MEDIA RELEASE

DIRECTORS' COMPETENCY CRUCIAL TO UPHOLD QUALITY IN FINANCIAL REPORTING

- **Key findings from review of annual financial statements**

Singapore, 14 July 2020 – There is room for improvement in the quality of financial statements (FS) issued by companies incorporated in Singapore, based on the findings from the latest Financial Reporting Surveillance Programme (FRSP) report issued by the Accounting and Corporate Regulatory Authority (ACRA). It was observed that the lack of deep knowledge and due care by preparers and directors were the root causes contributing to material non-compliances with accounting standards (NCs) found under the programme.

2 ACRA reviews the financial statements of Singapore-incorporated companies for compliance with the accounting standards in Singapore under the FRSP. To assess the general state of financial reporting, ACRA analysed the 2016 financial statements filed by 584 listed companies with ACRA, as well as deep-dived into potential NCs identified in selected 2016, 2017 and 2018 financial statements.

Findings from the third cycle of review

3 Overall, 94% (or 549) of the 2016 financial statements received "clean" audit opinions, an encouraging sign that the financial statements by listed companies generally complied with accounting standards. Amongst the 35 FS that received modified audit reports, a total of 95 areas were qualified or disclaimed by the statutory auditors. A majority were related to impairment of assets (34 occurrences, or 36%), going concern assumption (19 occurrences, or 20%) and limitations imposed on the scope of audit (13 occurrences, or 14%).

4 11 sets (or 55%) of FS were found to contain a total of 31 material non-compliances with accounting standards, of which one third resulted in adjustments to the reported financial results and/or positions by the companies. The material non-compliances arose from accounting areas such as accounting treatment for major complex transactions, and business valuations or impairment assessments.

5 Following ACRA's reviews, four listed companies rectified the material NCs by re-stating and re-auditing their past years' FSs. Collectively, the consolidated pre-tax profits or losses for the four companies were adjusted by one to eight times and the consolidated net assets by 15% to 68%. Two other listed companies rectified by making additional disclosures or restating comparatives in their subsequent 2018 and 2019 FS. The rectification by these companies have provided stakeholders with more reliable financial information to make decisions.

6 Through engagements with the companies, it was observed that the material NCs were attributed to the following factors:

a. **A lack of deep knowledge** among the finance teams, Chief Financial Officers (CFOs) and Audit Committees (ACs) leading to incorrect application of accounting standards. This becomes more challenging when the accounting matters are complex and/or involve specialised areas such as business valuations and impairment assessments; and

b. **A lack of due care** by the finance team, CFOs and ACs. This includes failure to act upon the areas qualified or disclaimed by the statutory auditors, and accepting modified audit reports consecutively, instead of making adjustments to the FS. There were also instances where directors failed to pick up unrealistic operating cash flow figures, which suggested inadequate attention being paid to this important statement.

Strengthening Financial Reporting Competency

7 Of the six companies that had rectified the material NCs, four had CFOs and AC Chairpersons with either accounting qualifications or were members of accounting professional bodies, or both. This highlighted the need for audit committees to invest more time and exercise due care to review the FS before issuance. The AC members for the remaining two companies did not have any accounting qualification or relevant accounting experience. When appointing the audit committee, the board should ensure there is a right mix of members possessing the appropriate skills and expertise in the areas of accounting and auditing. The board should also provide guidance and support to the AC, including allowing access to experts and consultants for advice on more complex areas.

8 The board should also place emphasis on raising competency in financial reporting, starting with a competent and suitably qualified finance team. There should be training for the finance team, CFO and AC to bridge any competency gaps, and to acquire deep accounting knowledge needed to understand the principles behind the standards, as well as apply the standards correctly to achieve faithful representation of transactions. The AC should also guide CFO and finance team to resolve statutory auditor's concerns, to avoid the issuance of modified audit reports by the statutory auditors. In turn, statutory auditors can help by highlighting accounting and auditing issues early.

9 With rising economic uncertainties and the COVID-19 situation, companies are under pressure to continue their operations and deliver financial sustainability. It is crucial for directors to put in place a strong culture of corporate governance, and to apply rigour when reviewing and approving the FS, to ensure that the FS provides an accurate picture of the financial standing of the company.

10 ACRA will continue to focus our efforts on ensuring that investors and other stakeholders are provided with reliable and meaningful financial information.

11 The FRSP Third Report 2020 is available at www.acra.gov.sg.

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Attachment:
Annex A: Key findings from the third cycle of ACRA's Financial Reporting Surveillance Programme (FRSP)

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About ACRA

The Accounting and Corporate Regulatory Authority (ACRA) is the national regulator of business entities, public accountants and corporate service providers in Singapore. We provide a trusted and vibrant environment for businesses to thrive and flourish, and contribute towards making Singapore the best place for business.

For more information, please visit: www.acra.gov.sg.

Annex A

Key findings from the third review cycle of Financial Reporting Surveillance Programme

A1. As of 31 March 2020, the reviews for 20 financial statements (FS) were completed. They comprised FS of 19 listed companies and FS of one non-listed company, all incorporated in Singapore.

A2. 11 (or 55%) FS were found to contain a total of 31 material non-compliances with accounting standards (NCs). The reviews were concluded with the following regulatory outcomes:

a. <u>four listed companies restated and had their past years' FS re-audited</u> (i.e. revised past FS). Collectively, their consolidated pre-tax profits or losses were adjusted by one to eight times and their consolidated net assets by 15% to 68%. For one company, its consolidated net cash flows generated from operating activities were also reversed to cash flows used in operating activities, while for another company, its consolidated net cash flows generated from operating activities were adjusted downwards by more than 20%;

b. <u>one listed company</u> made additional disclosures in its subsequent 2018 FS, while <u>another listed company</u> restated the comparatives in its subsequent 2019 FS; and

c. <u>five listed companies were not required to restate</u> because their material NCs were related to either one-off transactions or transactions that were terminated subsequently.

A3. With a total of 31 material NCs found, this gives a higher average of 1.6 material NCs per FS in this review cycle, as compared to 1.0 in the second review cycle. Seven (or 35%) reviews were concluded with three to six material NCs, as compared to four (or 8%) in the second review cycle. The increase can be attributed to the shift in our selection of FS for review. In particular, five FS that received qualified audit opinions or disclaimers were reviewed, as compared to nil in the second review cycle.

Analysis of material NCs

A4. 45 enquiries on potential material NCs were made in this review cycle. More than half (31, or 69%) of those enquiries resulted in material NCs. The three areas with the highest instances of material NCs were as follows:

a. accounting for major complex transactions (5 instances);
b. presentation in the statements of cash flows (4 instances); and
c. business valuations or impairment assessments (3 instances).

These areas had been suggested as areas of review focus by directors in the Practice Guidance issued by ACRA to guide directors in their review of 2016 and 2017 FS.

A5. From our engagement with companies, the root causes of the material NCs can be attributed to:

(a) A lack of deep knowledge

The accounting standards in Singapore are principles based and can be complex. An accountant, CFO or AC member with insufficiently deep accounting knowledge will face difficulty applying them correctly. This becomes more challenging when the accounting matters involve specialised areas such as Companies Act, business valuations and impairment assessments.

The report included six case studies in this area. In two cases, the directors had failed to state whether the FS present a true and fair view in the directors' statements in accordance with the Companies Act. In another case, the directors had failed to engage a valuation expert to value a complex financial instrument. This led to the Black Scholes Model being inappropriately used to value conversion options with variable exercise dates and several possible outcomes for generating investment returns.

(b) A lack of due care

The FS should be prepared to faithfully tell the story of a company's financial performance and position. Directors and management are in the best position to ensure the 'story' told reflects commercial reality and should put efforts in doing so.

The report included two case studies in this area. In one case, the directors had failed to adjust for significant transactions that occurred between the associate's financial year-end and the Group's financial year-end, even though the statutory auditors had highlighted this in the audit report three years in a row. In another case, the directors had failed to pick up the red flag, where the consolidated cash *generated* from operating activities was incorrectly shown as more than twice the amount of the consolidated profit before tax. The Group should have reported cash *outflow* from operating activities instead.

A6. Of the six companies that had rectified the material NCs, four had CFOs and AC Chairpersons with either accounting qualifications or were members of accounting professional bodies or both. This highlighted the need for audit committees to invest sufficient time and exercise due care to review the FS before issuance. The AC members for the remaining two companies did not have any accounting qualification or relevant accounting experience. When appointing the audit committee, the board should ensure there is a right mix of members possessing the appropriate skills and expertise in the areas of accounting and auditing. The board should also provide guidance and support to the AC, including allowing access to experts and consultants for advice on more complex areas.

Study on FS with modified audit reports

A7. ACRA has analysed the 2016 FS of listed companies that were filed by 31 December 2017. Overall, 94% (or 549) of these FS received “clean” audit opinions, an encouraging sign that the financial statements by listed companies generally complied with accounting standards.

A8. From the 35 FS that received modified audit reports, a total of 95 areas were qualified or disclaimed by the statutory auditors. A majority were related to impairment of assets (34 occurrences, or 36%), going concern assumption (19 occurrences, or 20%) and limitations imposed on the scope of audit (13 occurrences, or 14%). This indicates the need to raise financial reporting competency in these areas, and for AC to be more active in resolving matters highlighted by statutory auditors.

A9. The proportion of Singapore-incorporated listed companies that did not receive clean audit opinions had increased from 35 (or 6%) for 2016 FS to 51 (or 9%) for 2018 FS. However, the number of companies with five or more areas qualified or disclaimed had declined from seven for 2016 FS to five for 2018 FS. Seven companies that did not receive clean audit opinions on their 2016 FS subsequently received clean audit opinions on their 2017 and 2018 FS, of which five did so without ACRA’s intervention. ACRA will continue to monitor this group of companies closely.