# FINANCIAL REPORTING PRACTICE GUIDANCE NO. 1 of 2021
(Issued on 14 DECEMBER 2021)

# AREAS OF REVIEW FOCUS FOR FY2021 FINANCIAL STATEMENTS UNDER ACRA'S FINANCIAL REPORTING SURVEILLANCE PROGRAMME

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

To guide directors in reviewing and approving the FS, ACRA is publishing the areas of FRSP review focus for the FY2021 FS.

**Our environment**

Close to two years have passed since the World Health Organisation declared COVID-19 a global pandemic. Countries around the world continue to adjust with the impact from the virus, although economies are slowly improving.

On 28 October 2021, the Monetary Authority of Singapore (MAS) issued its Macroeconomic Review, forecasting Singapore's gross domestic product (GDP) growth at 6.0% to 7.0% in 2021. MAS also said that the expansion in 2022 should be slower but still 'above trend'.[1]

Despite the positive economic outlook, there is still looming uncertainty over the pace and uniformity of economic recovery across different jurisdictions and industries.

**Our state of compliance with accounting standards**

Against this backdrop, high quality financial reporting remains an important cornerstone to build trust in our capital market and economy. At ACRA, we remain committed in enforcing the requirements in accounting standards to achieve the objective.

Of 15 completed reviews of FS in 2021, 9 (or 60%) FS were found to contain material non-compliances (NCs), leading to the following regulatory outcomes:

- two listed companies either restated or would restate the comparatives and/or make additional disclosures in their subsequent years' FS;
- four listed companies either revised or would revise their past years' FS. The consolidated pre-tax profits or losses of three companies were adjusted or expected to be adjusted by more than 100% individually. The consolidated net assets of one company is expected to be adjusted downwards by 28%; and
- a director of a listed company was levied composition fine, in view of the indication of negligence.

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[1] *Refer to https://www.mas.gov.sg/publications/macroeconomic-review/2021/volume-xx-issue-2-oct-2021*

Classification in cash flows statement remains an area of concern, making up 20% of the NCs found in 2021. This is followed by impairment of non-financial assets at 10%. These NCs are described in sections 1 and 2 below.

**Our review on FY2021 FS will focus on:**

1. Assessment of going concern and classification in cash flows statement
2. Impairment assessment of non-financial assets
3. Expected credit loss assessment
4. Supply chain financing (an emerging risk)
5. Interbank offered rate reform (a new development)

## 1. Assessment of going concern and classification in cash flows statement

We continue to see gaps in going concern assessments. Some companies had inappropriately assumed that the future events would follow the trend of prior years, despite changes in business environment and business models. Some companies had also viewed forecast assumptions or scenarios in silos when they might in fact be interlinked.

In addition, several companies classified their cash flow items incorrectly, leading to overstatement of operating cash flows:

- two companies had incorrectly classified the proceeds from disposal of an associate within operating cash flows, instead of investing cash flows; and
- one other company had also incorrectly classified cash outflows from advancement of a loan within operating cash flows, instead of investing cash flows.

Another company had incorrectly presented cash paid for the acquisition of non-controlling interests within investing cash flows, instead of financing cash flows.

**ACRA's Tips for Directors:**

- Is the Group in a 'close-call' situation, whereby a change in key assumptions may cast significant doubt on the Group's ability to continue as a going concern? If yes, the estimation uncertainties and critical judgements should be disclosed, even if the Board concludes that going concern assumption is valid and there is no material uncertainty on going concern.
- If the Group has multiple individually immaterial uncertainties that occur simultaneously in a 'worst case scenario', will the company remain a going concern? If not, the going concern assumption should be re-looked.
- Does the Group have red flags such as delays in project completion, breaches in loan covenants, not paying suppliers on time, and/or not receiving payments on time? If yes, the cash flow forecasts should be inspected in detail.
- Is management considering new, cheaper and/or innovative ways to finance operations? If yes, it may be wise to examine the financing terms as early as possible and seek advice on the accounting treatments.
- Does the Group rely on governmental supports? If yes, the impact when the supports taper off should be considered in the cash flow forecasts.

## 2. Impairment assessment of non-financial assets

We continue to observe instances where companies failed to perform value-in-use (VIU) calculation. They had also incorrectly recognised impairment loss based on recoverable amount determined using solely fair value less cost of disposal (FVLCD), when there was indication that VIU might be higher than FVLCD.

One company had also incorrectly determined FVLCD by averaging the FVLCD at the beginning and the end of the financial year. Other companies failed to consider the latest available market data and industry trends (e.g. expectations of COVID-19 recovery), as well as underlying characteristics of the asset or cash generating unit (CGU) (e.g. useful life, capital expenditure requirements).

***Case Study A***

*Company A used plant and equipment to manufacture Product Z. The plant and equipment had a finite useful life of 15 years and can be used to manufacture Company's A other products.*

*To manufacture Product Z, Company A is required to obtain a manufacturing license, which must be renewed every 5 years with the regulator. There is indication that the license may not be renewed due to environmental concerns.*

*Company A had incorrectly grouped the plant and equipment and manufacturing license as a single CGU. The plant and equipment could operate independently without the license.*

*Company A had also incorrectly forecasted cash flows of the CGU to perpetuity. There were limitations on the useful life of plant and equipment as well as possible non-renewal of the manufacturing license.*

**ACRA's Tips for Directors:**

- Has the Group re-deployed assets or restructured its business lines recently? If yes, CGUs may need to be re-identified and goodwill re-allocated.
- Has the Group changed its ways of doing business or servicing its customers recently? If yes, revenue growth rates and margins used should be aligned with industry and market trends. Historical results may no longer be a good indicator of future performance.
- Does the Group use the same discount rate across all CGUs or assets? Indiscriminate use of group-level discount rates should be avoided; discount rates need to be adjusted to reflect the risk at each CGU or asset level.
- Are the CGU operations constrained by finite-lived licenses or rights? If yes, cash flow projections should be prepared up to the expiry of those licenses or rights considering probability of renewal (see Case Study A above).
- Do cash flow projections in impairment test include inflows and outflows from future expansion? Capital expenditure to sustain operations should be considered but not inflows and outflows for business expansion or uncommitted restructuring.
- If a reversal of impairment charge is proposed, was the improved cash flows assumption in line with the assumptions used when impairment loss was recognised? If yes, the reversal should not be recognised.

## 3. Expected credit loss ("ECL") assessment

Directors and preparers continue to contend with the concept of ECL. Economic uncertainty also makes the ECL estimation process more challenging.

To illustrate the process, ECL provisions are typically made based on historical credit loss experience by each aging bucket (for the case of trade receivables), then adjusted with forward-looking estimates. This allows for impairment loss expenses to be recorded according to changes in credit risk of the asset, thus building an allowance for credit losses over the life of the instrument.

In determining the ECL provision for trade receivables, a company would need to first segment its customer base by their shared credit risk characteristics (e.g. by customer size, location, industry, product line). Thereafter, the expected loss rate is determined based on a combination of historical credit loss experience and forward-looking estimates (using factors that correlate with expected customer repayment behaviour).

***Case Study B***

*Company B derives revenue from customers in Country Y and Country Z. Management determines that expected loss rates on its trade receivables have a strong negative correlation with expected GDP growth rates of the countries its customers operate in. At year end, GDP of Country Y was expected to grow at 5.0% while GDP of Country Z was expected to contract by 10.0% due to recession.*

*It is not appropriate for Company B to group trade receivables from both countries for collective assessment and say, adjust for forward-looking estimates based on expected GDP growth rate of Country Y.*

*Based on the forward-looking information, the expected loss rate of receivables due from customers in Country Y could be lower than the historical loss rate while that of Country Z could be higher than the historical loss rate.*

**ACRA's Tips for Directors:**

- Do receivables that are assessed collectively share similar credit risk characteristics and historical loss patterns? If not, they should be further stratified by their profiles and assessed separately (see Case Study B above).
- Taking into account the relevant forward-looking information (e.g. expected GDP growth rate, unemployment rate, commodity prices), does the historical loss experience reflect the expected loss rate? If not, adjustments are required to arrive at the expected loss rate.
- Are there any debtors with deteriorating financial conditions and short-term liquidity issues? If yes, these may be indicators of increase in credit risk, to be adjusted for in the loss rate or singled out for specific impairment assessment.

## 4. Supply chain financing

Supply chain financing[2] (SCFs) refers to arrangements where a buyer receives funding on goods and services it purchased. In a submission to the IFRS Interpretations Committee, Moody's Investor Services said that less than 5% of entities it rates discloses information about the usage of SCFs, despite reports of its widespread usage[3].

SCFs can lead to cash flow issues if facilities are withdrawn abruptly. In addition, under a SCF arrangement, payment terms with finance providers could be extended (beyond the industry standards). Thus, if it continues to be presented as part of trade and other payables, this will obscure the buyer's actual amount of 'borrowings' and other risks/implications that come with it. Directors should ensure that such balances are appropriately classified and disclosed in the FS.[4]

***Case Study C***

*Company C is a large multinational construction company. The Company faced financial difficulties due to cost overruns from construction delays on multiple major projects and started to draw heavily on SCF facilities to finance its operations. Over time, it amassed large amounts of SCF facilities with various financial institutions.*

*After Company C collapsed, it was unveiled that it had about $0.5 billion of liabilities under SCF subsumed within trade and other payables. This is in addition to about $1.0 billion of net borrowings reported on balance sheet.*

## 5. Interbank offered rate (IBOR) reform

The Singapore Interbank Offer Rate (SIBOR) and Swap Offer Rate (SOR) are expected to be phased out in June 2023 and December 2024 respectively. These will be replaced by the Singapore Overnight Rate Average (SORA).

Many outstanding borrowing and hedging contracts in the market contain SIBOR and SOR components, which will need to be amended. Companies that apply hedge accounting with instruments that refer to IBORs may also need to take steps to preserve hedge accounting.

ISCA has published Financial Reporting Bulletin 9[5] to provide guidance. Directors are encouraged to engage professionals early to assess the accounting implications.

*The above factors are provided as a general guideline. They do not exhaustively define the requirements of the prescribed accounting standards in Singapore. When in doubt, directors should seek professional help. ACRA reserves the right to conduct review of other areas in the FS as deemed necessary.*

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[2] *This practice guidance focuses on arrangements that finance payables. Other common forms of supply chain financing such as financing for receivables and inventories have not been discussed.*

[3] *Refer to https://www.moodys.com/research/Moodys-Investors-Service-Letter-to-the-International-Financial-Reporting-Standards--PBC_205879*

[4] *The International Accounting Standards Board has published Exposure Draft ED/2021/10 with proposals for new disclosure requirements to enhance the transparency of supply chain financing arrangements and their effects on a company's liabilities and cash flows.*

[5] *Refer to https://isca.org.sg/docs/default-source/fr-frb/frb-9---acctg-implications-of-ibor-in-sg(r).pdf*