ACRA
ACCOUNTING AND CORPORATE REGULATORY AUTHORITY

BUILDING COMPETENCY
TO RAISE THE BAR ON FINANCIAL REPORTING

Financial Reporting Surveillance Programme
Third Report 2020

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 the 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 July 2020

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

CONTENTS

EXECUTIVE SUMMARY

This report summarises the key findings from the third review cycle of ACRA's FRSP and provides our insights on the quality of financial reporting by companies incorporated in Singapore.

Scope and outcome of reviews

We completed the reviews of 20 FS as of 31 March 2020. They comprised the FS of 19 listed companies and the FS of one non-listed company. The purpose is to ascertain compliance with the prescribed accounting standards in Singapore.

Of the 20 reviews completed, **11 (or 55%) FS were found to contain material NCs**, and were concluded with the following regulatory outcomes:

- **four listed companies restated and had their past years' FS re-audited** (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, the consolidated net cash flows *generated from* operating activities were reversed to cash flows *used in* operating activities, while for another company, the consolidated net cash flows generated from operating activities were adjusted downwards by more than 20%;
- one listed company made additional disclosures in its subsequent 2018 FS, while another listed company restated the comparatives in its subsequent 2019 FS; and
- five listed companies were not required to restate because their material NCs were related to either one-off transactions or transactions that were terminated subsequently.

As of 31 March 2020, seven reviews were ongoing.

Diagram 1 below shows the status of FS reviewed and the number of FS revised for the three review cycles.

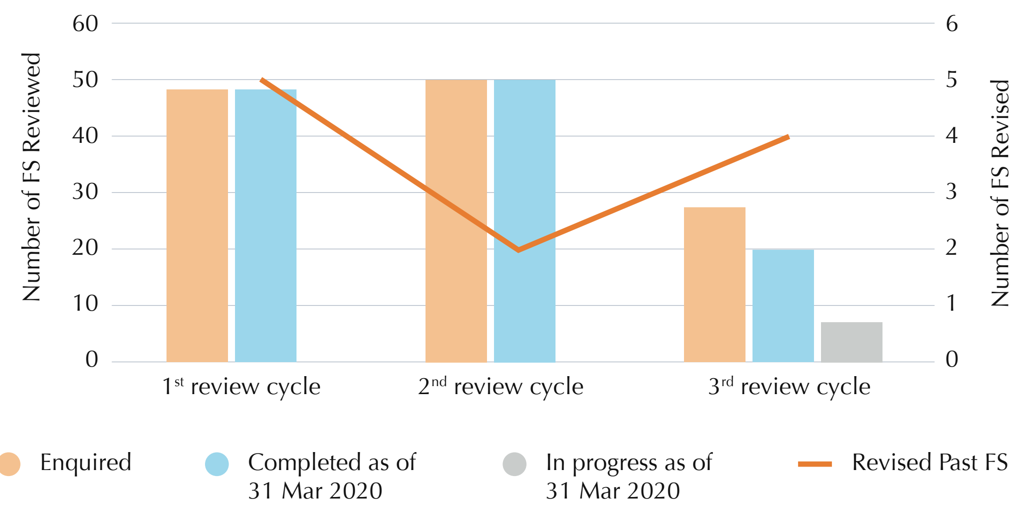


Diagram 1: Number of FS reviewed and FS revised for the three review cycles

Selection of FS for review

The table below summarises how we have selected the 27 FS for review and their review outcomes as of 31 March 2020.

	No. of FS reviewed	Completed as of 31 Mar 2020	Regulatory outcomes for completed reviews
FS selected from our study on FS with modified audit reports	7	5	• Two companies restated and had their past year FS re-audited. • One company made additional disclosure in its subsequent 2018 FS. • One review was concluded with material NC but restatement was not necessary. • One review was concluded with no enquiry.
FS selected from referral cases[1]	4	2	• One review was concluded with material NC but restatement was not necessary. • One review was concluded with no enquiry.
FS proactively selected, all received clean audit opinions	16	13	• Two companies restated and had their past year FS re-audited. • One company restated the comparatives in its subsequent 2019 FS. • Three reviews were concluded with material NCs but restatement was not necessary. • Seven reviews were concluded with either no material NC or no enquiry.
	27	20	

In this cycle, we reviewed seven FS with modified audit opinions that indicated potential material NCs for review. This stemmed from our study on the 2016 FS of Singapore-incorporated listed companies filed with us by 31 December 2017. In this study, we observed that **a majority (534 or 91%) of these listed companies received clean audit opinions on their 2016 FS**, and 15 (or 3%) had clean audit opinions with emphasis of matter due mainly to material uncertainties on going concern assumption. The remaining 35 (or 6%) received qualified audit opinions or disclaimers from their statutory auditors. These 35 FS had not received clean audit opinions for a median of two years (with a maximum of nine years), and had a median of three areas qualified or disclaimed (with a maximum of seven areas). More details are available in Chapter 1.

Similar to the results from our first two review cycles, we observed that FS with clean audit opinions can contain material NC(s). For this review cycle, two companies that received clean audit opinions were found to contain material NCs. Both companies restated their past year FS and had them re-audited as well. We have taken appropriate follow-up steps with their statutory auditors.

The FS proactively selected were based on risk-based criteria including significant public interests and specific transactions or operations which require significant judgements.

[1] Three with clean audit opinions and one with modified audit opinion.

Number of matters enquired and non-compliances

We found a higher average rate of material NCs in this review cycle. With a total of 31 material NCs found, this gives an average of 1.6 material NCs per FS, as compared to 1.3 and 1.0 in the first and second review cycles respectively. Of the 31 material NCs found, one third (11, or 35%) was due to recognition and measurement issues which are elaborated in Diagram 3 below.

The table below shows the nature of material NCs found across three review cycles.

Nature of material NCs	1st review cycle	2nd review cycle	3rd review cycle
Recognition and measurement	**20** (or 31%)	**21** (or 41%)	**11** (or 35%)
Presentation	**12** (or 18%)	**10** (or 20%)	**9** (or 30%)
Disclosure	**33** (or 51%)	**20** (or 39%)	**11** (or 35%)
Total number of material NCs	65	51	31

In this cycle, **seven (or 35%) reviews were concluded with three to six material NCs**, as compared to seven (or 14%) and four (or 8%) in the first and second review cycle respectively. The increase in the percentage can be attributed to the shift in our selection of FS for review. In particular, five (or 25%) FS reviews completed in this cycle received qualified audit opinions or disclaimers, as compared to nil in the first and second review cycles. Diagram 2 below shows the percentage of completed reviews as of 31 Mar 2020, categorised by the number of material NCs across the three review cycles.

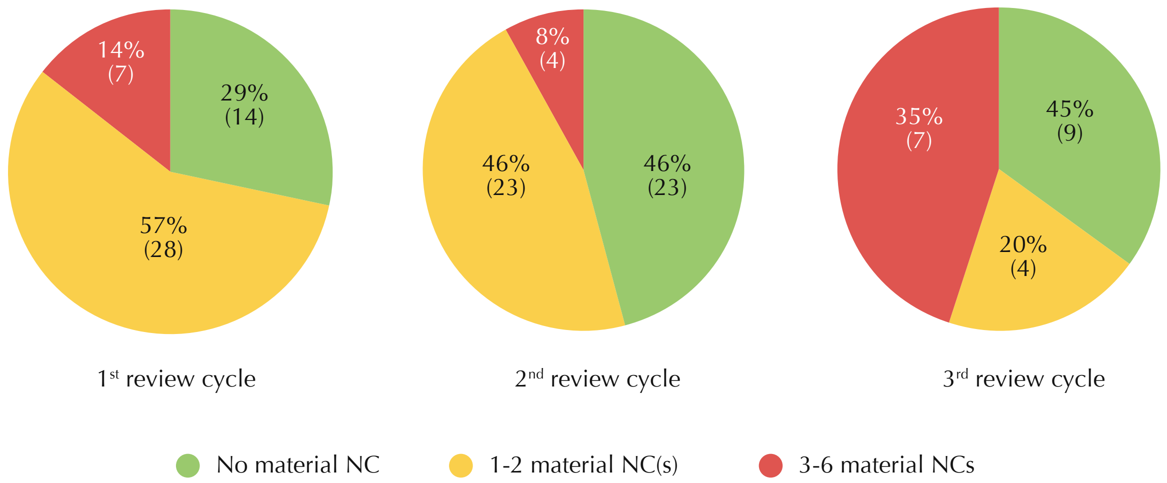


Diagram 2: Number of material NCs found in completed reviews as at 31 Mar 2020

In deciding the regulatory outcomes, we considered the financial effects of material NCs. The seven completed reviews with three to six material NCs were concluded with four revising their past year's FS, two restating comparatives in their subsequent FS and one with no further action required[2].

[2] The company had rectified its disclosures in its next set of FS before our letter stating the final outcome was issued.

Areas enquired and where material NCs were found

We made 45 enquiries on potential material NCs, in particular, in the areas of accounting for major complex transactions (9), and business valuations or impairment assessments (6). More than half (31, or 69%) of the enquiries were concluded with material NCs. These areas were suggested as areas of review focus for directors in the Practice Guidance[3] issued by ACRA to guide directors in their review of 2016 and 2017 FS.

Diagram 3 below shows the number of enquiries and material NCs by the accounting areas.

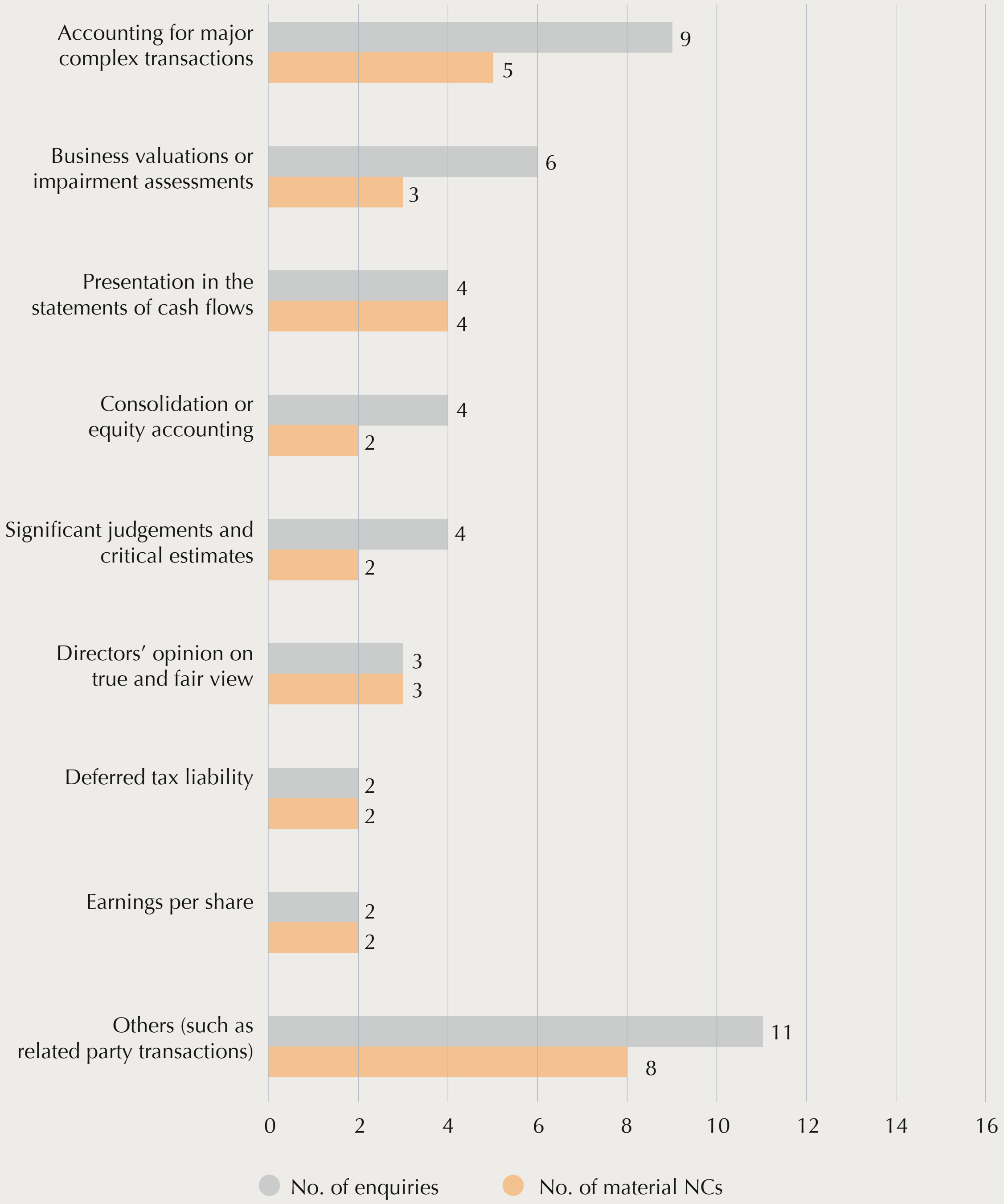


Diagram 3: Analysis of areas enquired, and with material NCs

[3] Please refer to Appendix B - Financial Reporting Resources for Directors.

Root causes of material NCs

We found material NCs in 11 completed reviews. Based on our correspondences and meetings with the directors and other company representatives, we attributed the root causes of the material NCs to:

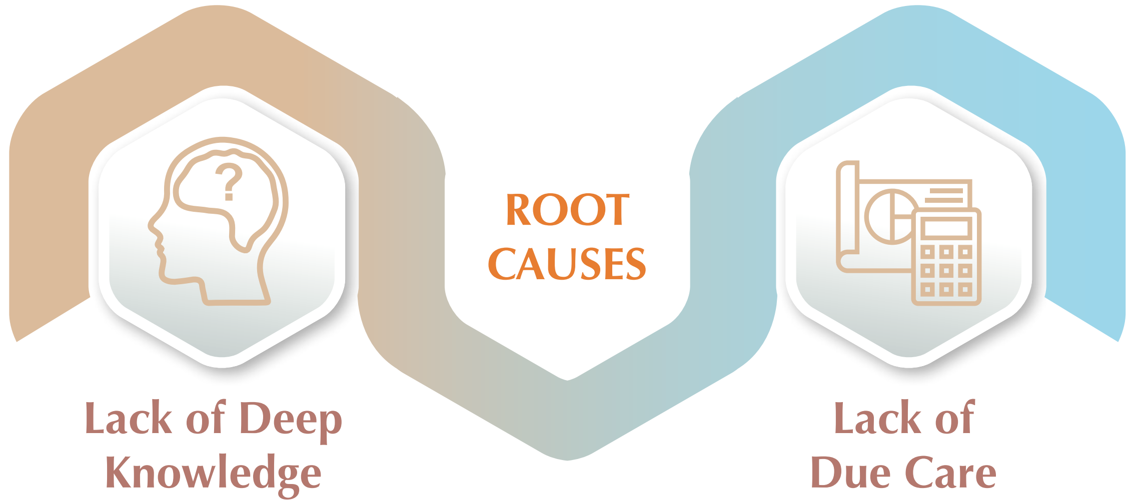


Diagram 4: Root causes of material NCs

A Lack of Deep Knowledge

The accounting standards in Singapore are principles based and can be complex. A lack of deep knowledge among the finance teams, Chief Financial Officer (CFO) or Audit Committee (AC) member may lead 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.

We illustrated six case studies under Chapter 2. In Case Studies K2 and K3, 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 Case Study K4, 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.

Of the six companies that had either revised past FS, added disclosure or restated comparatives in subsequent year FS, 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.

Case Study K1
Not performing impairment assessment

Case Study K2
Modified directors' statement

Case Study K3
Dealing with uncertainties

Case Study K4
Valuing a complex instrument

Case Study K5
Evaluating accounting policies

Case Study K6
Reflecting substance of a transaction

A Lack of Due Care

Case Study D1
Recurring non-compliance highlighted by auditor

Case Study D2
Glaring error in cash flow statement

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

We illustrated two case studies, in which directors and/or management had failed to act upon and/or pick up the material NCs, in Chapter 3.

In Case Study D1, 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 Case Study D2, the directors failed to pick up the red flag, where the consolidated cash *generated* from operating activities in the cash flow statement was shown as more than twice the amount of the consolidated profit before tax. The Group should have reported cash *outflow* from operating activities instead.

Collaborations with other government agency and professional body

Based on filings with ACRA as of 31 March 2020, 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. For 2018 FS, they included 16 companies that did not receive clean audit opinions for the first time and 12 companies that received qualified audit opinions or disclaimers for four consecutive financial years or more. Five companies had five or more areas qualified or disclaimed for 2018 FS. This trend is not healthy, although there were some companies that succeeded in receiving clean audit opinions subsequently, as elaborated in Chapter 1.

We will continue to strengthen our capability to take enforcement actions against those who did not exercise due care or deliberately not comply. To this end, ACRA and the Monetary Authority of Singapore have set up a joint forum in late 2019, to better monitor and review accounting and disclosure lapses.

Due to weaknesses we observed in the area of business valuations and impairment assessments, ACRA will continue to collaborate with and tap on the technical expertise of the Institute of Valuers and Appraisers, Singapore, for complex valuation issues identified during our FS reviews under the FRSP.

Building competency to raise the bar on financial reporting

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 the Board 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.

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 the 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. Together, we will uphold a trusted financial reporting community in which businesses can survive and thrive.

1 STUDY ON FINANCIAL STATEMENTS WITH MODIFIED AUDIT REPORTS

Annual financial statements (FS) seek to provide comparable and reliable information about the results of operations, financial position, and cash flows of a company. As the financial information is used by various stakeholders to make decisions such as whether to invest in, extend credits to and/or enter into contracts, the FS must be prepared in accordance with the prescribed accounting standards in Singapore.

If a set of FS receives qualified audit opinions or disclaimers from the statutory auditors (also referred to as modified audit reports), the company shareholders will not have access to comparable and reliable financial information. If there are many FS that receive modified audit reports in Singapore, this will undermine the credibility of our financial reporting eco-system in the longer run.

KEY OBSERVATIONS ON 2016 FS FILED BY 31 DECEMBER 2017

We have analysed the 2016 FS of Singapore-incorporated listed companies that were filed with us by 31 December 2017. Here are our key observations:

- **534 companies (or 91%) received clean audit opinions** on their 2016 FS from their statutory auditors. This is a good sign as it means most shareholders had access to reliable financial information;
- **15 companies (or 3%) received clean audit opinions with emphasis of matter** on their 2016 FS, due mainly to material uncertainties on going concern assumption; and
- **35 companies (or 6%) did not receive clean audit opinions** on their 2016 FS from the statutory auditors. Of this, 12 received qualified[1] audit opinions while 23 companies received disclaimers[2]. There was no adverse audit opinion received.

[1] An auditor will issue **qualified audit opinion** when the auditor is unable to conduct the audit properly or when there is a disagreement with management in circumstances such as the application of accounting standards. The issue(s) must also be material but not pervasive to misrepresent the financial performance and financial position.

[2] If the issue(s) is/are both material and pervasive, the auditor will issue a **disclaimer of opinion** or adverse opinion, depending on whether there is a limitation of scope in the auditors' work.

35 listed companies that did not receive clean audit opinions for 2016 FS

We further analysed the 35 listed companies that received qualified audit opinions or disclaimers on their 2016 FS. We observed that:

- these companies had not received clean audit opinions for **a median of two years**, with the maximum of nine years.

  Six companies had not received clean audit opinions for six or more years, of which two were reviewed in this cycle. Both reviews concluded with the companies having to revise their past year(s)' FS.

  We did not select the remaining four companies for review because they were either in the process of ceasing their operations, or the areas qualified or disclaimed comprised only auditing issues;

- these companies had **a median of three areas** qualified or disclaimed in their 2016 FS, with the maximum of seven areas.

  Seven companies had five or more areas qualified or disclaimed, of which two were reviewed in this cycle. Both companies had also not received clean audit opinions for six or more years, as mentioned above.

  The remaining five companies had not received clean audit opinions for one to three years. As the areas qualified or disclaimed in their 2016 FS did not indicate potential material NC with accounting standards, they were not prioritised for review;

- 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%). Diagram 5 below shows the analysis of areas being qualified or disclaimed; and

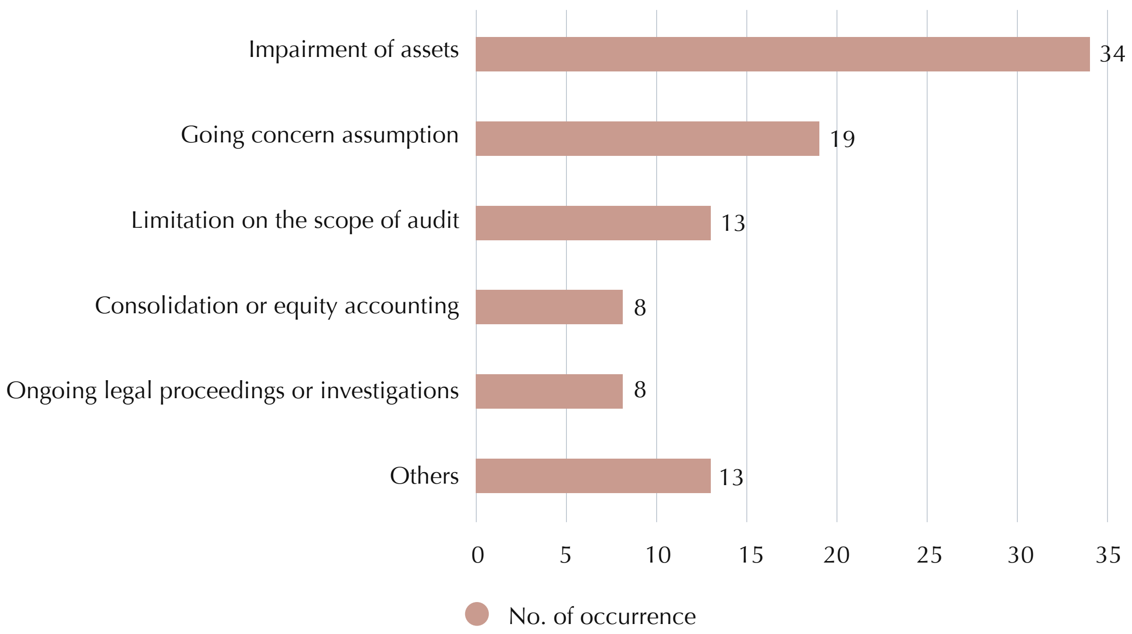


Diagram 5: Areas subject to qualified audit opinions or disclaimers in 2016

- in addition to the two FS mentioned above, three other FS were reviewed. They comprised the FS of one company whose directors' statement contradicted with their duties under the Companies Act and the FS from two companies that indicated potential material NCs with accounting standards. These three companies had not received clean audit opinions for a median of two years and had a median of three areas qualified or disclaimed by their statutory auditors. The three reviews were concluded with one company making additional disclosure in its subsequent 2018 FS, one FS was found to contain material NC but no restatement was necessary and another closed with no enquiry.

FS with qualified audit opinions or disclaimers for 2017 and 2018

Based on filings with ACRA as of 31 March 2020, the proportion of Singapore-incorporated listed companies that received qualified audit opinions or disclaimers increased from 35 (or 6%) for 2016 FS to 51 (or 9%) for 2018 FS, as shown in Diagram 6 below.

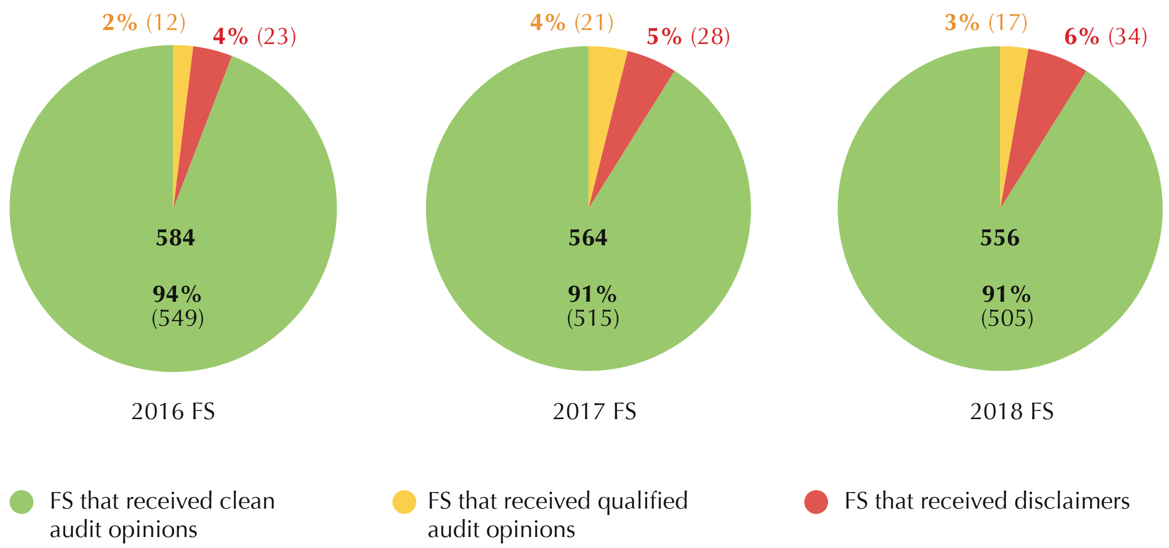


Diagram 6: Analysis of FS with clean and modified audit reports

- for the 2017 FS, 23 companies did not receive clean audit opinions for the first time. Of this, 19 companies had one to two areas qualified or disclaimed by their auditors, while four companies had three or more areas disclaimed. Three companies subsequently received clean audit opinions on their 2018 FS, of which both 2017 and 2018 audit opinions were issued by the same audit firms. The areas commonly qualified or disclaimed were going concern assumption, limitation in audit scope (e.g. access to audit work papers of component auditors and outgoing auditors), ongoing legal proceedings or investigations, and impairment of assets; and

- for the 2018 FS, 16 companies did not receive clean audit opinions for the first time. Of this, 13 companies had one to two areas qualified or disclaimed by their auditors, while three companies had three to four issues disclaimed. The areas commonly disclaimed were going concern assumption and impairment of assets.

We also noted that some companies were making efforts to receive clean audit opinions subsequently and were successful in doing so:

- **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 this, six companies were audited by the same audit firms across three financial years, and two were reviewed by us. They comprised companies that received disclaimers (3) or qualified audit opinions (4) on 2016 FS, for a period ranging between one and three years. Each had between one and three areas qualified or disclaimed in their 2016 FS;

- **seven companies that did not receive clean audit opinions on their 2017 FS subsequently received clean audit opinions on their 2018 FS.** Of this, five companies were audited by the same audit firms in both financial years. They comprised companies that received disclaimer (1) or qualified audit opinions (6) on 2017 FS. Three did not receive clean audit opinions for five or more years as of 31 Dec 2017, of which only one indicated potential material NC(s) with accounting standards and was prioritised for review. The remaining four companies did not receive clean audit opinions for a period ranging from one to three years as of 31 December 2017. All seven had a maximum of two areas qualified or disclaimed by the auditors;

- **the number of companies that did not receive clean audit opinions for four or more years have declined from 13 companies for 2017 FS to 12 companies for 2018 FS.** The decline was due to companies subsequently receiving clean audit opinions on their 2018 FS from the same audit firms. Diagram 7 below shows the volume of companies that received consecutive qualified audit opinions or disclaimers; and

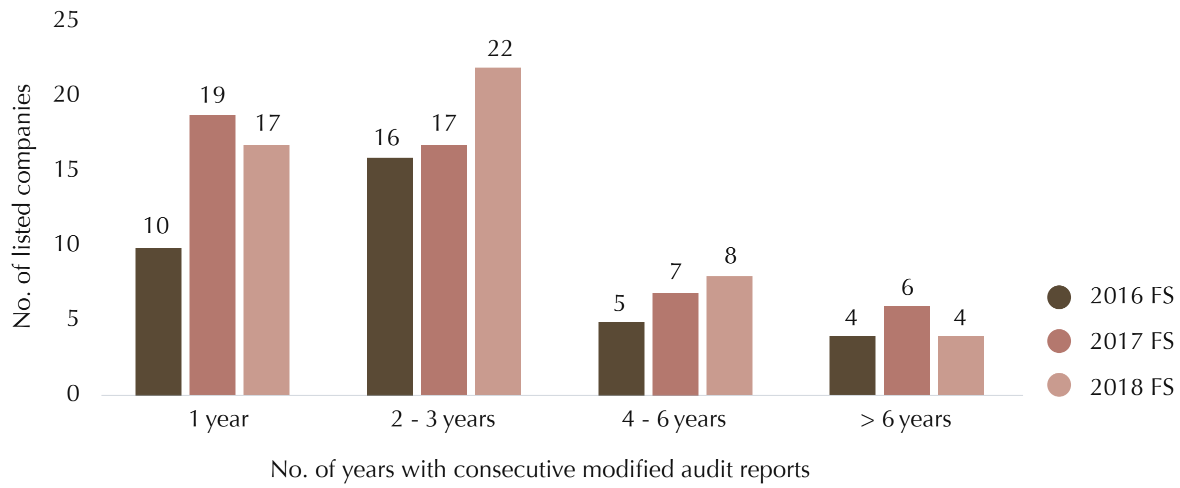


Diagram 7: Analysis of listed companies with consecutive modified audit reports

- the number of companies with five or more areas qualified or disclaimed had declined from seven for 2016 FS and 2017 FS to five for 2018 FS, as shown in Diagram 8 below. Had subjective areas such as going concern assumption and uncertainties from ongoing legal proceedings been excluded, the median of areas qualified or disclaimed per FS would reduce from two for 2016 FS to one for 2018 FS.

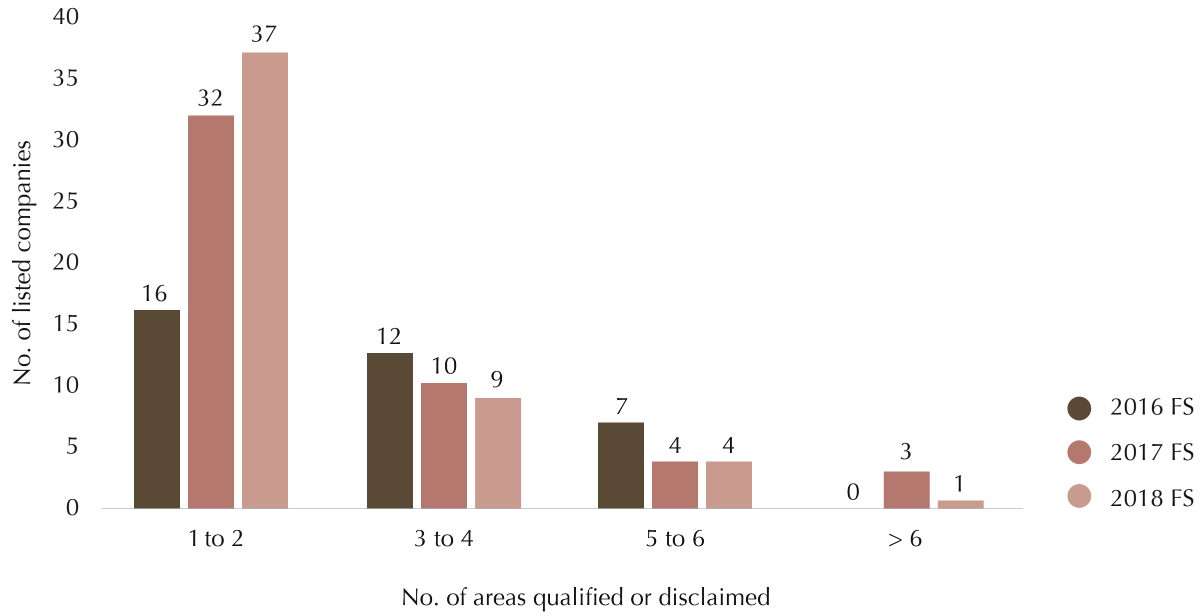


Diagram 8: Analysis of areas qualified or disclaimed

Collective responsibility

A climate of economic uncertainty presents an opportunity for companies to assure investors that their fundamentals remain strong and risks are adequately reflected and/or disclosed in the FS. The AC can help by ensuring that the FS give a true and fair view, and provide transparent and timely disclosures. All stakeholders in our financial reporting ecosystem play an important part to uphold and improve the quality of financial reporting in Singapore. Together, we can make Singapore a trusted and vibrant place for businesses to grow and flourish.

2 CASE STUDIES INDICATING A LACK OF DEEP KNOWLEDGE

Directors must robustly challenge management's rationale for not performing impairment assessment when there is indication of impairment

An asset should not be booked at a carrying amount that exceeds the value that can be recovered from the asset. When there is an objective evidence or indication that an asset may be impaired, an impairment assessment must be performed by computing the asset's recoverable amount. If the asset's recoverable amount falls below its carrying amount, an impairment loss must be recognised.

In Case Study K1, the statutory auditor had issued a disclaimer of audit opinion, highlighting that there was objective evidence of impairment but management failed to compute the asset's recoverable amount.

Directors should have resolved the disagreement between management and auditors, avoiding the issuance of the disclaimer. By failing to act timely, the Group reported consolidated pre-tax loss that was understated by close to eight times, and consolidated net asset that was overstated by close to 60%. As a result, shareholders and other investors did not have access to reliable financial information in this case.

Case Study K1

Background

The Group owned a 55%-equity interest in a joint venture (JV). The carrying amount of the JV accounted for more than 50% of the consolidated total assets as of 31 March 2017.

The statutory auditor had issued a disclaimer on the Group's FS for the financial year ended (FYE) 31 March 2017 (FY2017, reviewed by ACRA). One matter included in the disclaimer was as follows:

"Management has not carried out a review of the recoverable amount of its joint venture… as management is of the view that there is no indication of impairment. Accordingly, we are unable to obtain sufficient appropriate audit evidence to determine whether the recoverable amounts of the joint venture have reduced or have exceeded their carrying amounts as at 31 March 2017. Consequently, we are unable to determine whether any further impairment or reversal of impairment as at 31 March 2017 is required."

Red Flags

Using the list of objective evidence of impairment in FRS 39 *Financial Instruments: Recognition and Measurement*, ACRA observed that:

- the JV had incurred operating losses for JV's FYEs from 31 December 2012 to 31 December 2017, except for FYE 31 December 2015;
- the JV was in a net current liability position since 31 December 2015, which grew by more than 50% to $11 million at 31 December 2016;
- the JV had a total deficit in equity that increased 4.5 times to $9 million at 31 December 2016; and
- the market capitalisation of the Group as of 31 March 2017 was close to 60% below its reported net assets as of 31 March 2017, and this JV was the Group's main asset.

This led ACRA to enquire into the directors' basis for accepting management's treatment of not computing the recoverable amount of the investment.

Directors' Explanations

The directors explained that:

- the Group's former JV partner (that owned the remaining 45% interest of the JV) had sold its shares in the FYE 31 March 2016 (FY2016). The directors expected to sell its shares in the JV at the same price per share. Therefore, the directors recognised a reversal of impairment loss in FY2016 and retained that carrying amount without adjustment in FY2017; and
- while the JV continued to incur losses, it reported revenue growth in its FYE 31 December 2016. Therefore, directors accepted management's basis for not computing the recoverable amount.

ACRA's Analysis and Conclusion

We are unable to accept directors' explanations because:

- there was clear objective evidence of impairment as of 31 March 2017. While the JV's revenue rose by 40% to $10 million in FYE 31 December 2016, its pre-tax loss remained high at around $7 million in the same year; and
- it would not be appropriate to use the selling price in FY2016 by the JV partner, given the JV's consecutive losses. Furthermore, the directors had not found a buyer despite searching for one since FY2014.

Following the completion of our review, the directors wrote down the investment value to 5% of the reported carrying amount as of 31 March 2017. By failing to act timely, the Group reported pre-tax loss that was understated by close to eight times for FY2017, and net asset that was overstated by close to 60% at 31 March 2017.

Tips for Directors

Read the draft auditor's report and take immediate action on material NCs before authorising the FS for issue.

Be careful when using long-past transaction price in assessing the current value of an asset. Assess if the transaction price remains realistic, considering factors such as the asset's recent financial performance, market sentiments and where applicable, failed attempts to sell.

Directors must not add disclaimer in its statement for areas disclaimed by the statutory auditors

Financial statements belong to companies. When the statutory auditors conclude that there are material misstatements in the FS or that there is insufficient evidence to base their opinion on, they will escalate their concerns to the AC. If the concerns are not addressed, the statutory auditors will issue modified audit reports.

On the other hand, directors are responsible for overseeing the Group's financial reporting process and for presenting FS that comply with the prescribed accounting standards at annual general meetings.

Section 157A of the Companies Act also provides that the business of a company shall be managed by, or under the direction or supervision of, the directors. This empowers directors to take action to resolve any disagreement between management and the statutory auditors.

In Case Study K2, directors had failed to work with management to deliver FS that comply with the prescribed accounting standards in Singapore. The statutory auditors issued a disclaimer of opinion on that FS. It was not appropriate for directors to follow suit, stating in their statement that the FS gave a true and fair view 'subject to' the matters highlighted in the disclaimer of opinion. By doing so, directors breached section 201(16) and the Twelfth Schedule of the Companies Act.

Case Study K2

Background

The statutory auditor had issued a disclaimer on the consolidated FS for the financial year ended 31 March 2017 (FY2017, reviewed by ACRA) due to various accounting matters, including a material NC highlighted in Case Study K1.

The directors also issued the following statement accompanying that FS:

"In the opinion of the Directors,
(i) <u>subject to the matters highlighted in the Independent Auditors' Report</u>, the accompanying consolidated financial statements of the Group and the statement of financial position and statement of changes in equity of the Company together with the notes thereto are drawn up so as to give a true and fair view of the financial position of the Group and of the Company as at 31 March 2017 and of the financial performance, changes in equity and cash flows of the Group and changes in equity of the Company for the financial year then ended."

Red Flags

By inserting "*subject* to the matters highlighted in the Independent Auditors' Report", directors would breach section 201(16) and the Twelfth Schedule of the Companies Act. This is because directors had not opined whether the consolidated FS are drawn up so as to give a true and fair view of the financial position and performance of the Group.

Directors' Explanation

The directors explained that in their opinion, the consolidated FS gave a true and fair view of the financial position and performance of the Group. This was achieved through the review by the Audit Committee before sending to the Board for approval, and through the assurance given by the CEO and the CFO to the Board.

In view that the statutory auditor had issued a disclaimer of audit opinion, the directors referred to the disclaimer in their opinion for completeness. Directors acknowledged their mistake.

ACRA's Analysis and Conclusion

As explained in Case Study K1, due to the NC, the Group reported pre-tax loss that was understated by close to eight times for FY2017, and net asset that was overstated by close to 60% at 31 March 2017. As a result, directors had breached section 201(5) of the Companies Act for not presenting FS that comply with the prescribed accounting standards at annual general meetings, in addition to the breach under section 201(16) and the Twelfth Schedule of the Companies Act.

Whenever statutory auditors issue qualified audit opinions, adverse audit opinions or disclaimers of opinion, directors (whether part of AC or not) must form a view whether they agree with the statutory auditor's or management's position. If directors agree with the statutory auditor's position, directors should direct (and ensure) management put through the necessary audit adjustments. By not putting through the proposed audit adjustments, the management's position will be taken as directors' position.

Tips for Directors

Resolve any accounting issue(s) or disagreement(s) between the management and the statutory auditors. By not resolving the issue(s) and/or disagreement(s), directors may be authorising FS that do not comply with the accounting standards.

Set up and maintain a finance team with deep accounting knowledge and experience. The team will prepare FS that comply with the prescribed accounting standards from the onset, avoiding the need for directors to resolve accounting issues at the last minute.

Directors must not shy away from making the best estimates when dealing with uncertainties at the point of authorising the FS

Dealing with uncertainties such as legal proceedings and disputes is an unavoidable part of doing business. Quite often, directors are unable to **accurately** predict the outcomes at the point of authorising the FS for issue.

The prescribed accounting standards in Singapore do not expect directors to predict the exact outcomes. Instead, the accounting standards provide for directors to make reasonable estimates using the latest, reliable information, and provide adequate disclosure in the FS. By doing so, shareholders are informed of the directors' best estimates and factors considered when making those estimates.

In Case Study K3, a material subsidiary of the Group had a dispute with its major customer. The customer filed a counter-claim for an amount that was more than twice of the consolidated net assets, which was disclosed as contingent liabilities in the consolidated FS. The material subsidiary, which also contributed to 46% of the consolidated net assets, was placed under judicial management.

It was not appropriate for directors to state that they 'were unable to express a view' in their statement accompanying that FS. Given the material financial effects, directors ought to also make the disclosures required by the accounting standards relating to the restrictions placed on the material subsidiary, and the amount of contingent liabilities, in the FS. This information was not confidential, given it was disclosed either in company announcements and/or court documents during the financial year.

Case Study K3

Background

The Group had a wholly owned subsidiary, S. S was in the construction business.

In 2016, S went into dispute with its major customer over specification and scope of the contract. In 2017, the Group ***announced*** the amount of counter-claim filed for arbitration by the major customer. In the consolidated FS for the financial year ended 31 Dec 2017 (FY2017, reviewed by ACRA), directors had ***disclosed*** about the legal proceedings, but not the amount of counter-claim.

During FY2017, S was also placed under judicial management. As of 31 December 2017, S' contribution was more than 30% of the consolidated total assets, more than 20% of the consolidated total liabilities and more than 40% of the consolidated net assets.

The directors stated the following in their statement for FY2017 FS:

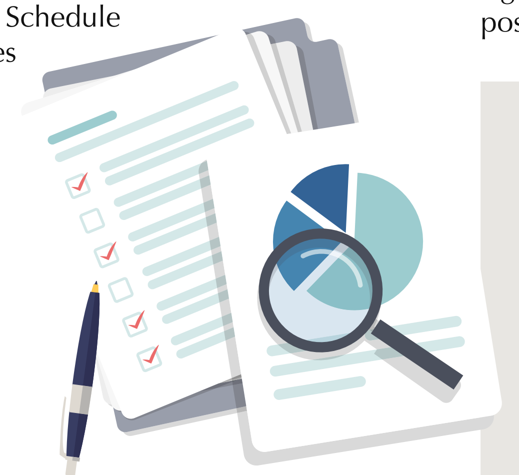
"except for the matters in Note 2, the consolidated financial statements of the Group and the statement of financial position and statement of changes in equity of the Company are drawn up so as to give a true and fair view of the financial position of the Group and of the Company as at 31 December 2017 and the financial performance, changes in equity and cash flows of the Group and changes in equity of the Company for the year ended on that date…"

Red Flags

The amount of counter-claim by S' major customer was more than twice of the consolidated net assets as of 31 December 2017. Paragraph 86 of FRS 37 *Provisions, Contingent Liabilities and Contingent Assets*, and paragraph 45 of FRS 11 *Construction Contracts* require the amount of contingent liability to be disclosed.

With S being placed under judicial management, the Group also faced significant restrictions on its ability to access or use S' assets, but did not disclose about the restrictions. The Group also did not disclose the carrying amount of assets and liabilities to which the restrictions applied, as required by paragraph 13(c) of FRS 112 *Disclosure of Interests in Other Entities*.

By inserting "except for the matters in Note 2…", directors would also breach sections 201(5), 201(16) and the Twelfth Schedule of the Companies Act, for the same reasons explained in Case Study K2.



Directors' Explanation

The directors explained that at the height of the dispute, they had to deal with non-disclosure clause and various confidentiality rules. They were legally advised to refrain from publishing matters relating to the arbitration and hence, did not disclose the amount of counter-claim. Directors hoped that shareholders would follow the disclosures of the case through company announcements.

The directors also explained that the transaction was accounted based on their best judgement using the information available at that time. They had modified the opinion in their statement, given the uncertainty and variability in the possible outcomes of the dispute.

ACRA's Analysis and Conclusion

We were unable to accept the directors' views that the amount of counter-claim was confidential. The directors had announced the amount of the counter-claim during the financial year. The amount of the counter-claim was also available in court documents, that were publicly available.

FS must contain all necessary information to be read on its own. Information that was publicly disclosed should be included in the FS, where such disclosure is required by the accounting standards.

Given that the amount of the counter-claim was twice of the consolidated net assets, and S' assets accounted for more than 40% of the consolidated net assets, directors should make the necessary disclosures in the FS. This will give a complete picture of the financial effect of the contingent liability and assets subject to significant restrictions in the consolidated financial position.

Tips for Directors

Work with management early to gather the information necessary to make the best estimate. Avoid waiting until the Board and/or Audit Committee meetings to authorise FS for issue to discuss this.

If directors have made the best estimates using the latest, reliable information, and disclosed adequately in the FS, directors should be in the position to state whether the FS give a true and fair view.

Update the subsequent event disclosures if there are changes in the circumstances and/or new or more information obtained after the financial year end.

Directors should engage a professional valuer when there is no adequate in-house valuation expertise and the item is material

From 1 January 2018, the prescribed accounting standards in Singapore generally require more financial instruments such as unquoted equity investments to be carried at fair value.

The valuation of unquoted equity investments can be complex, particularly when they come with conversion option, redemption feature and/or stepped up dividends that will vary further depending on the occurrence of certain events. The different possible outcomes for investment returns must be factored in when valuing such investments.

In Case Study K4, the directors had incorrectly used the Black Scholes Model to value the conversion option with variable exercise dates and variable cumulative dividend rates that were contingent upon the occurrence of a material transaction by 31 December 2017.

The directors had also inappropriately valued the unlisted preference shares (without the conversion option) by reference to the price of listed preference shares issued by the same issuer, without adjusting for the absence of liquidity and the existence of step-up dividends.

Since March 2018, ACRA collaborates with the Institute of Valuers and Appraisers, Singapore (IVAS) established under the Singapore Accountancy Commission when dealing with complex material valuation issues encountered during the review of FS. Directors are encouraged to engage professional valuers accredited by IVAS to help them with the valuation of complex financial instruments, when their carrying amounts are material and/or will result in significant variability in the consolidated profit or loss.

Case Study K4

Background

The Group subscribed to ***unlisted*** preferred shares (PS) for $200 million in May 2016. The Group designated the PS to be accounted for at fair value through profit or loss.

The PS had the following features:

- if a material transaction under the control of the issuer occurred by 31 December 2017,
  - the Group would receive cumulative dividends of 7% per annum in the initial five years from the issue date, with a step-up to 8% to 10% per annum from Year 6 onwards (Step-up Dividends). Otherwise, the Group would receive cumulative dividends of 7% per annum up to 31 December 2017, and 10% per annum from 1 January 2018;
  - the issuer could opt to redeem the PS on or after 17 May 2021. Otherwise, the issuer could redeem the PS from 1 January 2018 (Redemption Feature); and
- the Group could exercise the option to convert the PS to ordinary shares of the issuer at any time after 27 June 2016. There was no expiration date on this option, and the exercise price was $25 of the (nominal) principal amount of PS per listed ordinary share of the issuer (Conversion Option).

In the consolidated FS for the financial year ended 31 December 2016 (FY2016, reviewed by ACRA), the directors wrote down the fair value of the investments by 30%, reducing the consolidated FY2016 pre-tax profit by 10%.

Red Flags

Based on commercial reality, given that the Step-up Dividends were above the market rates (based on the listed PS that the same issuer had issued), it would appear that the issuer was more likely than not to redeem the PS. If so, there was a good chance that the Group could recover the carrying amount of the investments (both principal and cumulative dividends). This was not aligned with the Group recording a 30%-decrease in the value within seven months from subscription.

Directors' Explanation

Directors explained that the 30% decrease recorded in FY2016 was supported by an in-house valuation using the following approaches:

- the Conversion Option was valued using the Black-Scholes model: As the share price of the issuer's ordinary share had decreased, this reduced the fair value of the Conversion Option. This contributed to a 10%-decrease (absolute).
- the *unlisted* PS (excluding Conversion Option) was valued by reference to the *listed* PS issued by the same issuer, which had no conversion option. Unlike the *unlisted* PS, the *listed* PS had no step-up dividends. As the price of that *listed* PS decreased by 20% seven months from subscribing to the *unlisted* PS, the Group applied the same 20%-decrease to the *unlisted* PS.

ACRA's Analysis and Conclusion

The directors should not have accepted the Black Scholes Model to value the Conversion Option because the model:

- was suitable for valuing option with a fixed exercise date. In this case, the Conversion Option had variable exercise dates; and
- was not be able to take into account the different possible outcomes to derive investment returns, arising from the interplay between the Conversion Option and the Redemption Feature coupled with the occurrence of the material transaction that is not under the control of the Group.

The directors should not have accepted the approach to value the PS (excluding Conversion Option) that failed to consider the following characteristics market participants would ordinarily consider when computing its fair value:

- the possibility of the issuer exercising the Redemption Feature leading to the Group recovering the subscription price of $200 million in full. In the event that the Group did not exercise the Conversion Option, redemption was one possible exit scenario and must be factored in; and
- the differences in the terms and features of the *unlisted* PS as compared to those of the *listed* PS issued by the same issuer such as the absence of liquidity (due to unlisted status) and Step-up Dividends. These adjustments must be factored in.

Tips for Directors

Assess whether the finance team is able to handle the complexity of the valuation. If there is a gap, directors should engage professional valuers accredited by the IVAS to complement in-house expertise.

Take a step back and assess if the valuation results are consistent with the understanding of the item being valued. Critically assess the assumptions and consider whether adjustment is made for the difference(s) in terms and conditions.

Directors must not apply an accounting policy that is not supportable by contractual rights and historical experience

Accounting policies are specific principles and procedures developed by management and used by finance team to prepare the FS in a consistent manner.

Accounting policies may differ from one company to another, but overall, they must conform with the requirements in the prescribed accounting standards in Singapore. Accounting policies must also be supportable in light of the company's experience.

In Case Study K5, the directors applied an accounting policy that deferred the recognition of forfeited customer advance as income for a minimum period of two years. The deferment was deemed necessary to take into account the likelihood of the customer initiating legal action. This was despite the fact that the Group had the contractual right to retain the forfeited advances and there was no actual case to date in which a refund was made.

Recognising forfeited advances as income in the year of cancellation, rather than two or more years later, is important to faithfully represent the consolidated financial performance across the financial years. It will also enable more meaningful comparison of financial performance across companies in the same industry.

Case Study K5

Background

The Group was in the business of constructing large equipment for its customers. The Group recognised revenue using the percentage of completion method, and collected 10% of the contract price in advance before starting construction.

In the consolidated FS for the financial year ended 31 December 2016 (FY2016, reviewed by ACRA), the Group recognised forfeited customer advances of $100 million as other income, which contributed 24% of the consolidated pre-tax profit.

Red Flags

In FY2016, the industry in which the Group was operating suffered a downturn. The Group's competitors were recording losses from cancellations during the financial year. The Group recognised a write-down of $60 million on the value of large equipment under construction, but its forfeiture income of $100 million exceeded such write-down.

Directors' Explanation

The directors explained that:

- of the $100 million forfeited advances recognised as other income in FY2016, $85 million pertained to contract cancellation from customers that defaulted payments in FY2015 and before. Only $15 million pertained to customer defaults in FY2016; and
- forfeited advances were not recognised as other income in the year of cancellation in view that the defaulted customer can initiate legal action or arbitration for a period of six years after contract cancellation. A full blown arbitration may also take around two years or more to conclude, depending on the complexity of the case.

Taking into consideration the likelihood of negotiation and arbitration, the directors applied the following policy to account for forfeited advance:

- if both parties agreed to transfer the forfeited advance to another contract or the Group agreed to refund the forfeited advance, the Group would reverse the liability when the transfer or refund was made;
- for other cases:
  - if the defaulted customer did not initiate any legal action or arbitration, the Group would reverse the liability (and recognise the forfeited advance as income):
    - **two years after the expiration of the refund guarantee**; or
    - **two years after the delivery of equipment to a new customer**, if the equipment under construction was subsequently sold to another customer, whichever is later; and
  - if the defaulted customer initiated legal action or arbitration, the Group would maintain the liability (and not recognise the forfeited advance as income) **until the case was resolved**.

ACRA's Analysis and Conclusion

The policy of recognising forfeited advances as income did not comply with paragraph 7 of FRS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Following the customers' default in payments, the Group no longer had any obligation to refund the forfeited advances given the following clauses in the contract:

- in the event of customer's payment default, the Group was contractually entitled to cancel the contract; and
- in such a cancellation, the Group had a contractual right to retain all payments received.

Using the Group's accounting policy, there could be a time lapse of four years between the contract cancellation and recognition of forfeiture income. In one actual case, the Group recognised forfeited advance as income in FY2016, when the default occurred in FY2012. The Group took two years to construct and deliver the equipment to the new customer (not related to the defaulted customer). The Group took further two years after that delivery before recognising the forfeiture advances as income. The contract entered with the new customer was separate from the original contract with the defaulted customer; and should not form an appropriate basis to delay in recognising the forfeited advances as income.

In addition, the Group's accounting policy was inconsistent with the Group's historical experience. In particular, there was no actual case in which the Group refunded the advances to defaulted customers. If so, the policy to maintain a full provision for all cases, including those that the customer did not initiate any arbitration, for a minimum period of two years would not be supportable.

On the date of cancellation, the Group should separately assess whether a provision for claim should be recognised. The consideration should be based on whether an outflow of resources is probable (beyond the likelihood of arbitration).

Tips for Directors

Check for one-off gain or loss that is material to the consolidated pre-tax profit or loss, and review its accounting treatment robustly.

If customer cancellations are few and the circumstances of one case can vary significantly from another case, it may be more practicable to assess their accounting on a case by case basis, rather than to apply a blanket policy.

Directors must identify accounting acquirer based on substance of the transaction

Reverse takeover (RTO) transactions are commonly used as a means for a private company (PrivateCo) to obtain a stock exchange listing status without going through an initial public offering process.

In a RTO, the PrivateCo would typically arrange to have itself 'acquired' by a smaller listed company (ListCo) through an exchange of equity interests. As part of the agreement, the directors of ListCo would be replaced by directors appointed by the PrivateCo.

Under such circumstances, PrivateCo, who is the legal subsidiary, would have the power to govern the financial and operating policies of the combined entity so as to obtain benefits from its activities. According to the prescribed accounting standards in Singapore, treating the legal parent (i.e. ListCo) as the accounting acquirer in such circumstances would place the form of the transaction over its substance.

In Case Study K6, the directors had incorrectly identified the ListCo as the accounting acquirer, rather than the PrivateCo. As a result, the assets of the PrivateCo were incorrectly recorded at fair values on the balance sheet, which overstated ListCo's post-RTO net asset value by approximately $500 million or 13%.

Case Study K6

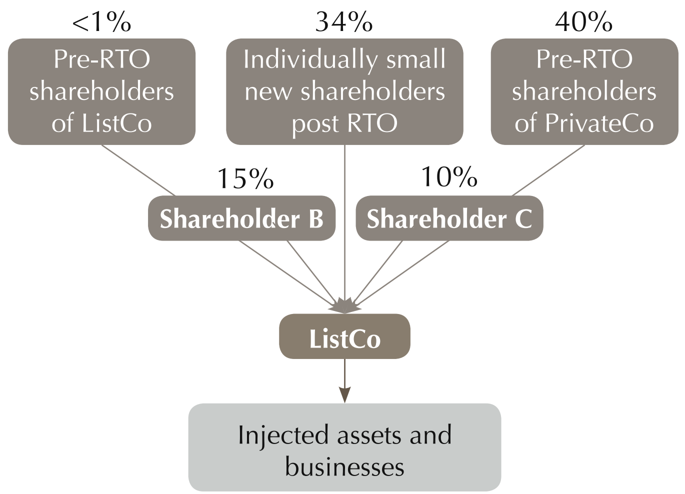
Background

The PrivateCo undertook an RTO involving multiple parties, as illustrated in Figure 1 below. The objective of the RTO was to transform the PrivateCo into an integrated real estate owner, developer and manager. On the same day, the pre-existing businesses of the ListCo were distributed to the pre-RTO shareholders of the ListCo.

Red Flags

After the RTO, we observed that:

- the pre-RTO shareholders of the PrivateCo held the largest minority voting interests (40%) of the post-RTO ListCo. In contrast, the pre-RTO shareholders of ListCo owned less than 1% voting interests;



- most directors and management of the PrivateCo became the directors and management of the post-RTO ListCo. In contrast, none of the pre-RTO ListCo directors or management were retained;
- the PrivateCo paid a premium exceeding $10 million over the pre-RTO fair value of the equity interests of the ListCo; and
- the size of pre-RTO PrivateCo was significantly larger that that of pre-RTO ListCo, as summarised in the table below:

Figures in S$ million	Pre-RTO PrivateCo	Pre-RTO ListCo
Net Assets	585	1
Profit (Loss) before Tax	36	(6)

The above factors (prescribed by paragraphs B15 and B16 of FRS 103 *Business Combinations*) indicate that the PrivateCo has in substance acquired the ListCo (which was a shell company with listing status after the distribution). Paragraph B19 of FRS 103 prescribes that in such a case, the accounting acquirer would be the PrivateCo, rather than the legal acquirer (ListCo).

Directors' Explanation

The directors were of the view that:

- none of the parties obtained control of the post-RTO ListCo. Accordingly, they identified the ListCo as the accounting acquirer;
- PrivateCo could not be the accounting acquirer as it was a transitory vehicle. Post RTO, PrivateCo distributed its shares to shareholders of ListCo; and
- accounting for all asssets injected into the RTO (including those of PrivateCo) at their fair values was more meaningful and relevant to the new shareholders.

ACRA's Analysis and Conclusion

We are unable to accept the directors' explanations because:

- **the lack of a single majority controlling interest does not preclude the identification of the accounting acquirer**. In fact, paragraph B15(b) of FRS 103 states that if no owner or organised group of owners has a majority voting interest, 'the acquirer is usually the combining entity whose single owner or organised group of owners holds the largest minority voting interest in the combined entity';
- as part of the RTO, the PrivateCo injected its assets and management business into the ListCo. After the RTO, the PrivateCo did not own any substantial assets or liabilities, except for the shares of the ListCo, which were distributed to PrivateCo's shareholders after the moratorium period. While the PrivateCo's ownership of the ListCo's shares may be viewed as transitory, there was no change in terms of the effective ownership. In particular, the pre-RTO shareholders of the PrivateCo became direct owners of ListCo, rather than indirect owners through PrivateCo; and
- the basic principle underlying the acquisition accounting method in FRS 103 is to present the combined entity from the perspective of the accounting acquirer. By applying this principle, the accounting acquirer (PrivateCo) should not step-up the values of its own assets at the RTO date. This is aligned with the concept that the accounting acquirer should not recognise a higher value of its own assets by virtue of an RTO it initiated.

Tips for Directors

Identify the accounting acquirer of an RTO using paragraphs B15 to B18 of FRS 103. The results will produce information that is comparable with other accounting information.

Ask about alternative accounting treatments when faced with complex transactions. Be satisfied with management's rationale on why the adopted treatment is compliant with the accounting standards.

3 CASE STUDIES INDICATING A LACK OF DUE CARE

Directors must avoid recurring material non-compliance and not use disclosure to compensate for wrong accounting

Directors should be committed to present FS that comply with the prescribed accounting standards in Singapore. This will ensure the financial performance and position of the Group are comparable to those in the same industry, thus allowing shareholders to make more informed decisions.

In Case Study D1, the investee's financial year was 31 December 2016 while the Group's financial year was 31 March 2017. The directors had failed to adjust for significant transactions or events that occurred between 1 January 2017 and 31 March 2017 in the consolidated FS, which was material. The statutory auditors issued a disclaimer of opinion highlighting the material NC not once, but three years in a row.

This indicated that the directors had not exercised sufficient due care. If a material NC can be quantified (as stated in the statutory auditors' report), directors ought to take the additional effort to rectify the material NC.

Furthermore, the material NC had recurred three years in a row. While there was full disclosure on the (wrong) treatment in the FS, it does not compensate for the wrong accounting.

Case Study D1

Background

The Group accounted for a 55%-owned JV using equity accounting.

In the consolidated FS for the financial year ended 31 March 2017 (FY2017, reviewed by ACRA), it was disclosed that:
"The investee's financial year-end is 31 December, which is not co-terminus with the Group's financial year-end of 31 March. Audited financial statements of 31 December of the investee had been used in equity accounting for the Group's share of results."

The statutory auditors had issued a disclaimer of opinion on FY2017 FS, of which one matter recurred three financial years in a row:
"…the Group's investee with financial year ended 31 December is not co-terminus with the Group's financial year-end of 31 March… Had the Group equity accounted on an adjusted basis, the resultant net financial impacts would have been an increase in share of loss of investee and a corresponding increase in total comprehensive loss of $2 million, which is ***material*** *to the Group's financial statements for the financial year ended 31 March 2017."*

Red Flags

When the investee's financial year-end differs from that of the Group, paragraph 34 of FRS 28 *Investments in Associates and Joint Ventures* requires adjustments be made for the significant transactions or events that occur between the investee's financial year-end and that of the Group. Given that the amount could be quantified by the statutory auditor and was material, it was unknown why the directors had not reflected them in the consolidated FY2017 FS.

Directors' Explanations

The directors explained that the adjustment was not material, because it was below 5% of the consolidated net asset value.

In addition, the Group had a backlog of uncompleted audits (FY2013 and FY2014), and the current directors were under pressure to clear those instead. Moreover, the Group was transparent to readers by explicitly disclosing this in the financial statements.

ACRA's Analysis and Conclusion

The consolidated profit or loss was a key measure used by shareholders to make investment decisions. Based on the amount quantified by the statutory auditors, the adjustment would increase the consolidated **loss** after tax in 2017 by 7%.

Given that the amount can be quantified, directors should take the additional effort to reflect the adjustment in the Group's FY2017 FS. By failing to reflect the adjustment, the current directors had also failed to present FS that complied with the prescribed accounting standards at the annual general meeting, despite making efforts to deliver the past overdue FS. Furthermore, this material NC had recurred three years in a row. While disclosure allows some users the ability to adjust the error for themselves, this makes the FS difficult to use and may even mislead some users who fail to note the disclosures.

Tips for Directors

Resolve the material NCs highlighted in modified audit reports before authorising the FS for issue.

Identify the root cause of material NCs when qualified audit opinions or disclaimers of opinion are received consecutively. Take action to strengthen internal controls and/or deepen the expertise of the CFO and senior accountants. Use ACRA's Audit Quality Indicators for the appointment or re-appointment of statutory auditors.

Directors are expected to pick up glaring errors in the consolidated statement of cash flows

Cash flow statement is an important primary statement used by shareholders. Cash generated from operating activities reflects the Group's ability to realise operating profits into cash inflows. Net cash from financing activities is also used to assess the Group's ability to re-finance and maintain liquidity.

When preparing the consolidated statement of cash flows, some finance teams will use a shortcut and attribute the entire movement in trade and other payables to operating cash flows. A material NC may arise when the Group has significant other payables due to unpaid purchases of property, plant and equipment (PPE), which should be excluded from both operating and investing cash outflows. By not excluding the unpaid purchases, the cash generated from operating activities and used in investing activities will be distorted.

In Case Study D2, the directors failed to identify that the unpaid purchases of PPE were not excluded from the statement of cash flows. The directors also failed to pick up two material line items that were incorrectly presented in the consolidated statement of cash flows. These items had led the Group to incorrectly report cash generated from operating activities as more than twice the amount of the consolidated profit before tax.

These errors could have been identified and resolved if the finance team, CFO, statutory auditors and directors exercised sufficient due care when preparing, auditing or reviewing the consolidated statement of cash flows. By failing to do so, the shareholders had relied on the consolidated net cash from operating activities that was overstated by more than 100% as it should have been negative.

Case Study D2

Background

The Group had classified ongoing construction projects as work in progress within PPE.

In the consolidated FS for the financial year ended 31 December 2016 (FY2016, reviewed by ACRA):

- the consolidated net cash from operating activities increased by 150 times from \$2 million in 2015 to \$306 million in FY2016. The fluctuation arose from two items:
  - an 'Increase in trade and other payables' of \$204 million in FY2016, as compared to a 'Decrease in trade and other payments' of \$7 million in the financial year ended 31 December 2015 (FY2015);
  - a deduction of 'Exchange differences arising from foreign currency translation' of \$18 million from the consolidated profit before tax in FY2016. In FY2015, \$1 million was added to the consolidated profit before tax for the same item; and
- the consolidated net cash used in investing activities increased by 86% from \$214 million in FY2015 to \$399 million in FY2016. This was due to 'Contribution from non-controlling shareholders' of \$72 million (FY2015: \$2 million).

Red Flags

It did not appear realistic for the consolidated net cash generated from operating activities to:

- increase by 150 times to \$306 million in FY2016; and
- be twice the amount of the consolidated FY2016 profit before tax (\$131 million).

The "Increase in trade and other payables" of \$204 million in FY2016 also did not align with the trend of 'material purchased, consumables used and subcontractors' fees' and 'other operating expense', which increased only by \$179 million collectively in FY2016.

The amount of 'Exchange differences arising from translation' suggested that (non-cash) exchange differences from translating functional currency to presentation currency might have been incorrectly included. These exchange differences were recognised as other comprehensive income, and should not be presented as adjustments to the consolidated profit or loss.

The classification of 'contribution from non-controlling shareholders' within investing cash flows did not appear to comply with paragraph 42A of FRS 7 *Statement of Cash Flows*, which requires such amount to be presented as financing cash flows.

Directors' Explanation

The directors explained that:

- the unpaid purchases of PPE amounting to \$166 million (FY2015: \$40 million) was incorrectly included in the "increase in trade and other payables" of \$204 million (FY2015: decrease of \$7 million) within operating cash flows. The "additions to PPE" classified within investing cash flows should be reduced by the same amounts;
- the exchange differences from converting functional currency to presentation currency was incorrectly included as working capital changes within operating cash flows; and
- the 'contribution from non-controlling shareholders' presented within investing cash flows should be presented under financing activities instead.

ACRA's Analysis and Conclusion

Following restatements by directors, the consolidated:

- net cash inflow from operating activities in 2016 reduced by more than 100%, turning into net cash outflow of \$27 million;
- net cash used in investing activities in 2016 reduced by 72% to \$113 million; and
- net cash from financing activities in 2016 increased by 89% to \$105 million.

The finance team should exercise more due care when preparing the consolidated statement of cash flows. This can be done by analysing the movements in other payables separately. The CFO and directors should also conduct robust review of the consolidated statement of cash flows to pick up these anomalies.

Tips for Directors

Ask for explanation if the consolidated cash generated from operating activities differ significantly from the consolidated operating profit for that year. Check reasonableness before accepting management's explanations.

Check for large fluctuations in each line items presented on the consolidated statement of cash flows. Assess whether they are supportable based on your knowledge of the Group's activities and other disclosures in the FS.

APPENDIX A

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.

Through the FRSP, ACRA ascertains whether the annual financial statements of Singapore-incorporated companies are prepared in compliance with the prescribed accounting standards in Singapore.

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, financial statements that:

(a) comply with the prescribed accounting standards 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.

Focusing on what matters to investors

The ultimate goal of the FRSP is to ensure that investors are provided with reliable and comparable financial statements 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.

Deep-dive into accounting issues

Financial statements are selected for review using a risk-based approach. Emphasis is placed on the financial statements of listed companies with:

(a) significant public interest risks based on criteria such as market capitalisation, revenue and asset size, as well as multiple employees, creditors, customers and other stakeholders;

(b) operations that require subjective judgement in accounting for their transactions, hence increasing the risk of significant misstatement; and

(c) modified audit opinions indicating potential non-compliance with the prescribed accounting standards and other requirements of the Companies Act.

Focusing on compliance with accounting standards

Enquiries are addressed to directors when a desktop review of the financial statements indicates a potential material non-compliance with the prescribed accounting standards in Singapore.

Depending on the number and complexity of matters raised, directors are typically given between three to six weeks to respond with a written reply. All responses must be received in writing. Physical meetings will be requested when the issues are complex and could benefit from a discussion. Measures are taken to ensure strict confidentiality for all information provided to ACRA.

Section 31(1) of the ACRA Act (read with section 6(1)(a) of the ACRA Act and the Second Schedule to the ACRA Act) empowers ACRA to require any person to furnish information or produce any book or document in connection with the review. The statutory auditor or other experts may also be called upon to assist with the enquiries or investigation.

Obtaining the first expert opinion from the ISCA-FSRC

To benchmark enquiries and material non-compliances to expert views and market practices, ACRA collaborates with the ISCA-FSRC to review most of the financial statements under FRSP. ISCA-FSRC is the Financial Statements Review Committee under the Institute of Singapore Chartered Accountants.

Established more than 30 years ago, the ISCA-FSRC comprises 12 experienced audit partners from the various audit firms in Singapore, with a majority from the Big-Four[1] audit firms. They bring a wealth of accounting knowledge and experience to the FRSP. Each member must declare their independence and sign undertaking to safeguard confidential information in respect of the case before the review and participation in the meetings.

[1] Big-Four audit firms comprise Deloitte & Touché, Ernst & Young, KPMG and PwC.

Obtaining the second expert opinion from the FRTAP

When material non-compliances are considered complex and/or judgemental, ACRA consults the FRTAP for a second independent expert opinion. The FRTAP comprises senior audit partners, directors, Chief Financial Officers, financial controllers, academia and investors.

A review group of five members is drawn from the 19-member FRTAP to deliberate on each case. Each review group must comprise three senior audit partners with at least one non-auditor representative. Each member must declare their independence and sign undertaking to safeguard confidential information in respect of the case before proceeding with the review and deliberation.

Obtaining the valuation expert opinion from the IVAS-FRSP

When there is potential material non-compliance(s) relating to valuation matters, ACRA collaborates with the IVAS-FRSP for the review of these matters. IVAS-FRSP is a subcommittee under the umbrella of the Singapore Accountancy Commission. IVAS-FRSP comprises eight valuation specialists, i.e. partners or directors, from the various audit and consultancy firms in Singapore.

Each member must declare their independence and sign undertaking to safeguard confidential information in respect of the case before the review and participation in the meetings.

Deciding the regulatory outcome

The prescribed accounting standards in Singapore are principle-based, which require judgement during their application. It is important that preparers, CFOs, directors and statutory auditors make the judgement faithfully. If two or more methods are appropriate to achieve the outcome, ACRA will accept both methods. The judgements made should be documented by preparers in support of honest and fair attempt to meet the principles. Disclosure does not compensate for wrong accounting.

Non-compliance and areas for improvement are incidences where the financial statements did not comply with the prescribed accounting standards in Singapore, differentiated by the nature and extent of the misstatements, which are assessed using both quantitative and qualitative factors.

From the third review cycle, all reviews under the FRSP are completed with the following regulatory outcomes:

(a) Concluded with no enquiry;

(b) Concluded with no material non-compliance(s);

(c) Concluded with material non-compliance(s) but restatement was not necessary;

(d) Concluded with material non-compliance(s), requiring restatements of comparatives and/or additional disclosures in subsequent year's financial statements; or

(e) Concluded with significant non-compliance(s), requiring restatements and re-auditing of past years' financial statements.

For more egregious cases of non-compliance with adverse impact to the financial statements or situations where a company fails to remediate satisfactorily within the prescribed timeline, ACRA will consider 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 restate the financial statements under section 202B of the Companies Act.

Failure to comply with sections 201(2) and/or (5) of the Companies Act is an offence, which carries a penalty of up to S$50,000. For aggravated offences committed with the intent to defraud, the maximum penalty is S$100,000 and may include imprisonment of up to two to three years. It should be noted that the law imposes duties equally on all directors, and non-executive directors as well as nominee directors are equally liable for breach of this duty. ACRA calls upon the directors for statement-taking before imposing any of the first three regulatory sanctions above.

Directors of listed companies should also consider the implications from the SGX Listing Rules. In particular, with reference to the SGX Listing Manual,

(a) under Rule 703, the directors of a listed company that is required to restate comparatives in the subsequent year's financial statements and/or restate and re-audit the past year's financial statements, must also consider whether the restatement 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 re-appointment(s) as a director of any company listed on the SGX.

APPENDIX B

Financial Reporting Resources for Directors

1. **Directors' Duties in relation to Financial Reporting**
   Lists the directors' duties in relation to financial reporting under the Companies Act and provide guidance to directors in carrying out the financial reporting duties.

2. **Financial Reporting Practice Guidance**
   Reminds directors of the risks of misstatements in the upcoming financial statements and how to better meet the information needs of investors and other users of those financial statements. Issued annually.

3. **Past Reports on ACRA's Financial Reporting Surveillance Programme**
   Features the regulatory outcomes, general observations and case studies developed from real-life cases for each review cycle.

4. **Singapore Institute of Directors' Professional Development Courses for Directors**
   (a) DFF Director Financial Reporting Fundamentals

   This course is designed for directors without financial or accounting background. It provides directors with essential accounting knowledge and practical tips, and equips them with the key tools and concepts to review company financial statements.

   (b) LED 5 Audit Committee Essentials

   This module covers the role and duties of the Audit Committee, how it should be structured, its functions and regulatory obligations and duties.

5. **Accounting Standards issued by the Accounting Standards Council**
   - Singapore Financial Reporting Standards (International)
   - Financial Reporting Standards

6. **ISCA Financial Reporting Guidances**
   Shares technical views and insights on issues, and/or best practices in an area/industry. While non-mandatory, directors should be prepared to explain departures if called upon to do so.

7. **ISCA Financial Reporting Bulletins**
   Highlights emerging topic issues for consideration by the accountancy profession in Singapore.