FINANCIAL REPORTING PRACTICE GUIDANCE NO. 1 of 2023
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AREAS OF REVIEW FOCUS FOR FY2023 FINANCIAL STATEMENTS

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

This publication which highlights the areas of review focus for FY2023 FS, acts as a guide to directors, especially those in Audit Committees (ACs), in reviewing FS and discharging their duties as directors. ACs are advised to pay close attention to these emerging risks and trends.

As audit quality is also an integral part of the financial reporting ecosystem, ACs should actively engage the external auditors and monitor the audit process to identify and resolve collectively any areas of concern. High quality audits play a crucial role in building confidence and trust in financial markets.

ACCOUNTING IMPACT FROM MACROECONOMIC UNCERTAINTIES

The Ministry of Trade and Industry (MTI)'s *Advance Estimates* indicated that the Singapore economy expanded by 1.0% on a quarter-on-quarter seasonally-adjusted basis in Q3 2023, up from 0.1% in Q2. Against the external outlook, prospects for the Singapore economy are muted in the near term but should improve gradually in H2 2024[1]. On 11 August 2023, MTI forecasted Singapore's GDP growth at 0.5% to 1.5% in 2023[2] while the actual overall GDP growth in 2022 was 3.6%[3]. Nevertheless, Singapore's GDP growth is expected to improve gradually over 2024.

In October 2023, the Monetary Authority of Singapore (MAS) reported an ease in Core Inflation to 3.4% year-on-year in August 2023, considerably lower than its peak of 5.5% in January 2023. MAS Core Inflation is projected to be around 4% for 2023, unchanged from last year. It is projected to broadly decline over the course of 2024, while CPI-All Items inflation is projected to average between 3.0 to 4.0% in 2024[1]. There are both downside and upside risks to inflation. Shocks to global food and energy prices or domestic labour costs could bring about additional inflationary pressures. However, a sharper-than-expected downturn in the global economy could induce a general easing of cost and price pressures.

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1 Source: *Macroeconomic Review Volume XXII Issue 2, Oct 2023* https://www.mas.gov.sg/publications/macroeconomic-review/2023/volume-xxii-issue-2-oct-2023

2 Source: *MTI Narrows Singapore's GDP Growth Forecast for 2023 to "0.5 to 1.5 Per Cent"* https://www.singstat.gov.sg/gdp

3 Source: *Singapore's GDP Expanded by 0.7 Per Cent in the Third Quarter of 2023* https://www.mti.gov.sg/Newsroom/Press-Releases/2023/10/Singapore-GDP-Expanded-by-0_7-Per-Cent-in-the-Third-Quarter-of-2023

Macroeconomic uncertainties will have significant impact on a company's performance and financial position. Directors are reminded to pay close attention to the following accounting considerations in their preparation of the FS:

IMPAIRMENT

- Inflation continues to **put pressure on the top line and cost line**. These may result in recession risks and **impact cash flow forecasts for impairment assessments**.
- Higher interest rates will put **upward pressure on the discount rate** used in the discounted cash flow model which would **lower the net recoverable amount**.
- When assessing recoverable amounts of cash-generating units (CGUs) containing goodwill or intangible assets with indefinite useful lives, **sensitivity disclosure** [4] should be made if a **reasonable possible change in key assumption(s) would cause the carrying amount to exceed recoverable amount**.

DEBT COVENANTS

- Rising interest rates leading to higher discount rates would **reduce asset values**, which could lead to a **breach of debt-to-equity or asset-to-liability ratios**.
- Borrowers should monitor the **terms of existing debt/loan arrangements for possible breaches** and **obtain waivers**[5] **before year-end** if they do not satisfy debt covenants and wish to continue classifying the debt as non-current.

GOING CONCERN

- ACs of highly leveraged companies should **perform a robust assessment**, including **detailed scenario analysis** of the impact of higher interest rates together with other factors, to assess if there are any **material uncertainties on the company's ability to continue as a going concern**. This will include considerations for borrowings approaching maturity and whether there are realistic expectations of repayment or committed refinancing due to the high interest environment.
- Cash flow projections should be updated with **current interest and discount rates, market conditions and business expectations up to the date of authorising the FS**. Management should consider the fact and circumstances of the individual company and all available information about the future **for at least, but not limited to, the twelve months** from the end of the reporting period.
- If there are **material uncertainties**[6] about going concern or if the going concern assessment involves **significant judgement**, such material uncertainties and significant judgement should be disclosed, including **management's plans to mitigate the conditions that cast significant doubt on going concern**.

4 To refer to paragraph 134(f) of SFRS(I) 1-36 *Impairment of Assets*.

5 To refer to paragraph 75 of SFRS(I) 1-1 *Presentation of Financial Statements*.

6 These include events or conditions arising after the reporting period. To refer to paragraph 16(b) of SFRS(I) 1-10 *Events after the Reporting Period*.

ACRA's Tips for ACs

- Obtain an understanding from management about **discerning events** (if any) **existing on and after the reporting date**, up to the date of authorising the FS, when reviewing appropriateness of impairment and going concern assumptions.
- **Do not just rely on historical trend information. Re-assess** if the basis for inputs and assumptions used in cash flow projections are valid and supportable.
- **Engage external auditor early** to ensure that management's going concern assessment is adequate and/or appropriate.

ACCOUNTING IMPACT FROM CLIMATE CHANGE MOVEMENTS

With the effects of climate change becoming increasingly pronounced, global calls for efforts to combat climate change have grown exponentially and with new sense of urgency.

Locally, the Singapore Exchange (SGX) has introduced a phased approach to mandate climate reporting[7] for issuers. For financial year commencing between 1 January to 31 December 2023, climate reporting will be mandatory for issuers in the (a) financial industry; (b) agriculture, food and forest products industry; and (c) energy industry. Following this, it will be mandatory for issuers in the (d) materials and buildings industry; and (e) transportation industry for financial year commencing between 1 January to 31 December 2024. For all other issuers, climate reporting will remain on a "comply or explain" basis.

Singapore has also implemented a carbon tax, which is set at $5 per tonne of carbon dioxide equivalent (tCo2e) until 2023, and will be progressively increased to $50 to $80 per tCo2e by 2030[8].

ACs should start considering how climate-related risks might have a material impact on a company's operations, and accordingly, its financial performance, position and cash flows.

[7] Source: *SGX Sustainability Reporting* https://www.sgx.com/sustainable-finance/sustainability-reporting

[8] Source: *National Environment Agency Carbon Tax* https://www.nea.gov.sg/our-services/climate-change-energy-efficiency/climate-change/carbon-tax

EXPECTED CREDIT LOSS (ECL)

- Changes in credit risk due to climate change **often impact periods beyond 12-months**. Companies should assess if a 12-month probability of default remains supportable or if there has been a significant increase in credit risk requiring lifetime ECL to be estimated.

- Homogeneous groupings used previously such as customer ratings might need to be **disaggregated into sub-groups**, where climate-related risks might impact loss patterns and probability of default for each sub-group differently.

IMPAIRMENT

- The impact of climate change may result in changes to **revenues expected to be generated** from an asset, the **length of forecast period**, **discount rates and growth rate assumptions**. These factors will impact the asset's **value-in-use** and **recoverable amount**.

- A company's **cost base may increase** as it adopts greener initiatives to sustain its business and adhere to regulations. Examples include suppliers passing down increasing cost from carbon tax and purchasing cleaner-energy or more energy efficient machinery and equipment. Such **costs should be factored into cash flow forecasts for impairment assessments**.

- If there are plans to purchase greener fixed assets, companies should **re-evaluate the useful lives and residual value of the existing fixed assets**. In some cases, certain assets may **become obsolete and need to be written down**.

GREEN FINANCING

- **Sustainability bonds (or green bonds)** have specific requirements that the proceeds will only be used on specified climate-related projects. Issuers should consider the implications if **the proceeds are not used** for designated green purposes and whether this constitutes a **breach** that makes the debt **repayable on demand** or a **default that will accelerate the bond repayment**.

- Complexities may arise in the accounting for **sustainability-linked bonds** due to the **variability in the amount of interest payable**, which is dependent on whether the ESG targets are met. If the ESG targets are not met, issuers should consider the **changes in expected cash flows**.

PROVISIONS

- If there are expected potential loss of revenue, increased costs (e.g. from carbon tax) or plans to terminate contracts or agreements due to changing preference towards sustainable products or sourcing, companies should consider the need to **recognise a provision for onerous contract**.

- A **provision for restructuring** should also be recognised if a company has drawn up a **detailed formal plan** to make significant changes to its operations to achieve climate-related targets and **has raised valid expectations that the plan will be implemented** i.e., either by starting to implement the plan or announcing its main features to those affected by it.

ACRA's Tips for ACs

- Directors should understand **how climate-related risks can impact the FS**. Educational materials available for further reading include those published by the Institute of Singapore Chartered Accountants (ISCA)[9] and International Financial Reporting Standards (IFRS) Foundation[10].
- ACs should remain vigilant for **greenwashing attempts** especially when commitments have been made towards ambitious goals such as carbon neutral or carbon zero emissions within a short period of time.
- With increasing requirements for climate reporting, ACs should ensure **consistency between financial and non-financial reporting** on **key climate-related assumptions, risks and opportunities**.

ACCOUNTING IMPACT FROM GEOPOLITICAL UNCERTAINTIES

Escalations in geopolitical uncertainties, such as the Russian-Ukraine war and more recently the Israel-Hamas war, continue to have significant impact on many companies in FY2023, not only in war zone areas but also globally where business activities may be affected by recent developments.

Companies with operations, customers and suppliers in affected regions may experience delays in their operating cycles (e.g., delays in supply chain and collection process, etc.).

International sanctions are also becoming increasingly pervasive. The imposition of sanctions by the United States and the European Union on Russia are wide-ranging, impacting banks, businesses, exports, imports, etc. Recent chip sanctions imposed by the United States on China, aimed to curb China's technological development and exports, may also affect companies in related industries such as semiconductor, microelectronics and information technologies.

Entities affected by these developments should carefully consider the resulting accounting implications which will impact FS preparation.

[9] This technical bulletin is issued by the ISCA AASC-FRC ESG Working Group and is accessible from https://www.isca.org.sg/docs/default-source/technical-bulletins/technical-bulletin-1-(clean).pdf?sfvrsn=7b90f511_2

[10] This educational material is issued by the IFRS Foundation and is accessible from https://www.ifrs.org/content/dam/ifrs/supporting-implementation/documents/effects-of-climate-related-matters-on-financial-statements.pdf

PROVISIONS

- If losses are expected to outweigh the economic benefits from a revenue contract, companies should consider the need to **recognise a provision for onerous contract**.

- When applicable, a **provision should be recognised** to record any obligation from delayed/cancelled deliveries to customers or breaches in contractual terms.

EXPECTED CREDIT LOSS (ECL)

- Companies should consider if **trade restrictions imposed** by various governments, as well as the exclusion of major Russian banks from the SWIFT payment system, will **affect previous assessments of ECL**.

- ECL assessments should consider recoverability of amounts owed by debtors who **not only have operations but also significant customers or inventory** in affected areas.

GOING CONCERN

- In the assessment of going concern, companies should consider the likelihood of **possible disruptions to production** (e.g., business failure of key suppliers, temporary closures of own operations, disruptions to workforce availability, etc.), and any **significant deterioration in the company's net working capital position** due to suppliers demanding earlier repayment or customers delaying payment beyond agreed credit terms.

IMPAIRMENT

- Companies should assess the **recoverability of the carrying amount of an asset or CGU**, taking into account increased costs, possible supply chain disruptions and changes in cash flow expectations for the asset or group of assets. For example, intangible assets such as software being developed by companies in affected region(s) might face disruptions in the development phase and might require impairment assessment.

- Physical assets that have been **damaged or left idle** in affected regions should also be **assessed for impairment.**

- If **inventories are slow moving** because of imposed trade sanctions or have been **physically damaged** due to the war, they should be **written down to the lower of their costs and net realisable values**.

- Companies may decide to **dispose various assets or subsidiaries** to comply with various government sanctions imposed. If so, non-current assets held for sale and discontinued operations should be measured at **lower of carrying amount and fair value less cost of disposal**, and presented separately in the statement of financial position. Assets held for sale must be **available for immediate sale in current condition** and the sale must be **highly probable** and **expected to be completed in one year** from the date of classification.

DEVELOPMENTS

<u>New accounting standards</u>
The following accounting standards have been issued and will take effect as follows:

For annual reporting periods beginning on 1 January 2023:

- SFRS(I) 17 *Insurance Contracts*
- Amendments to SFRS(I) 1-1 *Presentation of Financial Statements* and SFRS(I) Practice Statement 2: Disclosure of Accounting Policies
- Amendments to SFRS(I) 1-8 *Accounting Policies, Changes in Accounting Estimates, and Errors:* Definition of Accounting Estimates
- Amendments to SFRS(I) 1-12 *Income Taxes*: Deferred Tax Related to Assets and Liabilities Arising from a Single Transaction
- Amendments to SFRS(I) 1-12: International Tax Reform—Pillar Two Model Rules

For annual reporting periods beginning on 1 January 2024:

- Amendments to SFRS(I) 1-1: Classification of Liabilities as Current or Non-current
- Amendments to SFRS(I) 1-1: Non-current Liabilities with Covenants
- Amendments to SFRS(I) 1-7 *Statement of Cash Flows* and SFRS(I) 7 *Financial Instruments Disclosures*: Supplier Finance Arrangements
- Amendments to SFRS(I) 16 *Leases*: Lease Liability in a Sale and Leaseback

<u>Base Erosion and Profit Shifting (BEPS) Pillar Two</u>
While companies are temporarily exempted from applying deferred tax accounting related to Pillar Two tax reforms, those with annual reporting periods beginning on or after 1 January 2023 are reminded to (i) disclose in their FS that they have applied the exception; (ii) disclose separately their current income tax expense related to Pillar Two income taxes; and (iii) provide qualitative and quantitative information about the exposure where the Group has operations in countries that have enacted or substantially enacted Pillar Two tax reforms.

ACRA's Tips for ACs

Directors are encouraged to review and understand the new requirements and consider their implications earlier. In compliance with the accounting standards, meaningful disclosures on the impact of adoption of these standards, which have been issued but not yet effective, should be made in the FY2023 FS.

QUALITY CONTROL (“QC”) REVIEWS

With the amendments to the Accountants Act (“AA”), ACRA's inspection powers were expanded to include QC review on accounting entities with effect from 1 July 2023. In a QC review, ACRA assesses the quality controls of accounting entities against the requirements of the Singapore Standards on Quality Management. A robust system of quality management will ensure that accounting entities deliver consistent and high quality audits. More details of the QC review, including our observations with respect to accounting entities' system of quality management will be shared in the upcoming 2023 Audit Regulatory Report[11]. ACs should consider the accounting entities' QC review findings and/or outcomes to assess their suitability as external auditors.

Following the regulatory legislation of quality control review of accounting entities' system of quality management, the Audit Quality Indicators guide relating to the indicator “Inspection – Result of external and internal inspections” has also been updated[12] for the QC review.

AUDIT INSPECTION FINDINGS

With the amendments to the AA, public accountants who have obtained “Not Satisfactory” inspection outcome are to disclose their audit inspection findings to the audit client of the inspected engagement if the audit client is a public interest entity. ACs are strongly encouraged to work with the auditor in deep diving into the root cause(s) and devise effective remediation plans.

ACs are also urged to take this opportunity to assess (i) the auditor's commitment towards the delivery of quality audits; and (ii) if the company's financial reporting was a contributory factor to the findings and, if so, how the quality of financial reporting could be enhanced.

ACRA's Tips for ACs

A quality audit will enhance the financial reporting of a company. Hence, we encourage ACs to stay abreast of ACRA's audit regulatory activities, including QC reviews[13] and audit inspections[14] through the public reports[11].

[11] The 2023 Audit Regulatory Report will be accessible from https://www.acra.gov.sg/training-and-resources/publications/reports/practice-monitoring-programme-public-reports

[12] Please refer to https://www.acra.gov.sg/accountancy/public-accountants/audit-quality-indicators-and-industry-average#Disclosure for the updated guide.

[13] Inspection results of the firm's system of quality management serves as an assessment of the firm's input-based measures to quality audits.

[14] Inspection results of audit engagements are a direct measure of audit quality.