

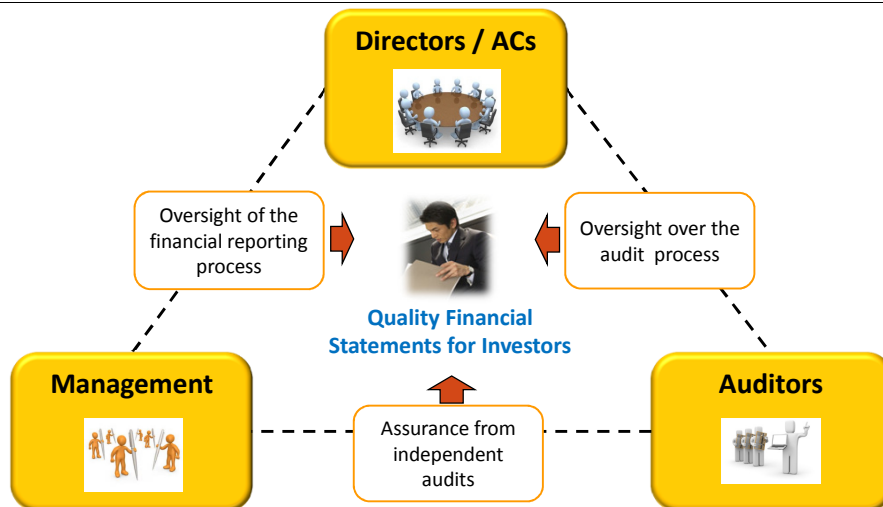
ACRA's Financial Reporting Surveillance Programme

Ms Julia Tay
Deputy Chief Executive, ACRA

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Financial Reporting – A collective responsibility



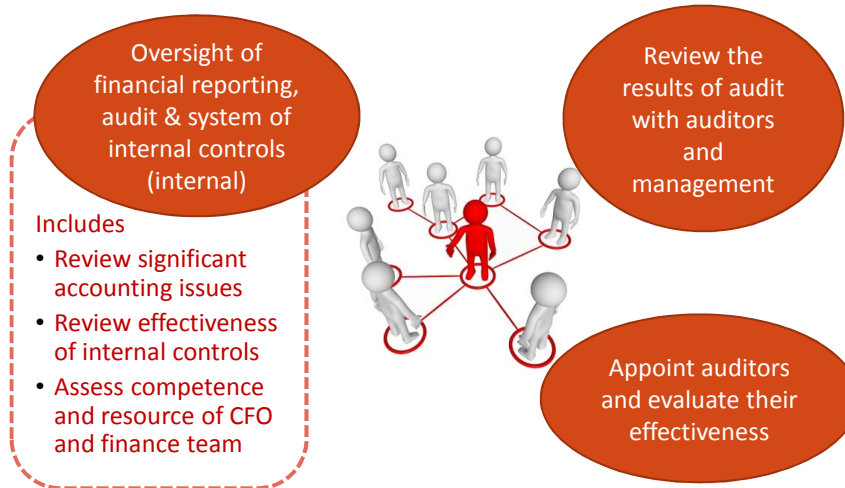
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AC well placed to govern financial reporting

- and help board of directors to discharge duties

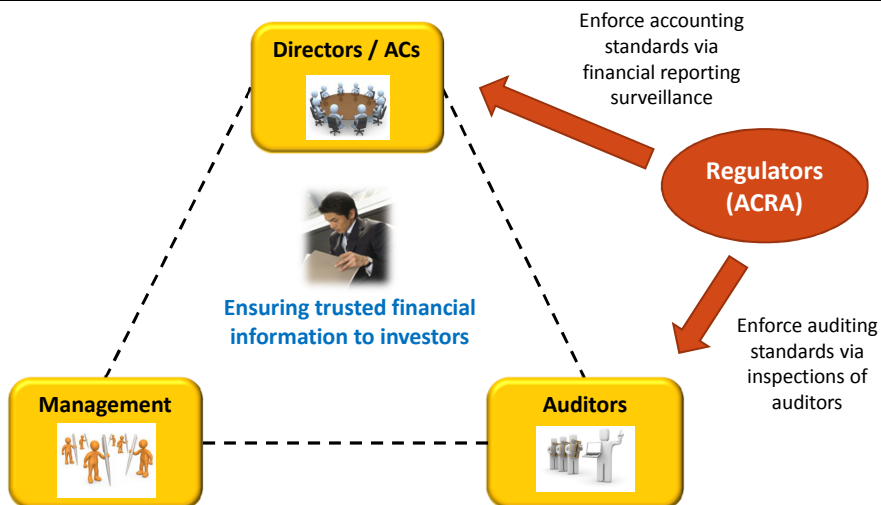


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The role of regulators - in protecting public interest



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BACKGROUND

Financial Reporting Surveillance

SELECT

REVIEW

ENQUIRE

CONCLUDE

1 Enforces section 201 of Companies Act

- **Directors are responsible** to prepare financial statements which:
 - are true and fair and
 - compliant with Accounting Standards - typically Singapore Financial Reporting Standards (SFRS).
- Section 204: Fines and imprisonment

2 Full review of financial statements (FS)

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SELECT

Risk-based selection

REVIEW

ENQUIRE

CONCLUDE

Significant public interests

Industries susceptible to accounting changes during the year

Risk - based

QUALIFIED

UNQUALIFIED

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REVIEW

Collaboration with ISCA-FSRC

ENQUIRE

CONCLUDE




ISCA's Financial Statements Review Committee (FSRC)

- Established >50 years
- Comprises ~ 30 senior & experienced audit partners
- Prior to collaboration, review FS for self regulation / quality monitoring of ISCA members (auditors)

Regulatory outcome decided by ACRA

- ISCA-FSRC provides the expert opinion



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ENQUIRE

Enquiry with Directors

CONCLUDE


ACRA sends enquiry letters to Directors







ACRA and ISCA-FSRC review FS and discuss

2nd letter






ACRA and ISCA-FSRC evaluate replies




ACRA interviews

If financial reporting breach is serious

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CONCLUDE **Regulatory Outcome** 

Severity ↓

Low

High

Closure

Advisory - Typically issued for less serious breaches
- Not a regulatory sanction

Warning **SGX App 7.4.1(k)**
Directors to announce at his appointment ... if he has been issued warning by regulatory authority

Composition

Prosecution **SGX Rule 703**
Listed co to announce immediately if sanction is "material information... likely to materially affect price"

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Case Study 1 - Profit and Loss

Consolidated Statement of Comprehensive Income (extract)	2013 \$'000	2012 \$'000
Gross profit	20,000	24,000
Other income	10,000	10,000
Expenses	(19,000)	(25,000)
Reclassification of fair value loss on disposal of subsidiary	(10,000)	-
Profit before tax	1,000	9,000

Profits dropped by \$8m mainly due to reclassification

Seemingly straight forward statement...

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Case Study 1 - Profit and Loss

Consolidated Statement of Comprehensive Income (extract)	2013 \$'000	2012 \$'000
Gross profit	20,000	24,000
Other income	10,000	10,000
Expenses	(19,000)	(25,000)
Reclassification of fair value loss on disposal of subsidiary	(10,000)	-
Profit before tax	1,000	9,000

2 Included gain on disposal of subsidiary \$8m

1 What is the nature?



Both items arose from the same transaction?

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Case Study 1 - Profit and Loss

Directors' response:

- Both items arose from the same transaction (disposal of subsidiary)
- "Reclassification of fair value loss on disposal" relates to available-for-sale (AFS) investment held by the disposed subsidiary
- The AFS investment was not sold/disposed by subsidiary – it was disposed because the subsidiary owning it was disposed

Learning point for directors:

Presentation can distort the substance of the transaction

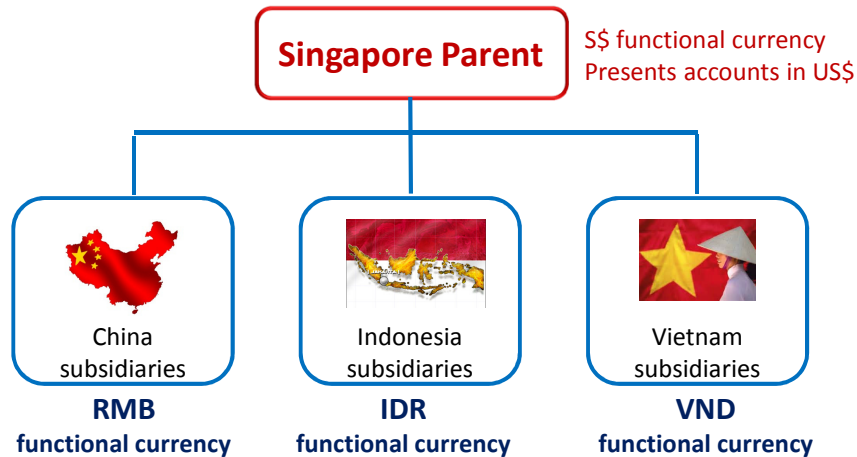
- \$8m drop in profit appeared due to the huge loss on disposal of \$10m
- **but in reality**, disposal of subsidiary only netted a loss of \$2m

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Case Study 2 - Cashflow Statement



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Case Study 2 - Cashflow Statement

Consolidated Statement of Cash Flow (extract)	2013 \$'000
Cash flows from operating activities	
(Loss) before tax	(12,000)
Adjustments for non-cash items	10,000
Net effect of exchange rate changes	(53,000)
Working capital changes	33,000
<i>Net cash flows used in operating activities</i>	<i>(22,000)</i>
Cash flows from investing activities	
Purchase of PPE	(51,000)
Net effect of exchange rate changes	97,000
<i>Net cash inflows from investing activities</i>	<i>46,000</i>
Cash flows from financing activities	
Proceeds from borrowings	16,000
Net effect of exchange rate changes	(30,000)
<i>Net cash outflows from financing activities</i>	<i>(14,000)</i>



Nature of exchange rate changes

1 Amount appears disproportionate with exchange loss included in P&L of \$20m

2 Exchange rate changes are non-cash items – why include in cashflow statement?

Case Study 2 - Cashflow Statement

Directors' response:

"Effect of exchange rate changes" was due to:

- **Translation** of holding company and subsidiaries' accounts from their respective functional currencies (RMB, IDR, VND) to the USD presentation currency in the group accounts
- **Translation losses are not cash flow items** and should not have been presented under investing and financing activities in the statement

Learning point for directors:

- You can detect anomalies even based on desktop review
- Ask questions when numbers do not make sense or when they are inconsistent with other numbers

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Case Study 3 - Note to Accounts

Note to accounts – Acquisition of a subsidiary (100%)	Book value \$'000	Fair value \$'000
Cash at bank	160	160
Trade receivables	390	390
Intangible assets	250	250
Trade and other payables	(500)	(500)
Total identifiable net assets	300	300
Goodwill on acquisition		5,700
Consideration paid		(6,000)
Cash acquired		160
Net cash inflow on acquisition		160

2 Why fair value exactly equals book value?

1 Paid 20 times of fair value of net assets

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Case Study 3 - Note to Accounts

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Total identifiable net assets	300	300
Goodwill on acquisition		5,700
Consideration paid		(6,000)
Cash acquired		160
Net cash inflow on acquisition		160

4 No increase, despite acquiring contract licensing deals (in SGX announcement)

3 Represents 95% of consideration and is not amortised

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Case Study 3 - Note to accounts

Directors' response:

Did not engage external valuer as acquiring mainly monetary items:

- For intangible assets of \$250K, directors of view that the fair value approximated the carrying amounts (no basis provided)
- No new intangible assets recognised as none in acquiree's accounts

Learning points for directors:

Question when goodwill is large relative to consideration

- What is the commercial substance of goodwill? Are we able to account to shareholders for the large amount of goodwill?
- Is the high purchase price paying for intangible assets such as brand name, technical know-how, customer contracts etc.?
- If so, how should these intangible assets be recognised and amortised?
- Should management seek external help since there is no in-house expertise?

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REPORT

Reports by ACRA



Public reporting is necessary to enhance:

- Transparency; and
- Market understanding of the application and interpretation of accounting standards

FY2013 accounts - Available by 3Q 2015

1

Annual report on key observations, companies not identified

FY2014 accounts – Available SOON

2

Annual guidance – areas of review focus for coming year

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Key takeaways for Audit Committees



Review of financial statements



Rigorous financial reporting and audit process



Competent and well resourced finance team



Appointment of management



Question judgemental treatment & disclosures



Seeking external help

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