RAISING THE BAR ON FINANCIAL REPORTING IN SINGAPORE:

What to expect for 2015 and beyond

ACRA's 10 Review Focus on 2015 Financial Statements[1]

On 9 December 2015, the Accounting and Corporate Regulatory Authority ("ACRA") issued *Financial Reporting Practice Guidance No. 2 of 2015* which highlights the ten areas of review focus under the Financial Reporting Surveillance Programme ("FRSP") for 2015 Financial Statements.

The practice guidance serves to guide directors and other financial statements preparers on some of the areas of potential misstatements in the financial statements, such as impairment assessment of long-life assets, impact from foreign currency movements, and the control assessment over investees.

A summary of the ten areas of review focus is provided in Table 1 at the end of this article for ease of reference.

New Auditor's Report

On 30 July 2015, new and revised auditor reporting standards were issued by the Institute of Singapore Chartered Accountants ("ISCA"), following approval from ACRA's Public Accountants Oversight Committee ("PAOC"). The new and revised standards and the related conforming amendments will be effective for audits of financial statements with financial years ending on or after 15 December 2016. Early adoption is permitted.

With this implementation, the auditor's report is expected to be dramatically different from the current norm. This development is expected to revitalise corporate reporting and be a game-changer in the way an external auditor's executes his judgment in each engagement. It is highly likely that the auditor's report could turn into one of the most-read documents in an annual report.

[1] "2015 Financial Statements" refer to financial statements with financial year ended between 1 January 2015 and 31 December 2015.

Among the key changes, there is a new section on the auditor's report highlighting "key audit matters" ("KAM") where it requires an auditor to justify why each KAM in the audit was considered significant and how the matter was addressed in an audit. The objective of this could be seem as a step forward in enhancing better transparency of the financial statement where stakeholders, especially the shareholders and investors, will be kept abreast of significant matters or issues within the company. This development should ultimately bring about improved financial reporting and enhance the value of an audit.

A summary of the key enhancements to the auditor's report is presented in Table 2 at the end of this article.

Implications to Stakeholders, Management and Preparers

The above changes and implementations will affect the entire financial reporting ecosystem, posing significant implications and challenges to all parties, including the stakeholders, management, financial statements preparers and the auditors.

Some of the pertinent issues that decision makers in a company ought to consider immediately are:

1. Embrace the change:

   There is a need for decision makers to familiarise themselves with the enhanced requirements, its impact and leverage on these enhancements to strengthen their roles in improving the company's financial reporting quality and corporate governance.

   In addition, the incorporation of the KAM in the new auditor's report could send different signals regarding the quality of the financial statements, regardless as to whether it is real or perceived. Therefore it is necessary that the management recognizes the change and its impact on their interaction with the stakeholders and public.

2. Increase communication with external auditors:

   Management should actively engage the auditors in order to understand the requirements of the enhanced corporate reporting requirements and how these will affect the company.

   It will be meaningful to have open dialogues with the auditors on significant developments and issues so as to arrive at an agreement on certain treatment of complex matters and also to ensure that expectations are aligned.

3. Pre-emptive measures:

   Companies are encouraged to do a field test of the new auditor's report requirements in financial year 2015 so as to better pre-empt the extent of work involved when the new standards kicks in from the financial year ending on and after 15 December 2016.

4. Identify and address significant risk areas:

   In the spirit of enhancing the quality of the financial report and good corporate governance, management should dedicate sufficient competent resources to proactively review and address the company's significant risk areas in respect of both the ACRA's review focus and the new audit reporting requirements.

Conclusion

Changes are inevitable and have just begun. The real test is whether the management and auditors could work hand-in-hand to embrace these changes. In order to avoid the likelihood of a substantial increase in auditor's remuneration, it is prudent for management to take immediate actions to gather sufficient accounting resources in managing those risky areas within the company. If this is appropriately managed, the likelihood of a substantial fee increase will be trivial.

If you wish to understand more on the implications of
the enhanced corporate reporting requirements, please feel free to approach:

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Table 1: ACRA's Ten Areas of Review Focus for 2015 Financial Statements

	AREAS OF REVIEW FOCUS
1.	**Control over investees** • Removal of the bright line of 50% voting power and new requirements for assessing whether an entity controls an investee from 1 Jan 2014 under SFRS 110 *Consolidated Financial Statements*. • More attention and care should be placed to assess how Reserved Matters could apply and affect an entity's decision-making over its investee and the ensuing implications on how the entity account for its investee.
2.	**Call or put option over shares of investee** Directors should: • Understand the business reasons and implications for entering into call and put options over shares of its investee; • Question how these options would impact the assessment on whether the entity controls or jointly controls or has significant influence over an investee; and • Enquire whether these options should be accounted for as derivatives.
3.	**Business acquisitions – reflecting the real value of the acquired business** • When an acquisition is accounted for as a business combination, directors should: a) Apply their knowledge on the reasons for acquiring the business; and b) Consider the factors in determining the purchase price paid for the business. • The directors should also determine if part of the goodwill is attributable to the acquisition of specific intangible assets such as customer lists. ➢ If so, such specific intangible assets should be separately valued and recognised during the purchase price allocation ("PPA") exercise. ➢ For the purpose of the PPA exercise, if there is no in-house specialist, directors should engage an external professional valuer to identify the specific intangible assets and value them separately. ➢ It is pertinent to differentiate goodwill from specific intangible assets because of the different accounting treatments between goodwill and the other specific intangible assets. • Upon recognition of the specific intangible assets, directors should understand the reasons for the remaining amount recognized as goodwill and disclose meaningfully to shareholders the real value of the acquired business.

Source:
https://www.acra.gov.sg/uploadedFiles/Content/Publications/Practice_Guidance/Practice%20Guidance_Areas%20of%20Review%20Focus%202015.pdf

Table 1: ACRA's Ten Areas of Review Focus for 2015 Financial Statements – Cont'd

	AREAS OF REVIEW FOCUS
4.	**Long-life assets value and impairment testing** Principles that directors could use when reviewing impairment tests include the following: • Whether the cash flow projections are reasonable and supportable; • Whether the terminal value used in cash flow projection is reflective of the current economic trends and maintainable; • Whether the discount rate apply is reflective of the general business environment and the risks specific to the asset; • Whether adequate disclosures have been made for recognizing an impairment loss.
5.	**Breaches of borrowing covenants** • Directors of companies with high gearing should query on whether all borrowing covenants have been met and whether loan repayments have been paid timely. • If not, directors should consider their implications, including whether the borrowings should be classified from a non-current liability to a current liability.
6.	**Sale-and-leaseback transactions** • Accounting for sale-and-leaseback transactions should be based on the "*substance over form"* consideration.
7.	**Statement of Cash Flows** • Operating cash flow should reflect the ability of a business to generate cash to fund its operations and investments, and to repay its debts. • Common errors in misstating the operating cash flows include: ➢ Balances relating to business combinations inappropriately included as part of working capital; ➢ Foreign currency translation differences taken directly to equity wrongly reflected as adjustments to operating cash flow, etc.
8.	**Impact from currency environment** • Owing to the recent significant currency movements in some countries, Singapore companies with significant investments in the affected countries should ensure that the recoverable amounts of assets denominated in foreign currency are properly measured in its functional currency.

Source:
https://www.acra.gov.sg/uploadedFiles/Content/Publications/Practice_Guidance/Practice%20Guidance_Areas%20of%20Review%20Focus%202015.pdf

Table 1: ACRA's Ten Areas of Review Focus for 2015 Financial Statements – Cont'd

	AREAS OF REVIEW FOCUS
9.	**Earnings per share ("EPS")** • When companies undertake capital structure changes such as share consolidation, share split, bonus shares or rights issue during the year, directors are to ensure that the basic and diluted EPS are adjusted during the period and for past periods to reflect the change in the number of shares without a corresponding change in resources.
10.	**Fair value measurement** • Directors should expect fair valuation of assets involving many significant unobservable inputs to be classified as Level 3 in accordance with SFRS 113 *Fair Value Measurement*. The Level 3 classification requires more disclosures and such disclosures should also be made at a meaningful level of aggregation.

Source:
https://www.acra.gov.sg/uploadedFiles/Content/Publications/Practice_Guidance/Practice%20Guidance_Areas%20of%20Review%20Focus%202015.pdf

Table 2: Key Enhancements to the Auditor's Report

KEY ENHANCEMENTS	VALUE
1. Key Audit Matters ("KAM") – NEW!	
• KAM are those matters that, in the auditor's judgment, were of most significance in the audit of the current period financial statements; • The requirement to communicate KAM is mandatory for audits of complete sets of general purpose financial statements of listed entities.	• Provides information of interest to users, enhances the value of the current binary auditor's opinion and increases the relevance of audit; • Insights provided in KAMs enable investors to focus on key audit issues which generally correlate to the significant risk areas of the entity - helps deepen engagement between stakeholders, management, directors and auditors.
2. Going Concern ("GC") – ENHANCED!	
• Descriptions of the respective responsibilities of management and the auditor for GC are included in the auditor's report; • A separate section under the heading "Material Uncertainty Related to Going Concern" when a material uncertainty exists and is adequately disclosed; and • New requirement for the auditor to evaluate the adequacy of disclosures in "close call" situations, when events or conditions are identified that may cast significant doubt on an entity's ability to continue as a GC but no material uncertainty concluded.	• Topic of GC is of significant interest in light of the global financial crisis. In the public interest for increased focus on GC matters by management and auditors.
3. Statement about the Auditor's Independence and Fulfilment of Relevant Ethical Responsibilities – NEW!	
• Affirmative statement about the auditor's independence and fulfilment of relevant ethical responsibilities	• Emphasises the importance of complying with ethical requirements as a basis for the audit and increases the focus on auditor independence

Extracted from: http://www.isca.org.sg/tkc/aa/current-issues/hot-topics/auditor-reporting/

Table 2: Key Enhancements to the Auditor's Report – Cont'd

KEY ENHANCEMENTS	VALUE
4. Disclosure of Name of Engagement Partner – ENHANCED!	
• Disclosure of the name of the engagement partner for audits of financial statements of listed entities, with a "harm's way" exemption, i.e. *disclosure is necessary unless, in rare circumstances*, such disclosure is reasonably expected to lead to a significant personal security threat	• Increases transparency and provides engagement partner with a greater sense of personal responsibility and accountability, which translates to improved audit quality
5. Enhanced Description of the Responsibilities of the Auditor – ENHANCED!	
• Description of auditor's responsibilities for the audit and key features of the audit have been enhanced and expanded	• Provides greater transparency of the audit process and provides enhanced understanding of the role of auditor and the nature of audit work
6. Ordering of Sections – ENHANCED!	
• "Opinion" section required to be presented first, followed by the "Basis for Opinion" section, unless law or regulation prescribe otherwise	• Recognises the importance of the auditor's opinion on the financial statements to users

Extracted from: [*http://www.isca.org.sg/tkc/aa/current-issues/hot-topics/auditor-reporting/*](http://www.isca.org.sg/tkc/aa/current-issues/hot-topics/auditor-reporting/)