ACRA Regulatory Updates

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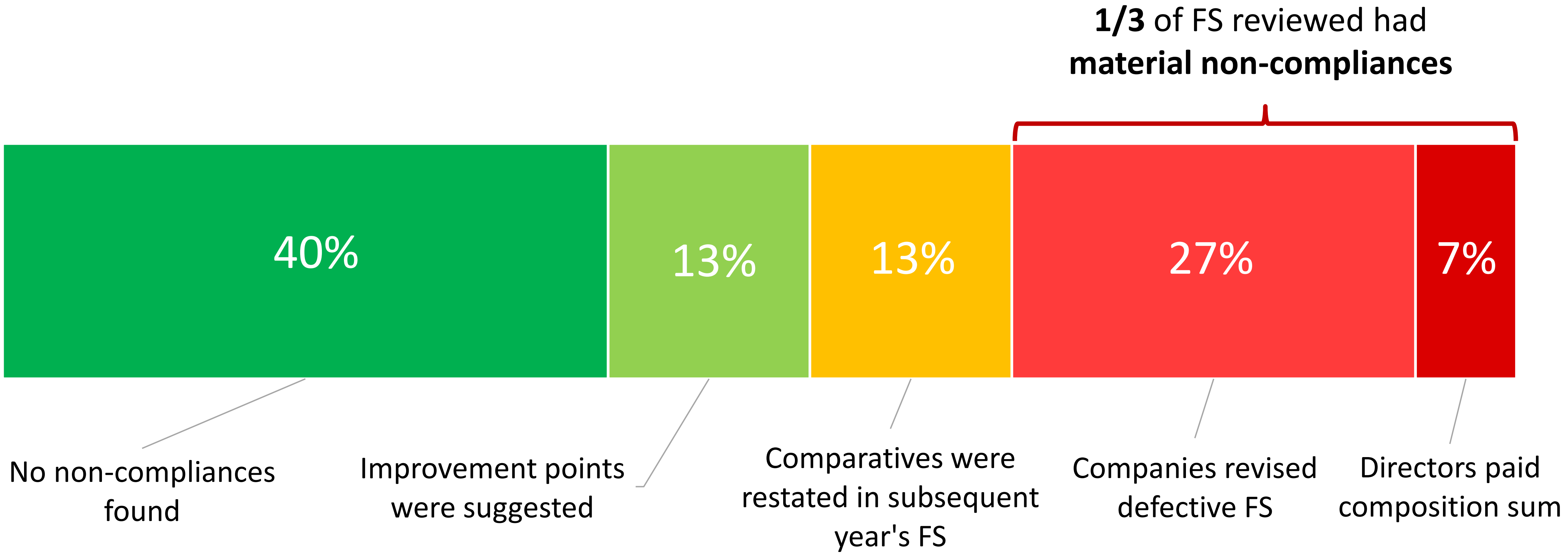
12 January 2022

Agenda

- FRSP Reviews in 2021
- Get Back to Basics
- Focus on the Risk Areas
- More than Meets the Eye
- Moving the Needle

FRSP Reviews in 2021

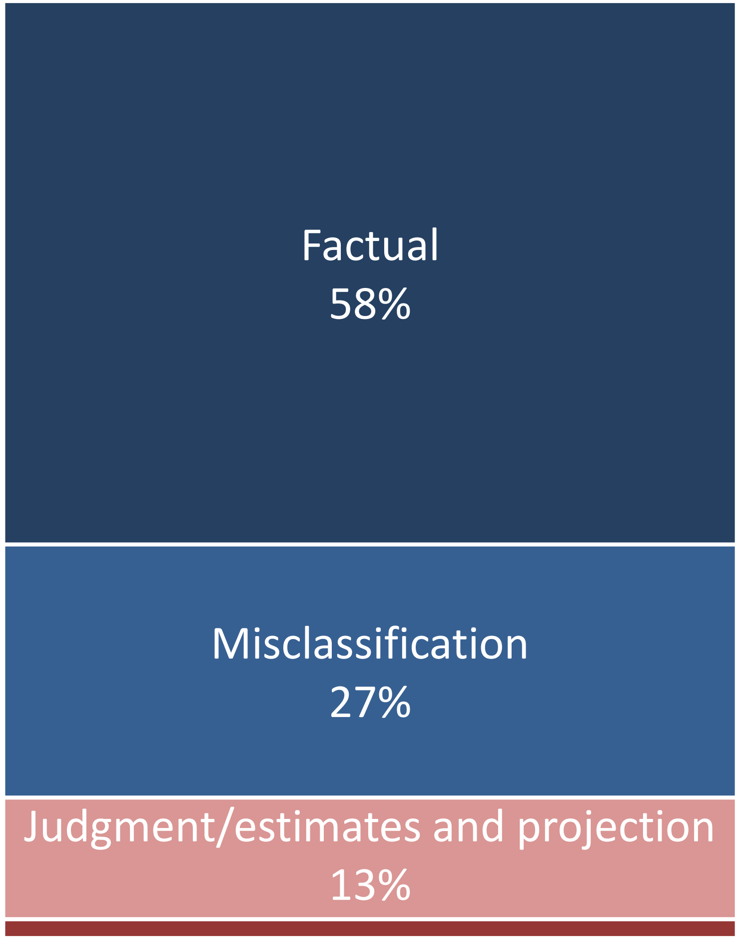
Outcomes from Reviews completed up to Nov 21



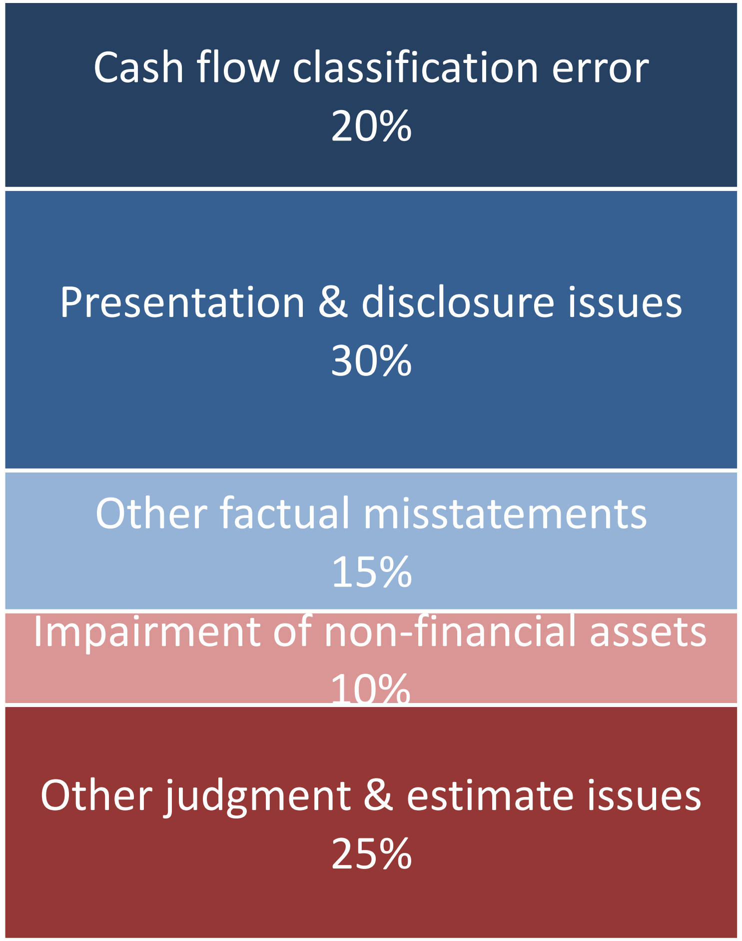
Get Back to Basics

Audit Adjustment Study 2021

85% are **factual** and **misclassification** misstatements



Non-compliances found by ACRA



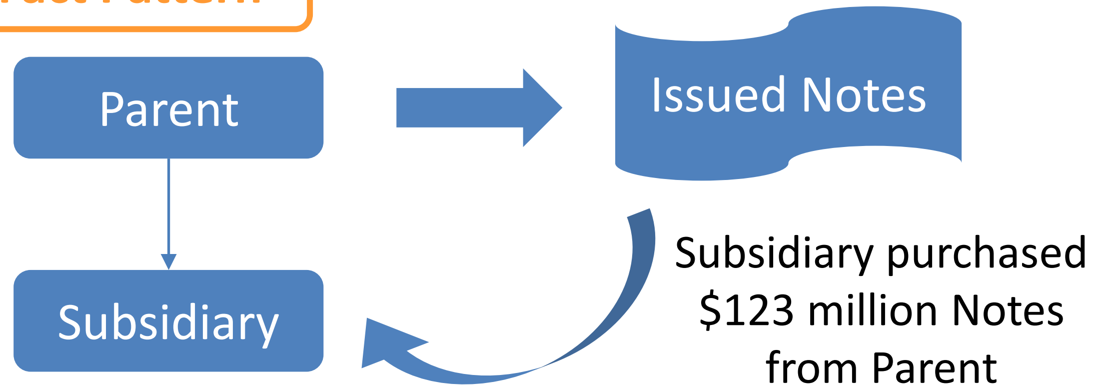
65% are **factual** and **misclassification** misstatements or **presentation & disclosure** issues

Get Back to Basics – #1 Consolidation

Accounting Requirements

Paragraph B86 of SFRS(I) 10 Consolidated Financial Statements requires an entity to "*eliminate in full intragroup assets and liabilities*, *equity, income, expenses and cash flows relating to transactions between entities of the group*" when preparing the consolidated financial statements.

Fact Pattern

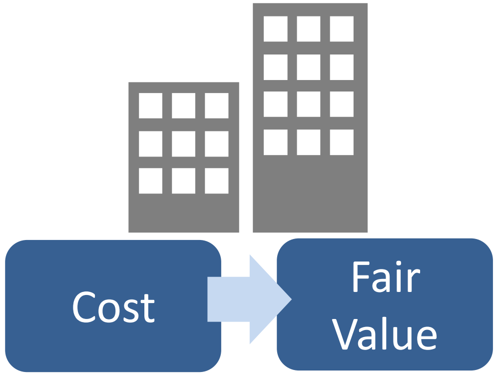


Consolidated balance sheet:	**$'mil**
Assets	
Other investments in Parent's issued notes	123
Liabilities	
Issued notes payable due to Subsidiary	(123)

Get Back to Basics –
#2 Change in accounting policies

Fact Pattern

- Accounting records of a subsidiary were destroyed in 2018.
- The subsidiary mainly owned investment properties (IPs).



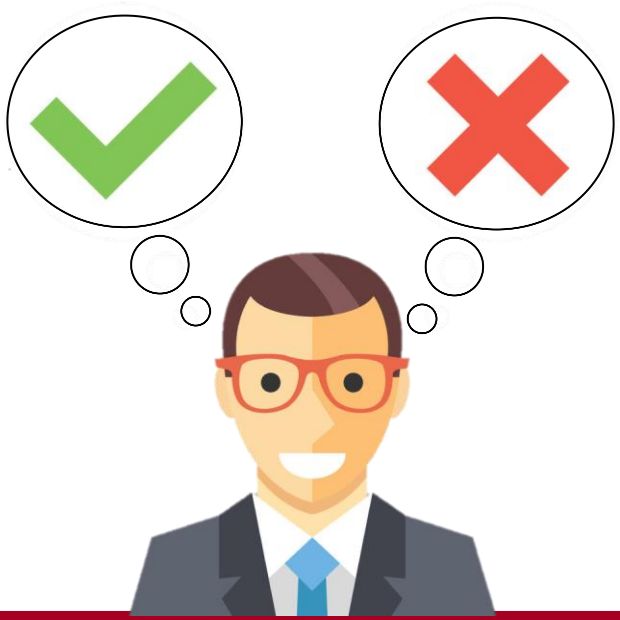
- Due to the absence of accounting records, the directors decided to change accounting policy for IPs from **cost model** to **fair value model** in 2018.

- The Group then applied the change in accounting policies prospectively.
- The Group obtained external valuations of the IPs at year-end and recorded the entire fair value gains in 2018 P&L.

Poll #1

Is it correct for the Group to apply the change in accounting policies prospectively?

A) Yes
B) No
C) Maybe



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Get Back to Basics –
#2 Change in accounting policies

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B) No

<u>Accounting requirements:</u>
Under SFRS(I) 1-8 *Accounting Policies, Changes in Accounting Estimates and Errors*, **<u>voluntary changes in accounting policies need to be applied retrospectively</u>**, as if the policy had always been applied.

<u>Financial implications:</u>
Fair value gains of $70 million (>100% of PBT) was incorrectly recorded in 2018.

Had the change been applied retrospectively, the Group's **profit before tax** of $50 million would turn into **loss before tax** of $10 million.

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Focus on the Risk Areas

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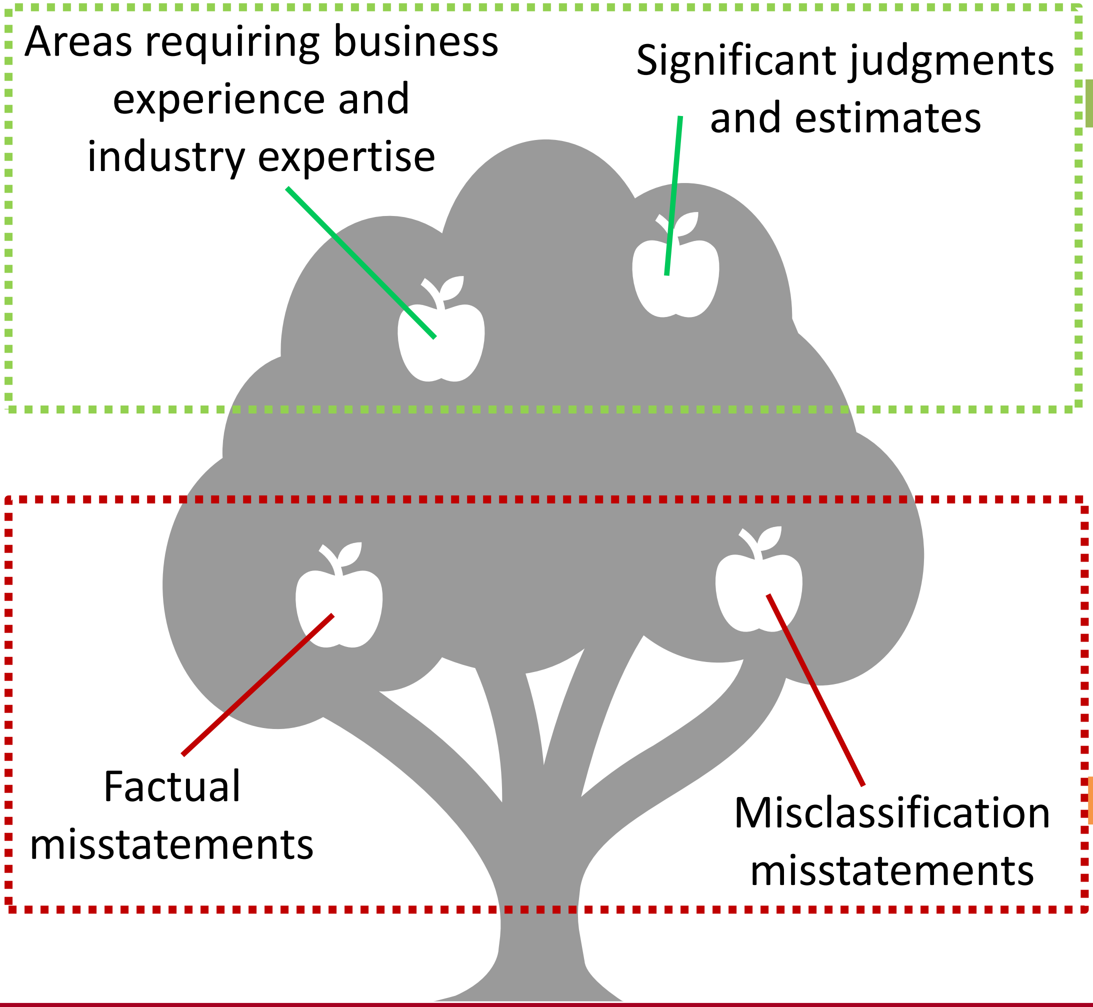


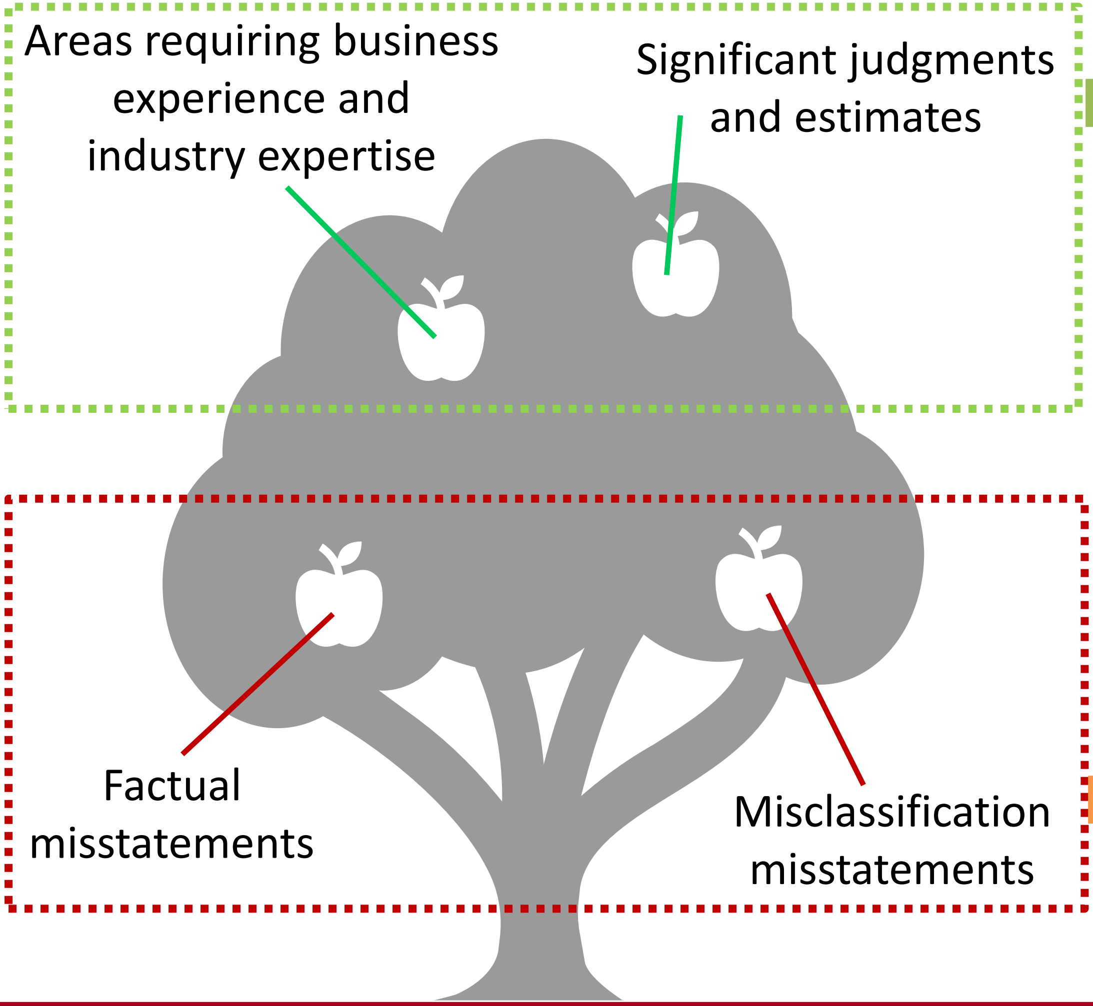
- Spend time on issues requiring significant judgments and estimates.

Audit Adjustment Study 2021:

- 13% of audit adjustments result from judgment, estimated or projected misstatements.
- Impairment related audit adjustments highest in terms of amount.

- Assess root causes of proposed audit adjustments
- Address gaps – e.g. finance team, internal controls

Focus on the Risk Areas



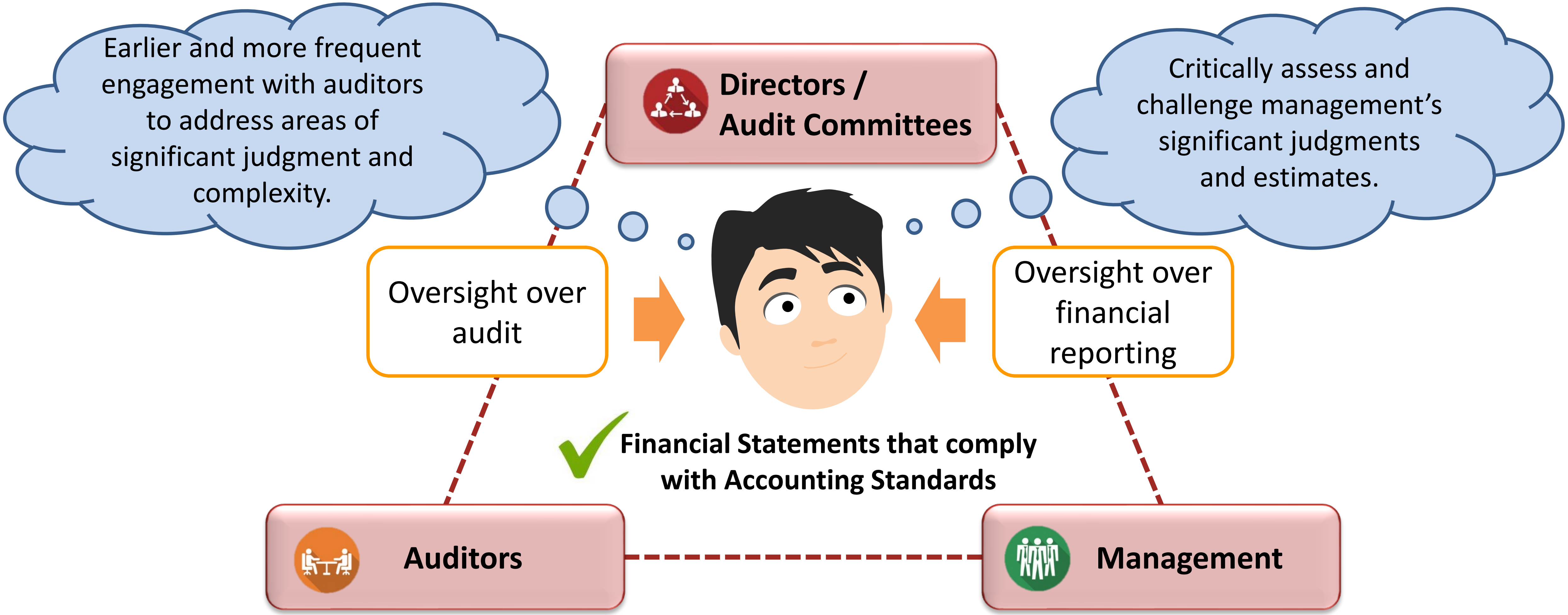
- Spend time on issues requiring significant judgments and estimates.

Areas of Review Focus for FY2021 FS

- Going concern and cash flow presentation
- Impairment of non-financial assets
- Expected credit loss assessment
- IBOR reform
- Supply chain financing

- Assess root causes of proposed audit adjustments?
- Address gaps – e.g. finance team, internal controls

Focus on the Risk Areas



Focus on the Risk Areas – #1 Impairment

Fact Pattern

Company

70% interest*

Joint Venture (JV)

*JV's carrying amount of $6 million, 22% of the Group's total assets

JV was a high-risk, early start-up company

Auditors had issued disclaimer on the recoverability of the investment in joint venture *"as the management was unable to provide sufficient documentary support for certain key assumptions made"* in the cash flows forecasts.

Poll #2

Extract of value-in-use computation prepared by management:

Discounted cash flows (in $'mil)										
Years	1	2	3	4	5	6	7	8	9	10
EBITDA	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Depreciation	(0.5)	(0.7)	(0.7)	(0.7)	(0.7)	(0.7)	(0.7)	(0.7)	(0.7)	(0.7)
EBIT	1.2	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Tax	-	-	-	-	-	-	-	-	-	-
PAT	1.2	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Add: Depreciation	0.5	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Less: Changes in net working capital	-	-	-	-	-	-	-	-	-	-
Free cash flow	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Discount rate	7.5%									
Present value	1.6	1.5	1.4	1.3	1.2	1.1	1.0	1.0	0.9	0.8
Net present value (NPV)	11.7									
Investment in JV (70%)	(6.0)									
Headroom	5.7									

Which of the following do not appear reasonable? (select all that apply)

A) Number of years in projection
B) EBITDA projection
C) Tax effect and changes in net working capital
D) Discount rate used
E) Comparison of NPV versus Book value

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Focus on the Risk Areas – #1 Impairment

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Extract of value-in-use computation prepared by management:

Discounted cash flows (in $'mil)

Years	1	2	3	4	5	6	7	8	9	10
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Net present value	11.7									
Investment in JV (70%)	(6.0)									
Headroom	5.7									

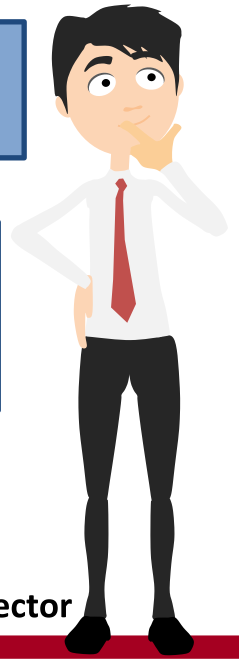
Why forecast more than 5 years? And no terminal value?

EBITDA projected the same every year -> how robust are the cash flow projections?

No tax? No net working capital adjustments?

JV was a high-risk, early stage start-up -> discount rate set too low?

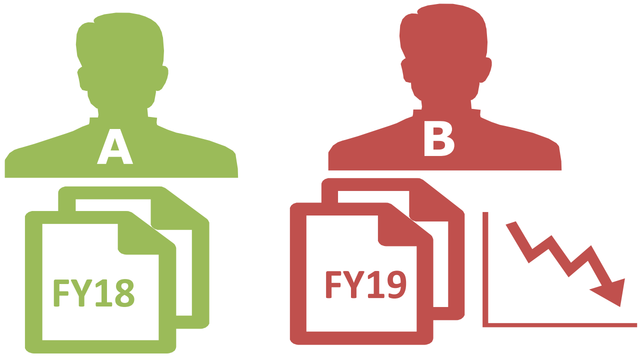
JV was 70%-owned -> NPV not adjusted to 70% interests?



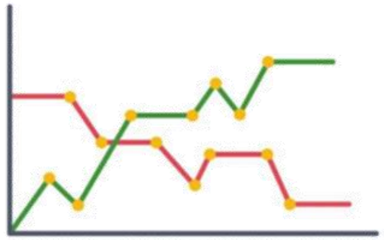
Director

More than Meets the Eye

Company X



- Company X engaged Valuer A in 2018 and Valuer B in 2019 to value the same investments for impairment assessment.
- Due to a different methodology used by Valuer B, valuation was significantly lower for 2019.



- Company X disagreed with Valuer B's valuation and used an **average of 2018 and 2019 valuations** for impairment assessment.
- This led to impairment loss, 60% of Company X's loss before tax in 2019.

Auditors had disclaimed their opinion as they were *"unable to obtain sufficient appropriate audit evidence to satisfy ourselves with respect to the recoverable amounts determined by management"*

More than Meets the Eye

Company X

Accounting Standards

Paragraph 9 of SFRS(I) 13 *Fair Value Measurement*

- Fair value should be determined at the measurement date.
- Not appropriate to average the fair values at two different valuation dates.

Cause for concern?

- Directors had engaged valuation expert but disregarded the valuation.
- Directors also disregarded auditor’s view highlighted in the disclaimer.
- By averaging fair values between two years, **the Company presented a better financial position**.

More than Meets the Eye

Company Y

Company Y

↓ Unquoted preference shares

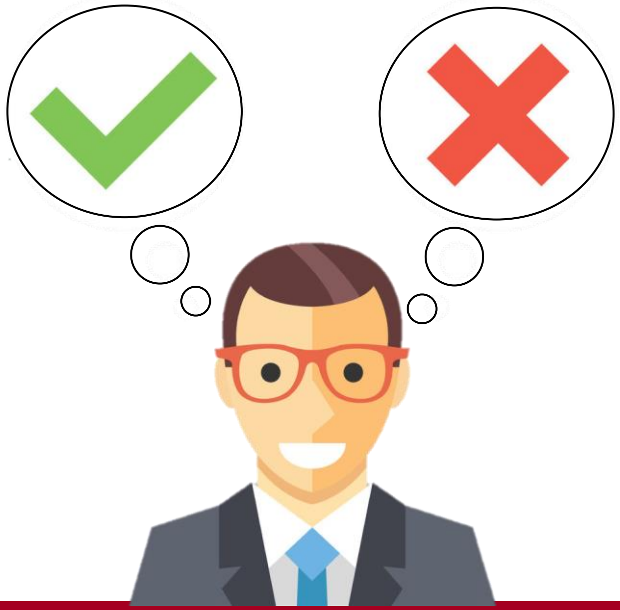
Investee

- Company Y invested in unquoted preference shares in an investee, and carried it at cost.
- On adoption of SFRS(I) 9 *Financial Instruments* on 1 Jan 2018, Company Y classified the investment as fair value through profit or loss.
- ‘Fair value’ on 1 Jan 2018 was determined <u>in-house</u> based on <u>net asset value</u> of the investee.
- Company Y engaged <u>professional valuer</u> to value the investment as at 31 Dec 2018 (year-end).
- The valuation by the professional valuer was more than 10x the ‘fair value’ determined in house. This led to significant fair value gain recorded in 2018 (>100% of Company Y’s PBT).
- There was no significant change in the investee’s business operations, prospects and plans between 1 Jan 2018 and 31 Dec 2018.

Poll #3

Is it correct for the Group to recognise the entire fair value gain in 2018?

A) Yes
B) No
C) Maybe



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More than Meets the Eye

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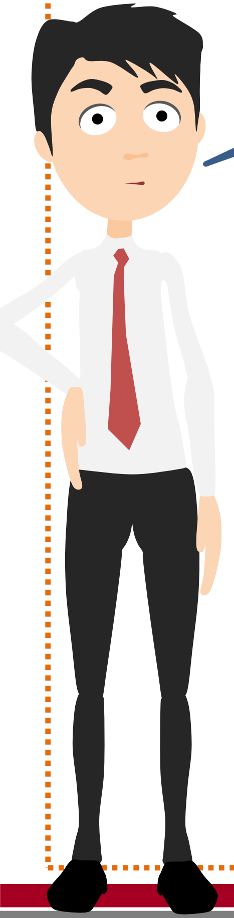
Company Y



B) No

Accounting Standards

Paragraph 61 of SFRS(I) 13 *Fair Value Measurement*
- Net asset value is not fair value.
- Market or income approach should have been used.

Cause for concern?

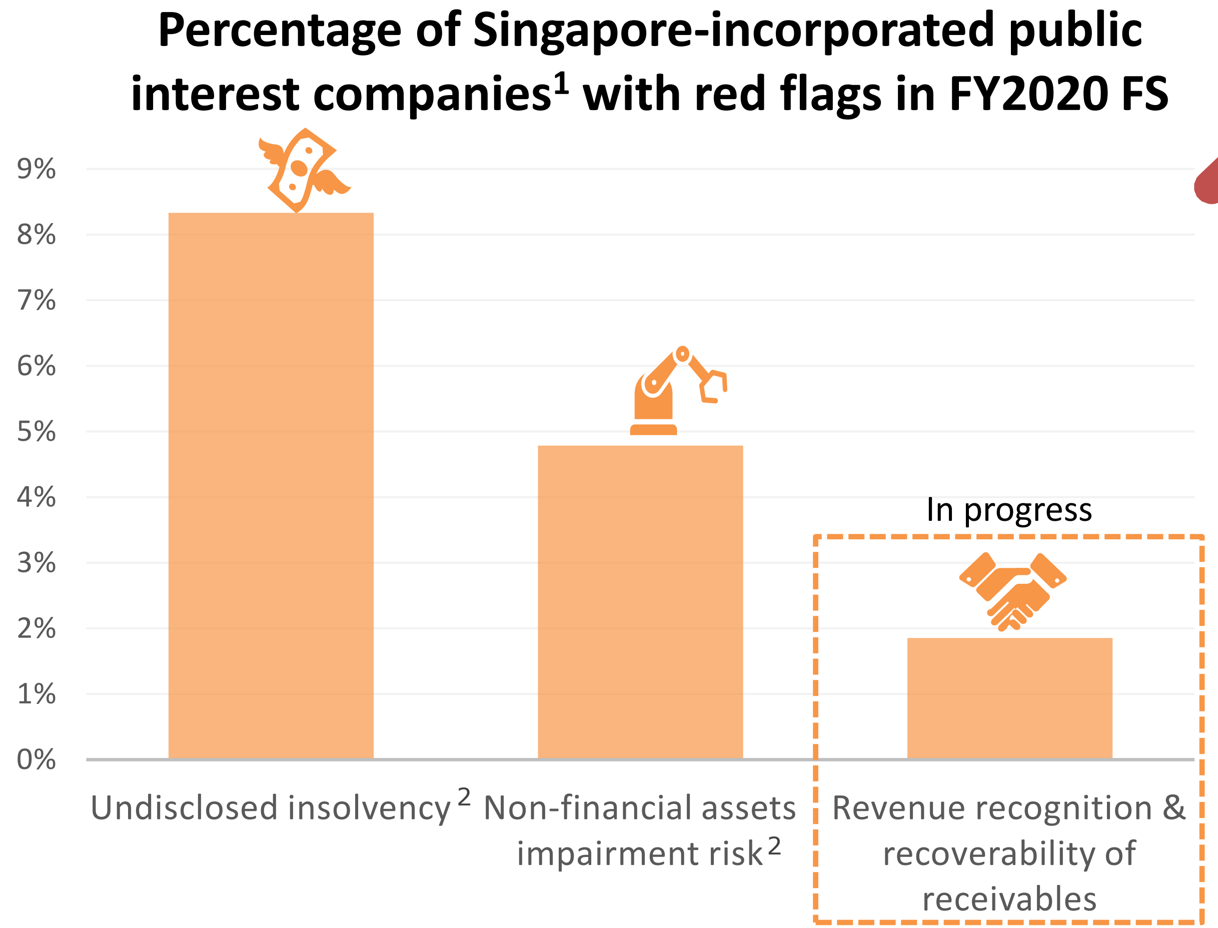
- No change in investee’s business operations, prospects and plan that would lead to significant fair value gain.
- Had ‘fair value’ on 1 Jan 2018 been determined using acceptable approach, portion of fair value gain would be recorded in opening retained earnings.
- Executive directors’ remuneration was tied to the Group’s financial performance.

Moving the Needle to Level the Playing Field

Stepping up our surveillance to be **more timely** and **targeted**.

Increasing the use of our enforcement powers and taking **more deterrent actions** against offenders.

Timely & Targeted Surveillance – Output from risk profiling models



1 648 companies with listed equity or debt or non-listed companies with high levels of debt
2 Risk areas highlighted in ACRA's Financial Reporting Practice Guidance No.1 of 2021

Factors for directors to consider

Undisclosed insolvency:
- Accumulated profits/losses
- Total equity
- Debt-to-equity ratio
- Current ratio
- Interest cover (ability to service interest)

Non-financial assets impairment risk:
- Earnings per share
- Profit/loss from operations
- Depreciation & amortisation over sales
- Loss making segments
- Market capitalisation vs book value

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Timely & Targeted Surveillance – Financial statements with red flags

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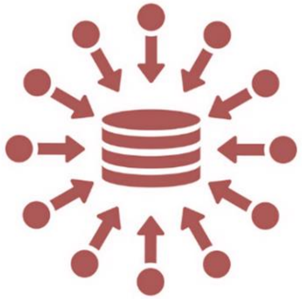
High level results

No. of red flags* in FY2020 FS:	**1**	**2**	**3**
Singapore incorporated companies with public interest	94	9	1

* Aggregate number of red flags based on 3 risk profiling models

Works in progress

Building new models to detect more red flags



Building capacity to extract data from sources to fuel our AI models and improve their accuracy

Calibrated Use of Enforcement Powers & Deterrent Sanctions

Powers of enforcement

39.—(1) In addition to the powers conferred on him or her by this Act or any other written law, an officer or employee of the Authority may, in relation to any offence under this Act or any written law specified in the Second Schedule —

(*b*) require any person to provide any information or produce any book, document or copy thereof in the possession of that person, and may, without fee or reward, inspect, make copies of or take extracts from such book or document;

54 companies currently being reviewed under FRSP

30 statements recorded from directors, auditors and key management in 2021 (versus 23 last year)

Composition fine levied against directors (versus nil last year)

Thank You!