ACRA
ACCOUNTING AND CORPORATE REGULATORY AUTHORITY

Raising the Bar of Financial Reporting

Financial Reporting Surveillance Report 2022

ACRA is the regulator of companies incorporated in Singapore and administers the Companies Act in Singapore. Through the Financial Reporting Surveillance Programme, ACRA ascertains whether the annual financial statements of Singapore-incorporated companies are prepared in compliance with the prescribed accounting standards in Singapore, thereby facilitating shareholders' and the wider public's access to comparable and reliable financial information for decision-making.

Scope/Disclaimer

When reading the findings set out in this report, the reader should bear in mind that ACRA has reached conclusions having regarded multiple factors in the actual circumstances, which are not fully illustrated in the case studies. Accordingly, these findings should not be read in isolation.

Published in January 2023

Abbreviations

ACRA	Accounting and Corporate Regulatory Authority
FRSP	Financial Reporting Surveillance Programme
FS	Annual Financial Statements
NC	Non-compliance with the prescribed accounting standards in Singapore

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Executive Summary – Scope and Outcome

This report summarises the key findings from ACRA's FRSP from 1 April 2020 to 31 March 2022. It provides our observations on the quality of financial reporting by companies in Singapore.

Scope

Recorded **63** statements from directors, officers and auditors → Concluded reviews of **33** FS → Found material NCs in **12** FS

Outcome

- **3** listed companies re-stated comparatives in their subsequent FS
- **5** listed companies and **1** non-listed company re-stated and had past years' FS re-audited
- **4** directors issued warnings, to announce when re-appointing as directors of listed entities
- **1** director paid a composition sum

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Executive Summary – Nature of Material NCs

Since the last report, we have developed risk profiling models to identify higher-risk FS for our review. This led to more focused reviews, resulting in fewer areas of enquiry for each FS.

Most of the material NCs affected the company's bottom line or key financial measure(s). The adjustments to consolidated pre-tax profits or losses and net assets ranged from 13% to 576%, and 3% to 32% respectively. Some companies also had their operating cash flows changed from positive to negative, or vice versa. Such misstatements could impact the decision-making of users of these FS.

Nature of material NCs	1 Apr 2018 – 31 Mar 2020	1 Apr 2020 – 31 Mar 2022
Recognition and measurement issues	11 (or 35%)	14 (or 61%)
Presentation issues	9 (or 30%)	6 (or 26%)
Disclosure issues	11 (or 35%)	3 (or 13%)
Total number of NCs	31	23

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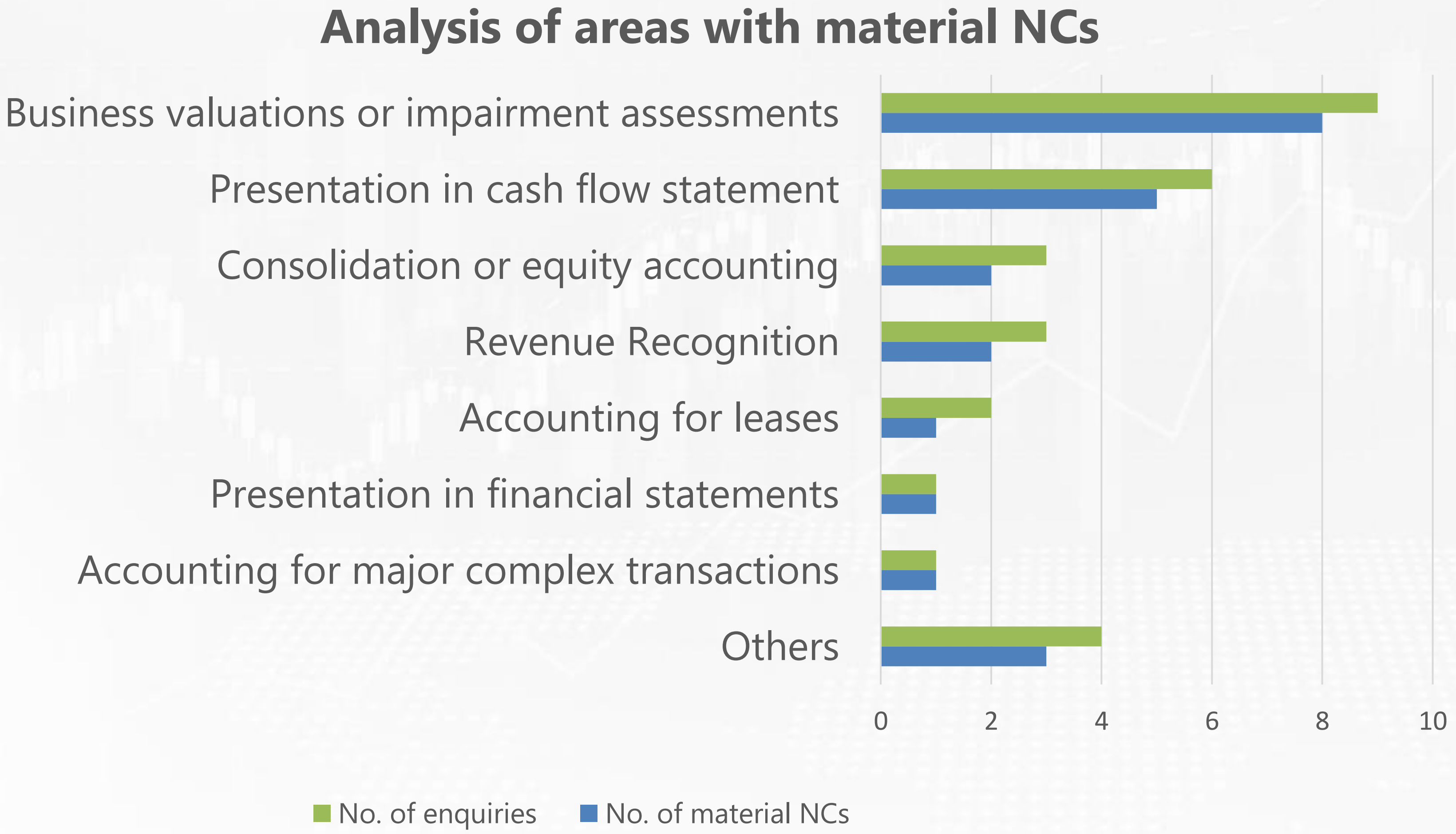
Executive Summary – Accounting Areas with NCs



Material NCs concluded were mainly on business valuations or impairment assessments (8) and presentation in cash flow statement (5). Both areas contributed to 57% of 23 material NCs concluded.

Directors are encouraged to engage qualified valuers for complex valuations and to place higher importance in their review of cash flow statements.

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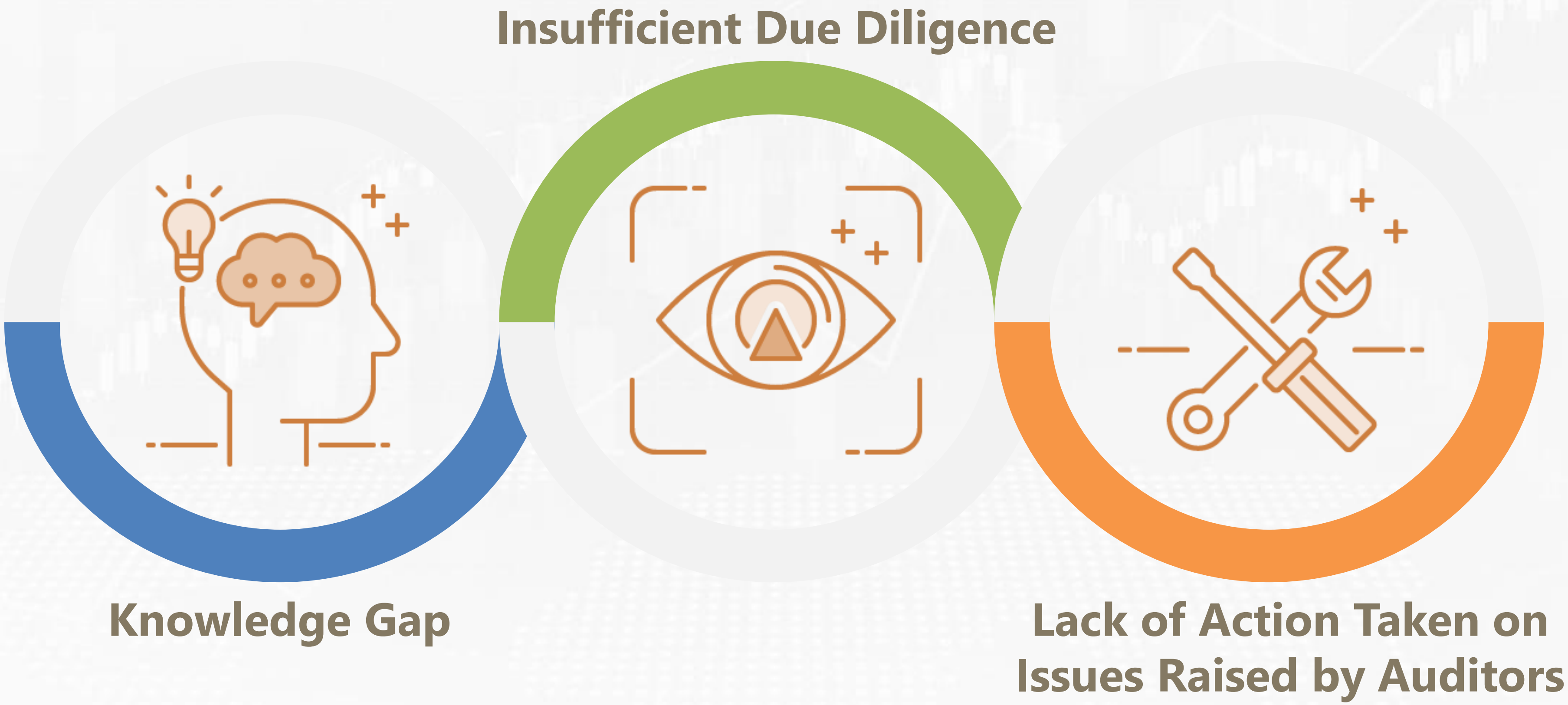
Executive Summary – Root Causes of Material NCs

Based on our correspondences or discussions with directors and management, the root causes of the 23 material NCs were due to:



We will illustrate these observations through cases in Chapters 1 to 3. To maintain the confidentiality of the companies, the cases presented have been anonymised.

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Executive Summary – Impact from Climate Reporting

As companies ramp up their sustainability efforts, Audit Committees (ACs) should consider the accounting implications.

Key risks from climate change include new regulations, increased costs of operation or production, changing consumer preference towards sustainable products and discontinuation of carbon intensive operations.

Chapter 4 highlights the key accounting and auditing considerations for ACs in their review of FS and engagement with the statutory auditor.

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1

Cases indicating Knowledge Gap

1 Knowledge Gap

A highly competent finance team and Chief Financial Officer (CFO) are quintessential to ensure accounting standards are applied right from the start. Should this first line of defence fail, it is also helpful for ACs to comprise more members with deep accounting knowledge to pick up anomalies.

If the finance team and CFO had deep accounting knowledge, the directors:

- in Case 1A, would be alerted that the property's change in use had occurred in the previous financial year, thus fair value gain should be recognised in the previous year;
- in Case 1B, would be advised correctly that intra-group balances and transactions should be eliminated, so that consolidated FS reflected the Group's financials as one economic entity; and
- in Case 1C, would be advised that that the Group and its partially-owned subsidiary should not adopt different accounting treatments for the same property units.

In each of the three companies, there is only one accounting-trained member in the ACs. If there were more AC members with deep accounting knowledge, issues might have been identified.

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Case 1A

The Group was a property developer. In 2019, the Group recorded fair value gain of $18 million, following a transfer of mixed-use property from development property (DP)[1] to investment property (IP)[2].

Of the fair value gain, $16 million arose from 147 apartments to be leased to a third party from June 2019.

The Group signed the lease agreement (LA) in October 2018 and disclosed signed LA as a corporate milestone in its 2018 annual report.

Board of Directors exercised its judgement that the change in use had not occurred in 2018 because the Group had:

- not identified the specific units to be leased out, hence unable to ascertain their fair values accurately; and
- missed the handover date in January 2019 and commenced work based on the lessee's specifications only after. The lessee was entitled to terminate the LA at no penalty if delay was > 30 days. An amendment agreement was signed after the work commenced in mid-2019.

ACRA concluded material NC because:

- the signing of the LA in October 2018 was an **objective evidence of change in use**[3,4]. The Group's announcements affirmed it;
- uncertainty over specific units to be leased out would not justify as a reason; all 147 units were located in the same block, hence their fair values should not differ significantly; and
- lessee's right to terminate the LA was a non-issue as the Group handed the units **six days** before authorising 2018 FS.

Without this fair value gain, Group would have reported a loss, instead of profit in 2019.

<u>Accounting standards requirements:</u>

[1] *DP was measured at lower of cost or net realisable value.*

[2] *IP was measured at fair value.*

[3] *Per Paragraph 57 of SFRS(I) 1-40 Investment Property, examples of evidence of a change in use include: (d)* ***inception of an operating lease to another party****, for a transfer from inventories to IP.*

[4] *As defined in SFRS(I) 16 Leases, inception date of the lease is "the earlier of the date of a lease agreement and the date of commitment the parties to the principal terms and conditions of the lease."*

Case 1B

In 2020, the Company issued listed notes maturing in 2021 (the Notes). Some Notes were purchased by its wholly-owned subsidiary from the open market in the same year.

Instead of eliminating[1] the transaction and balances, the Group presented and classified the Notes held by subsidiary as debt investments in 2020 consolidated FS.

Correspondingly, the Group presented the Company's liabilities owing to the subsidiary at amortised cost in its 2020 consolidated FS.

In the subsidiary's books, this was presented as investment in financial assets and was measured at fair value through profit or loss.

Board of Directors did not apply consolidation principles because:

- the subsidiary had purchased the Notes from third parties in the open market;
- the Notes should be recognised as asset at Group level as the subsidiary could raise capital by trading the Notes. Liability should also be recognised at Group level because on maturity, the Company would need to pay to the subsidiary; and
- if elimination entries were applied, consolidated balance sheet would not reflect the true underlying obligations of the Group as a whole.

ACRA concluded material NC because:

- the consolidated FS of the Group should depict the entire group as a single economic entity. Cash flowing out from a subsidiary into the holding company and vice versa would not have increased the overall net cash of the Group; and
- by not eliminating the transactions and balances, the Group had overstated its assets, liabilities and profit before tax in 2020.

Accounting standards requirement:

[1] *Appendix A of SFRS(I) 10 Consolidated Financial Statements defines consolidated FS as "the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity."*

Case 1C

The Group's subsidiary developed a mixed-use project in Malaysia.

When commercial units (CU) of the project was completed in 2018:

- the Group recognised revenue of $16 million for sold CU in consolidated FS; but
- the subsidiary only recognised revenue of $2 million for the same CU in its separate FS.

Board of Directors explained that:

- the subsidiary recognised revenue over time as (a) the **asset had no alternative use**[1]; (b) the **developer had enforceable right to payment** for performance completed to date, and (c) the developer had the right to sue the buyer for **full payment for the completed CU**, if they wish to do so; and
- the Group recognised revenue at **<u>point in time</u>** as (a) the **buyer could not sell the uncompleted unit** until after making the full payment or obtaining the developer's consent; (b) the developer's enforceable rights to payments was merely **protecting the developer against the buyer's failure to pay**, and (c) while the developer could not terminate the Sales and Purchase Agreement (SPA) and resell the uncompleted unit, it did not preclude the developer's performance to create an **asset with an alternative use.**

ACRA concluded material NC at Group level because:

- revenue under SFRS(I) 15 should be recognised **<u>over time</u>**, as the developer was contractually restricted from directing the asset for another use[1]. The SPA gave developer an enforceable right to sue buyer for specific performance; and
- revenue recognition policy should be **consistently applied** between the Group and the subsidiary, as they were assessed based on the same contractual terms in the SPAs.

<u>Accounting standards requirement:</u>

[1] *Paragraph B6 of SFRS(I) 15 Revenue from Contracts with Customers states that "In assessing whether an asset has an alternative use to an entity…an entity shall consider the effects of contractual restrictions and practical limitations on the entity's ability to readily direct that asset for another use,* ***such as selling it to a different customer****."*

2

Cases indicating Insufficient Due Diligence

2 Insufficient Due Diligence

Diligence is a core success factor for a competent finance team. If a finance team is not diligent, errors will be undetected when preparing the FS. Material errors could have been picked up had the CFO and/or AC paid close attention to the FS, as illustrated in the two cases below.

If the finance team was diligent:

- the loan advanced from the Executive Chairman in Case 2A would be separately identified and presented as financing cash flows. Instead, the loan was aggregated with trade payables, with movements classified as operating cash flows. By assessing the case facts and Other Information section in the annual report, the finance team could have picked up this error; and
- the purchase option in Case 2B would be included in the computation of right-of-use asset and lease liability, due to certainty in exercising the purchase option. If the finance team had read the lease agreement and the requirements of SFRS(I) 16 in more detail, the purchase option would have been identified and included in the computation.

In both cases, these were straightforward transactions that were neither complex nor required judgement. The errors could have been avoided if more due diligence was exercised.

Case 2A

The Group was a property developer. In the 2020 FS, the Group disclosed a $4.8 million increase in trade and other payables.

The increase was due partly to a loan advanced from the Executive Chairman to the Group ($2.5 million, 15% of the Group's trade and other payables).

The Group however presented the entire increase of $4.8 million as "*Cash flows from operating activities*" in its Consolidated Statement of Cash Flow.

Board of Directors explained that:

- the loan advanced was presented as "*Cash flows from operating activities*" because the balance was classified as Trade payables due to a related party on the balance sheet.

ACRA concluded material NC because:

- the nature of the balance was that of a loan from the Executive Chairman and not due to trade transactions (i.e. sales and purchases); and
- proceeds from loans and borrowings fall in the scope of financing activities[1].

The NC resulted in the Group:

- overstating cash generated from operating activities by 154%; and
- understating cash generated from financing activities by over 50 times.

Accounting standards requirement:

[1] *Per paragraph 17(c) of SFRS(I) 1-7 Statement of Cash Flows, examples of cash flows arising from financial activities include: (c) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowing.*

Case 2B

The Company operated a restaurant from a building it leased from a third party. As the restaurant was very successful, the Company renovated the building between 2016 and 2018. The value of the building appreciated to $3.5 million.

Under the lease agreement (LA), the Company had the option to purchase the building at $1 million at the end of the lease term.

However, the carrying amount did not appear to include the purchase option:

	31 Dec 2018	31 Dec 2019
Right-of-use assets	$300,000	$330,000
Lease liabilities	$300,000	$330,000

Board of Directors explained that:

- after the LA was entered in 2016, the Company commissioned a desktop valuation in early 2017 and the building was valued closer to the option purchase price ($1 million);
- subsequent to the renovation and commercial success of the restaurant, the value of the building appreciated to $3.5 million;
- due to the potential upside of $2.5 million, the Group had the intention to exercise the purchase option in the LA; however
- the Company had erroneously omitted[1] the exercise price of the purchase option during the assessment of the lease.

ACRA agreed with the Board and concluded material NC on this point. We noted that:

- if the finance team had been more diligent, they would have questioned why the current fair value differed vastly from the carrying amount of the right-of-use assets and lease liabilities; and
- this would have prompted a review of the initial lease recognised in 2016 and led to the realisation that the purchase option had not been accounted for.

Accounting standards requirement:

[1] *According to paragraph 27(d) of SFRS(I) 16 Leases, the exercise price of a purchase option should be included in the initial measurement of lease liability and right of use asset if the lessee is reasonably certain to exercise that option.*

3

Cases indicating Lack of Action Taken on Issues Raised by Auditors

3 Lack of Action Taken on Issues Raised by Auditors

In two reviews, the accounting NCs had been highlighted by the statutory auditors to ACs. However, ACs found themselves having little time or insufficient resources to address the issues raised. This led to missed opportunities to resolve NCs with accounting standards.

In Case 3A, the directors disagreed with the valuer's methodology but did not have time to seek a second valuation. Instead of getting management to conduct a value-in-use (VIU) computation, the directors adopted a '*conservative*' short-cut approach. Despite receiving a disclaimer of opinion from the statutory auditor, the directors did not change its approach.

In Case 3B, the management performed an in-house VIU computation. The statutory auditor highlighted in the disclaimer of opinion that they were unable to obtain sufficient evidence from management to support certain key assumptions used in the computation. Yet, the directors did not resolve the matter by revising the assumptions used or engaging a professional valuer to recompute the VIU.

The Group's property, plant and equipment (PPE) and intangible assets (IA) were allocated to a loss-making gas distribution cash-generating unit (CGU).

Valuer A determined the CGU's fair value less cost of disposal (FVLCD) at $80 million in 2018.

In 2019, the CGU remained loss-making and Valuer B determined the CGU's FVLCD **at $21 million**.

The Group disagreed with Valuer B's valuation and took a '*conservative*' approach to:

- impair the entire carrying amount (CA) ($24 million) of IA; and
- use the average of 2018 and 2019 valuations ($50.5 million) as a proxy to justify no impairment for PPE.

Board of Directors explained that:

- it did not agree with Valuer B's valuation methodology. As there was no time to obtain another valuation, it took the '*conservative*' approach; and
- management did not perform VIU computation[1], despite FVLCD<CA[2], because upstream and downstream gas prices could not be reasonably forecasted as they were controlled by local bureau and market forces.

ACRA concluded material NC because:

- the '*conservative*' approach should not override the explicit requirements in the accounting standards, which prohibit the Group to use FVLCD, without considering VIU. Impairment charges should also be allocated between PPE and IA in the CGU; and
- inability to reasonably estimate gas prices was not a valid reason. Other companies in the same industry had forecasted such cash flows based on historical price trends and other available information. In fact, the Group had determined the CGU's recoverable amount based on VIU in 2017.

<u>Accounting standards requirements:</u>

[1] *Paragraph 33(a) of SFRS(I) 1-36 Impairment of Assets puts forth factors that companies should consider in measuring value in use.*

[2] *Paragraph 19 of SFRS(I) 1-36 Impairment of Assets indicates that if either VIU or FVLCD exceeds the CA, the asset does not need to be impaired.*

Case 3B

The Group invested in a joint venture (JV) with plans to cultivate bioproducts. The JV's carrying amount accounted for 22% of the Group's total assets.

The Group performed an in-house VIU computation to assess impairment in JV in 2016.

Based on the VIU computation, the Group concluded that no impairment allowance was required.

The statutory auditor disclaimed its opinion that certain key assumptions used in the VIU computation were not sufficiently supported.

Board of Directors did not impair the investment in JV because:

- the VIU computation indicated no impairment was required; and
- based on profit forecasts, the JV was expected to breakeven at Year 4 (2020) and be profitable in Year 5 (2021) and onwards. Operations were expected to commence by mid-2017.

ACRA concluded material NC because the assumptions used in the VIU computation were not reasonable as follows:

- the discount rate[1] used (7.5%) was too low, considering the high-risk nature and early start-up stage of the JV;
- the JV's operation/production was assumed to occur every day for the 10-year forecast period, with no downtime and maintenance factored in. Also, replacement costs of assets with useful lives less than 10 years[2] were not incorporated; and
- the working capital changes[3] used to compute the recoverable amount of the CGU[4] were excluded in the VIU computation.

<u>Accounting standards requirements:</u>

[1] *Paragraph 55 of SFRS(I) 1-36 Impairment of Assets puts forth factors that companies should consider in determining the discount rate to use.*

[2] *Paragraph 39 and 41 of SFRS(I) 1-36 Impairment of Assets indicates items to be included in estimates of future cash flows.*

[3] *Working capital is a financial measurement which is calculated as the difference between current assets and current liabilities. Changes in working capital is included in VIU computations as a business has to ensure it is able to continue its operations through having sufficient cash flow to satisfy operational expenses.*

[4] *Paragraph 75 of SFRS(I) 1-36 Impairment of Assets states that the "carrying amount of a cash-generating unit shall be determined on a basis consistent with the way the recoverable amount of the cash-generating unit is determined".*

4

Impact from Climate Reporting

Impact from Climate Reporting

ACs should pay attention to the following accounting considerations when preparing their FS:

- impairment of non-financial assets;
- impact on useful lives, residual values, and recoverability of assets;
- contingent liabilities and provision for onerous contracts;
- sustainability-linked loan; and
- disclosures about assumptions & estimates, judgements and going concern assessment.

Impact from Climate Reporting

ACs should engage their statutory auditor on the following auditing considerations arising from climate related-risks:

- risk assessment and response to assessed risk, considering the entity's business model, industry factors and regulatory factors;
- audit evidence, especially for estimates that may be affected by climate-related risks;
- engagement of an auditor's specialist, such as a climate-change specialist, where necessary;
- appropriateness of management's use of the going concern basis of accounting; and
- key audit matters in the independent auditor's report.

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For more details, please refer to ISCA's Technical Bulletin *Addressing Climate-Related Risks in Financial Statements and Audits of such Financial Statements.*

Annex

About ACRA's FRSP

Annex - About ACRA's FRSP

Enforcing directors' duties over financial reporting

ACRA administers the Companies Act that applies to companies incorporated in Singapore. Companies incorporated outside Singapore as well as other investment vehicles such as real estate investment trusts and business trusts do not come under ACRA's purview.

Sections 201(2) and 201(5) of the Companies Act require the directors of a company to present and lay before the company, at its annual general meeting, FS that:

(a) comply with the prescribed accounting standards[1] in Singapore; and

(b) give a true and fair view of the financial position and financial performance of the company.

The directors must fulfil both conditions to discharge their responsibilities under the Companies Act.

Through the FRSP, ACRA ascertains whether selected FS of Singapore-incorporated companies are prepared in compliance with the prescribed accounting standards[1] in Singapore.

Focusing on what matters to investors

The ultimate goal of the FRSP is to ensure that investors are provided with reliable and comparable FS for their decision-making. As such, our review is focused on matters that may significantly impact the key measures used by investors such as revenue, profit, net assets and operating cash flows.

In determining the impact to key measures used by investors, quantitative and qualitative factors are considered. For example, emphasis will typically be placed on how properties are classified by a property-developer company, and how a complex or unusual transaction resulting in a significant gain is accounted for. More questions may be raised on the income statement if a company appears to face significant pressures in showing a trend of increasing earnings, or to build buffer provision amidst a difficult business environment.

[1] Singapore Financial Reporting Standards (International) or Financial Reporting Standards

Annex - About ACRA's FRSP

Review outcome

Reviews under the FRSP are completed with the following regulatory outcomes:

(a) concluded with no enquiry;
(b) concluded with no material NC(s);
(c) concluded with material NC(s) but re-statement was not necessary;
(d) concluded with material NC(s), requiring re-statements of comparatives and/or additional disclosures in subsequent year's FS; or
(e) concluded with significant NC(s), requiring re-statements and re-auditing of past years' FS.

For egregious cases or situations where a company fails to remediate satisfactorily within the prescribed timeline, ACRA will apply the following regulatory sanctions:

(a) issuance of warning letter;
(b) levy of Composition;
(c) prosecution; or
(d) application to Court for an order requiring the directors to re-state the FS under section 202B of the Companies Act.

Compliance with the relevant acts and rules

Failure to comply with sections 201(2) and/or (5) of the Companies Act carries a penalty of up to S$50,000. For offences committed with the intent to defraud, the maximum penalty is S$100,000 and/or imprisonment of up to three years. The law imposes duties equally on all directors, i.e. non-executive directors and nominee directors are equally liable for breach of this duty.

Directors of listed companies should consider the implications from the SGX Listing Rules:

(a) under Rule 703, the directors of a listed company that is required to re-state comparatives in the subsequent year's FS and/or re-state and re-audit the past year's FS, must also consider whether the re-statement constitutes 'material information' in relation to the company and, if so, an announcement should be made; and
(b) under Rule 704(7) and Appendix 7.4.1(k), a director who receives a warning letter from a regulatory authority must announce that fact at his future appointment(s) or reappointment(s) as a director of any company listed on the SGX.