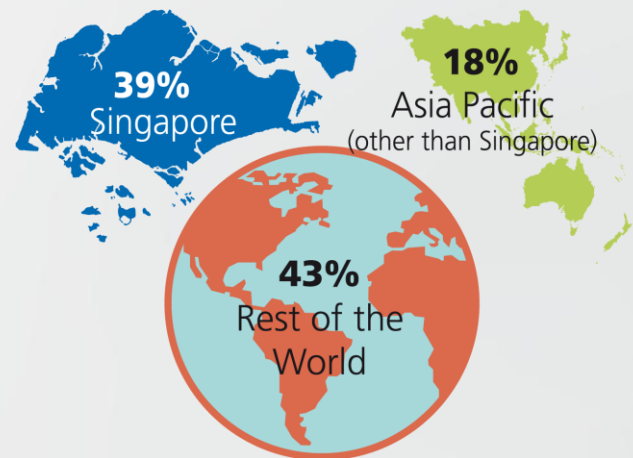


Institutional Investors

Type of organisations

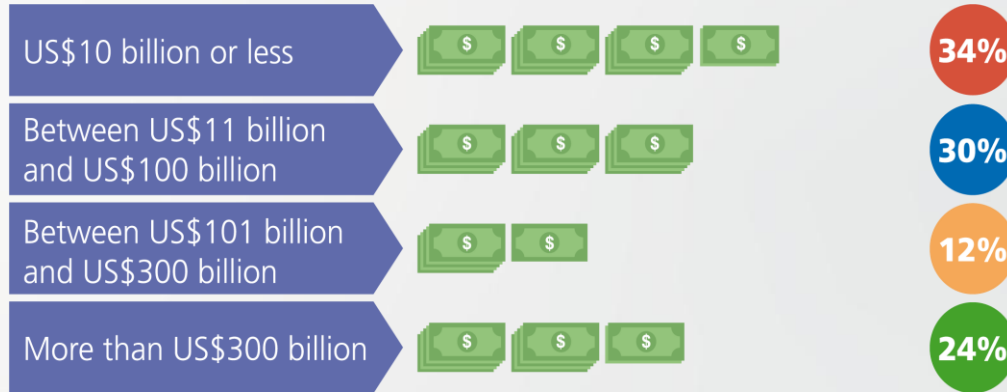


Headquarters of Organisation



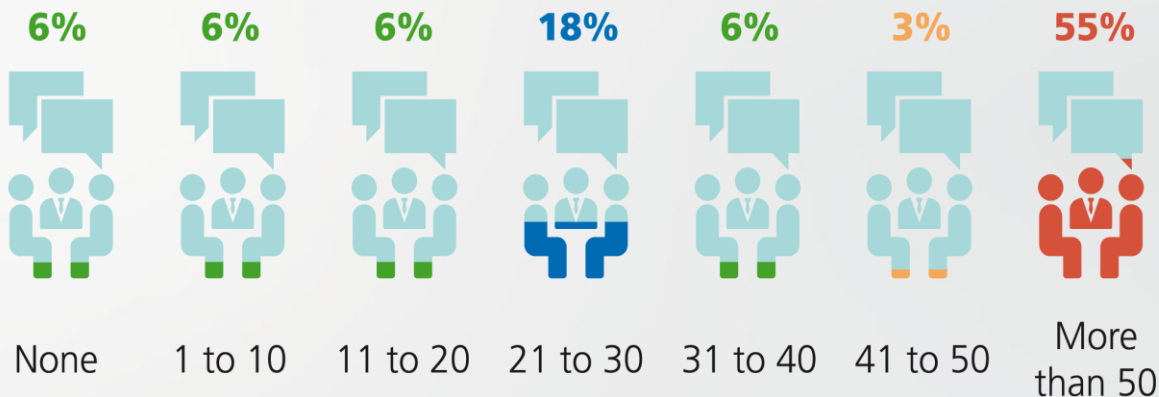
Institutional Investors

Total funds managed/ advised by organisation



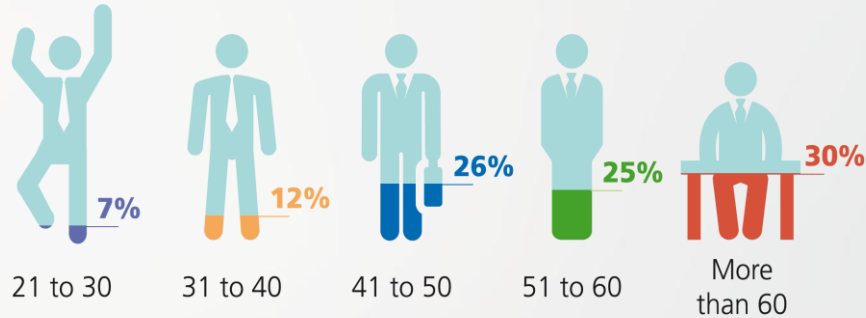
Institutional Investors

Number of one-to-one meetings (in person or through conference call) with management or board of directors each year

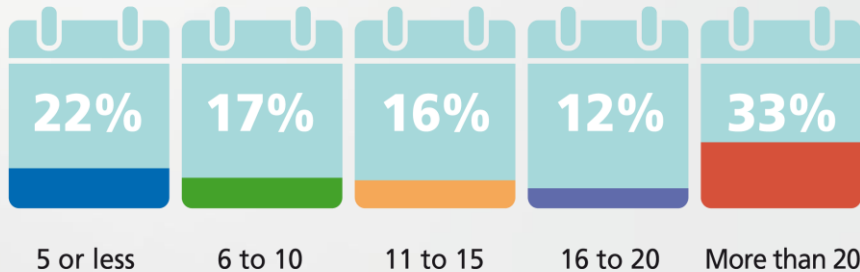


Retail Investors

Age group of retail investors

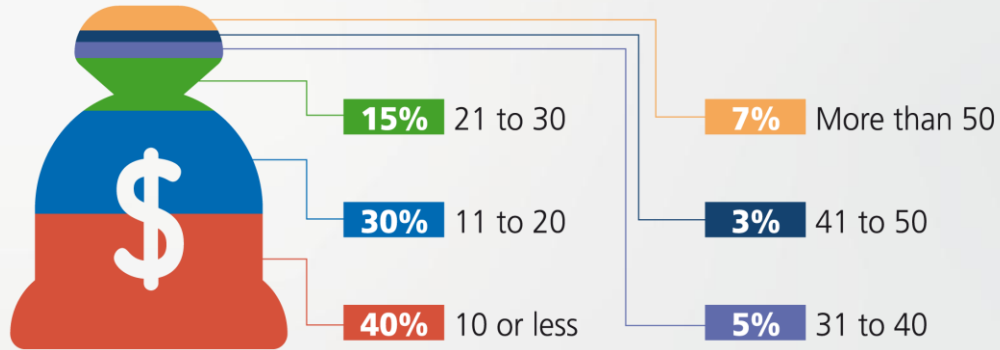


Years of investment experience



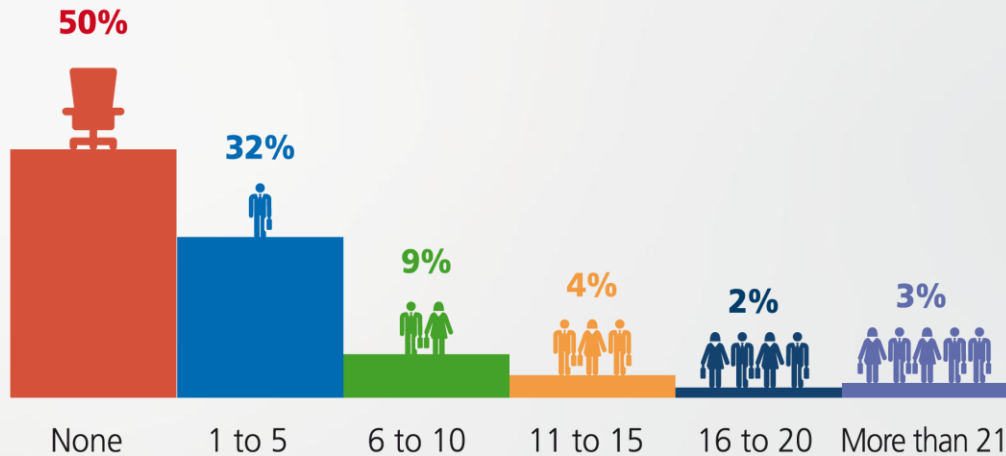
Retail Investors

Number of listed entities invested in



Retail Investors

Annual Attendance of AGMs



Survey



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INVESTORS' VIEWS ON

A. FINANCIAL REPORTING:

Information sources
for decision-making

Key financial
statement line
items and ratios for
decision-making

Types of questions
raised by
shareholders

Directors'
responsibility for
ensuring financial
statements comply
with accounting
standards

Regulatory
oversight of
financial
statements (FRSP)



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INVESTORS' VIEWS ON

B. STATUTORY AUDIT:

Level of confidence provided by audited financial statements

Impact of modified audit opinion on investments decisions

Impact of auditor choice on audit quality

Regulatory oversight of auditors (PMP)

Audit quality indicators (AQI)

Interactions with audit committees and auditors

Key Audit Matters (KAMs)



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INVESTORS' VIEWS ON C. CORPORATE GOVERNANCE:

Factors in assessing
the quality of
corporate governance

Types of questions
raised by
shareholders

Attendance at AGMs
under multiple proxies
regime



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Findings



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Financial Reporting

- **Investors view financial statements as the most important source of information for their decision making**

94%
Institutional investors

81%
Retail investors

- **Institutional investors also spent more time reading financial statements**
- Usefulness is limited by:
 - Too much aggregation
 - Insufficient disclosures
 - Disclosures that are difficult to understand



Financial Reporting

- Both institutional and retail investors rated net profit, operating cash flow, dividends and earnings per share as the most important quantitative financial statement items, although more retail investors rated earnings per share as "Very important" compared to other ratios



94% (I)
85%(R)

EARNINGS
PER SHARE



93% (I)
92%(R)

NET PROFIT



94% (I)
88%(R)

OPERATING
CASH FLOW



94% (I)
85%(R)

DIVIDENDS



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Financial Reporting

- **Institutional investors also value good disclosure on:**
 - Related party transactions
 - Accounting policies
 - Critical accounting judgements and key estimates



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Financial Reporting

- Institutional investors place most importance on gearing ratio, return on equity and return on invested capital, while retail investors place most importance on dividend yield, price/earnings ratio and net profit margin



**GEARING
RATIO**



**RETURN ON
EQUITY**

**RETURN ON
INVESTED CAPITAL**

Institutional investors



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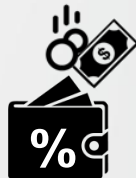
**GEARING
RATIO**

Institutional investors



**RETURN ON
EQUITY**

**RETURN ON
INVESTED CAPITAL**



**DIVIDEND
YIELD**

Retail investors



**NET PROFIT
MARGIN**



**PRICE
EARNINGS RATIO**



Audit

- **Statutory audits significantly increase investor confidence in the financial statements**



Audit

- **Modified audit opinions were also more likely to affect investment decisions of institutional investors**

88%
Investment
decision affected
Institutional
investors

71%
Investment
decision affected
Retail
investors

23%
unsure



Audit

- **Investors are more likely to engage auditors with the impending KAMs**
 - **Observation of control deficiencies**
 - **Why a matter was identified as KAM**
 - **How audit materiality was determined (Institutional investors)**
 - **Outcome of audit procedures (Retail investors)**



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Audit

- **Investors recognise the significance of auditor independence to audit quality**
 - **Audit fees**
 - **Tenure of audit firm and partner**
 - **Non-audit fees** (viewed as more important by institutional investors)
 - **Nature of non-audit services** (viewed as more important by institutional investors)



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Audit

- **Investors welcome more transparency and improved interactions with audit committees (“AC”)**

96%

Think the AC should provide commentary to shareholders about their views on the significant accounting issues highlighted as KAMs

89%

Like the AC to use AQIs to evaluate auditors

Like the AC to explain the basis for selecting the recommended auditor



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Regulatory Programmes and Initiatives

- Investors value regulatory programmes and initiatives aimed at improving financial reporting and audit quality, although more can be done to raise awareness on these initiatives

Independent regulatory oversight programmes over financial reporting and audits are important in ensuring good quality financial reporting.

75%



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Corporate Governance

- **Directors' experience, remuneration, independence and the company's internal control and risk management matters are most common aspects of corporate governance that investors are interested in**
- **Top 3 areas that investors have asked most questions about:**
 - Remuneration
 - Independence of directors
 - Risk management



Corporate Governance

- Multiple proxies regime
 - After the amendment to the Companies Act, indirect investors can be appointed as proxies and attend AGMs

18%
Will attend
more AGMs

61%
Contentious issues
Institutional investors

47%
Will attend
more AGMs

33%
Contentious issues
Retail investors

- Usually a “last resort” for institutional investors when other means of engagement have failed



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Key Takeaways



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Financial Reporting

- Companies (board of directors, audit committees and management) should ensure **continued relevance** of financial statements by focusing on providing high quality disclosures that are useful, sufficient and understandable to cater to various investor needs.
- Do not accept mediocrity: Investors should demand for **greater transparency** and clarity in disclosures relevant for them to make investment decisions.



Financial Reporting

- **More education** and **awareness** is needed to help investors understand, consider and use both qualitative and quantitative information in financial statements for better decision making.



Audit

- Auditors should seize the opportunity to demonstrate and communicate the **value of audit** to investors through KAMs reporting.
- Auditors should **be prepared** to answer questions from investors about the audit and KAMs raised at annual general meetings (AGMs).



Audit

- Audit committees should provide greater transparency to investors by:
 - Issuing an **audit committee commentary** in the company's annual report to explain significant financial reporting issues and to complement KAMs reporting by auditors.
 - Evaluating auditors **using AQIs** and communicating to investors the basis of selecting the recommended auditors.



Audit

- Companies should be prepared for **deeper levels** of engagement with investors who, armed with greater insights into the audit process and the underlying drivers of a company's performance, will demand **greater accountability** from its directors and management.
- Professional bodies and regulators need to create **greater awareness** amongst investors on their programmes and initiatives so that investors can leverage on them for their investment review and decisions.



Corporate Governance

- Companies should strive to provide **greater transparency** and **better disclosures** on their corporate governance practices and ensure that they stand up to scrutiny.



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Thank You!



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