

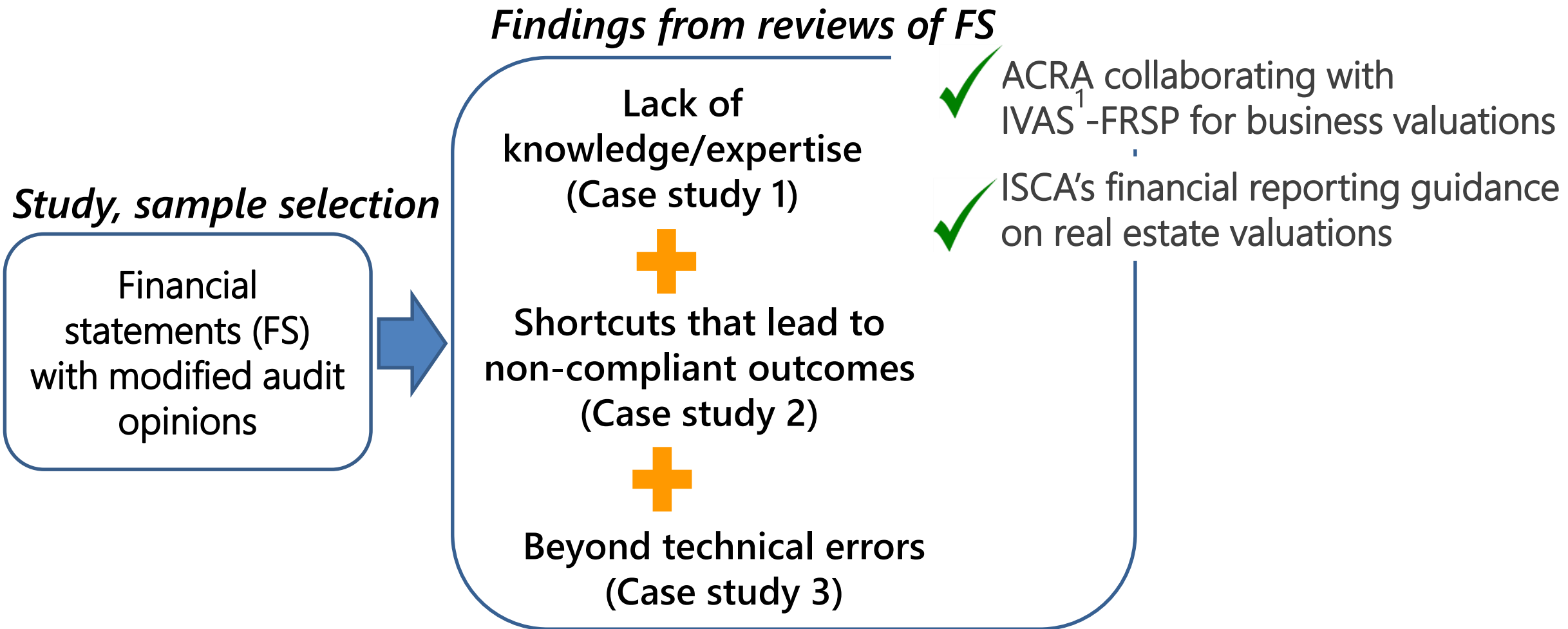
ACRA Regulatory Updates and Initiatives

[Observations from Financial Reporting Surveillance Programme (FRSP)]

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Agenda



¹ IVAS: Institute of Valuers and Appraisals of Singapore
(established under Singapore Accountancy Commission)

Study on FS with modified audit opinions

Financial statements (FS) of SG-incorporated listed companies filed @ 31 Oct 19

	FY2016	FY2017	FY2018
No of companies	584	564	560
Received modified audit opinions	35 (6%)	49 (9%)	48 (9%)

A high % of FS with modified audit opinions
=> Shareholders have no reliable financial data to make decisions

Study on FS with modified audit opinions

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1

7 companies received clean audit opinions in **subsequent FS** (FY2017 & FY2018)

2

3 companies with modified audit opinions for 5 years or more @ FY2016 received **clean audit opinions** for FY2018

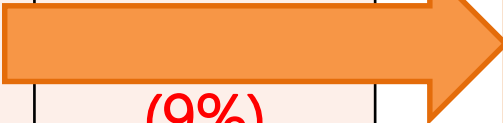
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Companies that newly received modified audit opinions **reduced** from 23 (FY2017) to 10 (FY2018)

Study on FS with modified audit opinions

Financial statements (FS) of SG-incorporated listed companies filed @ 31 Oct 19

	FY2016	FY2017	FY2018
No of companies	584	564	560
Received modified audit opinions	35 (6%)	49 (9%)	(9%)
Average (Maximum) no. of issues qualified	3(6)	3(12)	2(7)



7 FS with indication of material non-compliance(s) with accounting standards were selected for review

Wrapping up the third review cycle of FRSP

Categories of findings

**Lack of knowledge/
expertise**

**Shortcuts that leads
to non-compliant
outcomes**

Beyond technical error

Some common findings (more will be shared at AC pitstop on 26 May 2020)

- ✓ Models and assumptions in impairment tests (Case Study 1)
- ✓ Valuation of preference shares issued with options and redemption features
- ✓ Use of blanket policy that does not comply with accounting standards (Case Study 2)
- ✓ Presentation of cash flows within operating, investing and financing activities
- ✓ Transaction that does not reflect commercial substance
- ✓ Possible intention for accepting modified audit opinion and adjust in future FY (Case Study 3)

Case study 1 – Lack of expertise (1)



Fact Pattern

- The Group has one subsidiary, Co A (CGU 1) that delivers maintenance services in Singapore
- In 2017, the Group acquired Co B (CGU 2) that sells in RMB spare-parts used in similar maintenance services in China. Goodwill of S\$15m from acquisition was allocated entirely to CGU 2
- The Group performed impairment test on CGU 2's goodwill at end of 2018

Key assumptions used for CGU 2's impairment test:

- Discount rate 10% (CGU 1's discount rate)
- Cash flow projections based on approved financial budget/forecast, stopped at Year 3

	2018		2019
	Budget	Actual	Forecast
Gross Margin	12%	8%	14%
Growth rate	3%	1%	5%

- At end of 2018, goodwill was S\$15m, PPE was S\$2m, other working capital asset was S\$3m
- Management concluded no impairment as CGU 2's VIU of S\$17m exceeds carrying amount of S\$15m

Case study 1 – Lack of expertise (2)

Some anomalies to be identified:

- **Goodwill allocation:** allocate some to CGU 1 that benefit from the synergies?
- **Gross margin and growth rate:** verifiable and supportable?
- **Discount rate:** reflect risks specific to different CGUs? adjusted for country risk?
- **Carrying amount of CGU:** should be S\$20m, rather than S\$15m?
- **Forecast period:** 3 years sufficient, consistent with industry cycle?
- **Foreign currency cash flows:** estimated in the currency to be generated and discounted using discount rate for that currency?

Learning points for ACs:

- Seek external help if no expertise in-house, when asset value is material
- Helpful to have accounting/audit practitioner(s) within ACs
- Ensure senior auditors spent time and challenge mgt assumptions rigorously

ACRA collaborating with IVAS-FRSP

1 Working together

- IVAS-FRSP provides expert advice to ACRA on business valuation and impairment tests for financial reporting
- Extended MOU on 5 Jul 19



3 Practice guidance for FY19 FS

Challenging
economic
outlook



Rising
number of
M&A deals

ACs to focus on
impairment,
business valuation

2 Experience from two pilot cases

Areas covered:

1. Valuation of unlisted preference shares (PS) issued with put, call options and redemption features
2. Impairment test of assets in specialised industry



Learning points for ACs:

- Valuation model failed to reflect redemption feature market participants normally consider
- Valued unlisted PS based on value of listed PS with significantly different terms
- If management adjust assumptions given to valuer, assess reasonableness and impact

ISCA's guidance on real estate valuation

Published in Nov 2019 (<https://isca.org.sg/tkc/fr/financial-reporting-guidances/>)

Objective: Facilitate compliance with FRS

Common painpoints :

- Valuation is inadequate, e.g.
 - Prepared for purpose(s) other than financial reporting (e.g. financing)
 - Extent (desktop versus full review)
 - Inappropriate bases of value (e.g. market value vs fair value)
- Auditor keeps asking same questions
- Company not want to be involved



Areas covered in Guidance:

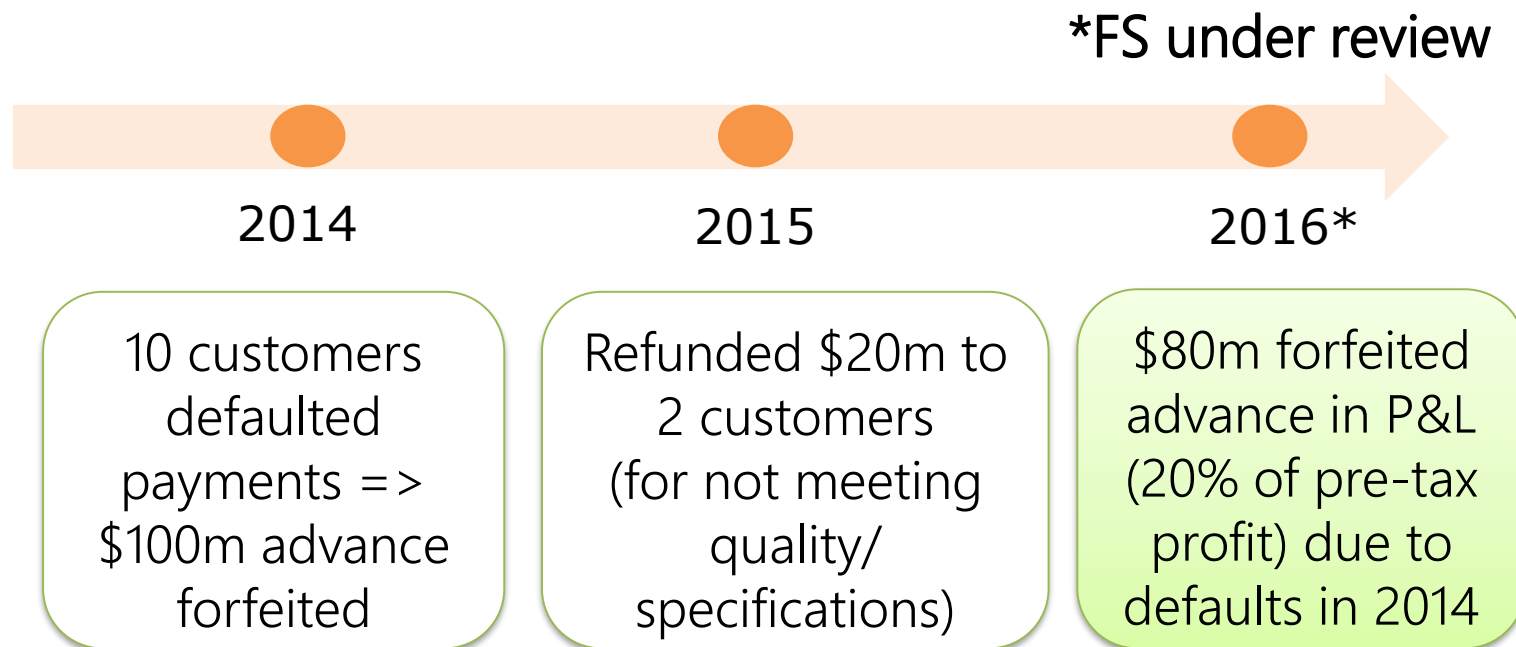
- **Proposed content of valuation report**
 - > contains info required by auditors to comply with auditing standards
- **Responsibilities of valuer, auditor and company to achieve compliance with accounting standards**

Case study 2 – Short cut that leads to non-compliant outcome (1)



Fact Pattern

- The Group customises large equipment for sale, and recognises revenue “over time”
- Contract terms:
 - The Group’s customers paid 15% advance upfront, with milestone payments based on work done
 - If its customers default milestone payments, the Group has the right to forfeit advance



Case study 2 – Short cut that leads to non-compliant outcome (2)

Company's response

"Our policy is to retain 100% of forfeited advances as potential claim liability for 2 years. 2 years is the period over which most customers will initiate arbitration/claim."

ACRA selected one customer contract to understand how policy works

- In 2014,
 - customer defaulted payment due to financial difficulty
 - customer did not raise dispute on quality/specifications -> no basis for claim
 - the Group wrote down partially constructed inventory by **\$6m in 2014 (loss)**
- In 2016
 - customer did not initiate any claim after two years
 - the Group recognised forfeited advances of **\$5m in 2016 (income)**

No basis to
postpone

Case study 2 – Short cut that leads to non-compliant outcome (3)



Historical trend: Refunded only 20% of forfeited advance

True & fair?

Learning points for ACs:

- Assess whether blanket policy is supportable (e.g. results in outcome similar to case-by-case assessments)
- Review movements of major provisions to identify over/(under) provision and re-assess policies when necessary

Case study 3 – Beyond technical errors (1)



Fact Pattern

Qualified Auditor's Opinion in FY2016

"...management had not recognised a **reversal** of impairment loss on property, plant and equipment amounting to \$5 million

This is **not in compliance** with FRS 36 *Impairment of Assets*."



PPE using cost model @ 31 Dec 16
Carrying amount: **\$25 million**
(net of accumulated impairment loss of \$6m)
Valuer's report: **\$30 million**

Notes to FY2016 FS

"Management had considered it appropriate not to recognise a reversal of impairment loss on these amounts which had **no direct bearing on the operating performance** of the Group and the Company."

Why not
reverse?

Case study 3 – Beyond technical errors (2)

ACRA reviewed FY2017 FS.

- The Group recognised \$5m reversal of impairment loss in FY2017 => profit in FY2017.
- Had reversal been correctly recognised in FY2016, the company would report a loss in FY2017.

	FY2016	FY2017
(Loss) /Profit as reported	(S\$19m)	\$2m*
(Loss) had reversal been recognised in FY2016	(S\$13m)	(S\$3m)

* After recognising gain of \$5m from reversal of impairment

The Company on watch list since FY2015.

Learning points for ACs:

- Resolve issues expected to be qualified by auditors
 - to work with management to put through adjustments
 - if not adjusted, will be taken as directors' position
- ACRA will consider other implication -> may affect outcome/sanction

Thank You!