2022 Mini-Guide for Audit Committees

Hot topics that ACs and Directors need to know

SGX RegCo's expanded enforcement powers and enhancements to rules

Guidance on financial risk indicators

Irregularities in financial reporting and lessons learnt

What ACs should look out for in audit adjustments

ACRA's area of review focus for FY2021 financial statements

AC Resources 2022

SGX RegCo's expanded enforcement powers and enhancements to rules

Topic	Details
1. Enforcement powers	Since 1 August 2021, SGX RegCo has the powers to: 1. Issue a public reprimand and require an issuer to comply with specified conditions; and 2. Prohibit – a. an issuer from accessing the facilities of the market for a specified period or until fulfilment of specified conditions; b. any issuer from appointing or reappointing a director or an executive officer for **up to 3 years**, if the individual is being investigated or is the subject of proceedings for contraventions of any relevant laws, regulations and rules relating to fraud, dishonesty, the securities or futures industry, corruption or breaches of fiduciary duties; and c. require a director or an executive officer to resign.
2. Whistleblowing framework	From 1 January 2022, SGX RegCo mandates all issuers to establish and maintain a whistleblowing policy, state in their annual reports that such a policy is in place, and provide in their annual reports explanations of how the following key requirements have been complied with: a. Designation of an independent function to investigate whistleblowing reports made in good faith; b. Ensuring that identity of whistleblower is kept confidential; c. Disclosure of commitment to ensure protection of whistleblower against detrimental or unfair treatment; and d. The Audit Committee being responsible for oversight and monitoring of whistleblowing. The requirement will take effect for issuers in respect of their **annual reports relating to financial years commencing from 1 January 2021**.

Guidance on financial risk indicators

Audit Committees are expected to be mindful in their reviews of issuers' financial statements, paying particular attention to areas where 'red flags' are more likely to exist. Useful questions which directors should keep in mind include but are not limited to:

	Questions
Statement of profit and loss	1. Is the performance for the current period materially different from the previous reporting period? Did the financial performance materially deviate from any statements or prospects previously disclosed? If so, has the company issued any profit guidance or clarification announcement to forewarn investors? 2. Are there any significant asset impairments or write-offs? Are methodologies used disclosed? 3. Are there significant write-backs? Are reasons provided satisfactory? 4. Are there significant variances in revenue and expenses? Has due enquiry been made and are reasons for the variances satisfactory? Was a breakdown of the operating expenses disclosed?
Statement of financial position	1. Are the fair values of the company's investment properties overstated? Are the inputs and assumptions used in its valuation techniques appropriate? 2. Are the company's non-financial assets (carried at cost) overstated and are impairment losses required to be recognised? 3. Are there any long outstanding receivables? Are these customers still in operation and are such receivables still recoverable? 4. Any significant increase in the company's advances to suppliers or prepayments? What is the rationale? 5. Any significant corporate guarantees entered into? What is the rationale? Has disclosure been made? 6. Is there any going concern issue? Is the company in a net liabilities or negative working capital position? Are bases for the Board's assessment that it is able to continue to operate as a going concern disclosed to enable trading to continue? 7. Is the company in need of funds despite cash hoard or strong cash-at-bank position? Why? 8. Is the company able to fulfil its repayment obligations in the next 12 months?
Statement of cash flows	1. Is the company having negative operating cashflows despite recording profits? Reasons?

Irregularities in financial reporting and lessons learnt

With more volatility and uncertainties in the market arising from COVID-19, opportunities for fraud could arise due to remote working arrangements along with operational or workforce disruption. Entities in financial distress or with liquidity pressures may rationalise to justify improper financial measures such as falsifying financial statements or applying inappropriate accounting treatments during this period to stay in business or gain access to capital markets. This increases the importance of the oversight role of a director. The Companies Act requires the directors of a company to present and lay before the company, at its annual general meeting, financial statements that comply with the Accounting Standards issued by the Accounting Standards Council; and give a true and fair view of the financial position and performance of the company.

Directors should exercise due care, competence and diligence in the review of the form and content of the financial statements to ensure that the financial statements presented are complete and consistent with their understanding of the entity. Based on our PwC Global Crisis Survey 2021 report, nearly double the number of Singapore entities sought forensic support compared to businesses globally. Based on the recent experiences, here are some areas directors should consider when reviewing the financial statements:

Revenue recognition:

- Changes in revenue, particularly long-term or non-standard contracts, that are inconsistent with the entity's activities and contractual arrangements.
- Judgements related to gross versus net presentation of revenue, and the related disclosures in the financial statements.

One-off transactions:

- Significant one-off gains or losses whereby the accounting treatment is inconsistent with the economic substance of the arrangement.
- Judgements over the transaction that may be biased or made without supportable evidence.

Valuation of assets:

- Indicators of impairment over non-financial assets such as goodwill, property, plant and equipment etc.
- Assumptions and judgements that are biased or inconsistent with the business plan, economic outlook and industry conditions which could inflate or deflate the valuation of both financial and non-financial assets.

Recognition of assets:

- Inappropriate deferral of costs into later periods.
- Capitalisation of inappropriate expenses as assets to improve profits.

Completeness of liabilities:

- Understatement of obligations such as provision for onerous contracts and financial guarantees.
- Incomplete disclosure of contingent liabilities and commitments.

Fair value measurement:

- Inappropriate use of valuation techniques and key inputs to determine the fair value of asset or liability.
- Assumptions and judgement made on level 3 unobservable inputs that are biased or inconsistent with market or industry conditions to determine the fair value.

Going concern:

- Indicators of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. Indicators include net current liabilities or net liabilities position, difficulty in securing re-financing or repayments of debt, breach of loan covenants and negative operating cash flows.
- Insufficient or lack of disclosure of the material uncertainties in the financial statements.

It is critical for directors to apply professional scepticism when reviewing the financial statements and challenge management's views on areas of significant judgement and estimates. This includes ensuring the financial statements are consistent with their understanding of the entity and adequate disclosures have been made.

Directors should also have oversight of the fraud risk programmes adopted by the entity which should include robust risk assessments, formalised responses to fraud risks and creation of dedicated fraud risk management programmes to address areas of highest risk. More information on how Singapore-based entities are responding to fraud and irregularities can be found in our PwC Economic crime report.

Explore more (PwC Global Crisis Survey 2021 report):

Explore more (PwC Economic Crime and Fraud Survey report):

What ACs should look out for in audit adjustments

With the increased complexity of businesses and application of financial reporting standards, it is vital for companies' finance teams to possess the necessary capability and expertise to prepare good and high-quality financial statements. Audit adjustments proposed and passed by the auditors can reveal much about a company's state of financial reporting. In this regard, ACRA has published a report based on a study led by Dr Themin Suwardy (Singapore Management University) and Dr Lim Chu Yeong (Nanyang Technological University) on audit adjustments of 412 listed companies in Singapore between 2018 to 2020 and a survey on the effectiveness of companies' finance functions involving over 279 audit committee chairs and heads of finance.

Some of the key findings of the study and what ACs should take note are as follows:

Key findings: Extent and nature of audit adjustments

Number and value of adjustments: Over 22,000 adjusting entries, with over 55,000 correcting lines, totaling approximately $78.7 billion were proposed by the auditors of the 412 SGX-listed companies between 2018 – 2020. This worked out to an average of 18 audit adjustments, with 45 correcting lines, totaling $63.6 million per company per year.

Prevalence of adjustments: 28 of the 412 SGX-listed companies (7%) had more than $100 million adjustment each year, accounting for almost 50% of the $78.7 billion total adjustments proposed. A large majority of these companies had adjustments that were either factual or misclassification errors and appeared to be a recurring trend every year from 2018 - 2020. This suggests a consistent lack of effort in addressing the underlying causes of audit adjustments.

Auditor vs Late Client adjustments: More than one third of total audit adjustments proposed were proposed by companies themselves. About 80% of late client adjustments were either factual (54%) or misclassification (25%) adjustments. The prevalence of late client adjustments was noted across companies with different market capitalisation, suggesting that this was not an issue confined to only companies of certain market size. A considerably high % of adjustments proposed by companies suggests there is room to improve the quality and timeliness of financial year-end closing and to 'get it right' for audit purposes.

Adjustment types: Majority (85%) of adjustments were factual and misclassification adjustments, with the remaining 15% being judgement, estimates or projection adjustments. Approximately 41% of companies saw the value of their proposed factual adjustments increased by more than 100% in 2020 as compared to 2018. For misclassification adjustments, 10 companies had proposed adjustments that were at least 5 times higher in 2020 as compared to 2018. Adjustments, particularly factual and misclassification adjustments, can be prevented if companies have a strong finance team and are able to address underlying root causes of audit adjustments promptly.

Underlying accounting issues: Audit adjustments relating to fair value measurements were most prevalent in the Financials industry (33%), followed by impairment issues in the Energy (30%), Financials (24%) and Information Technology (20%) industries, and over/under provision of accruals/ deferrals in the Utilities (28%) industry. Revenue recognition accounted for slightly over 25% adjustments in the Consumer Discretionary industry. This suggests specific areas companies in respective industries may wish to focus on to improve their financial reporting.

Key findings: Impact of audit adjustments

Impact of adjustments passed: Overall, about three quarters of proposed audit adjustments were eventually reflected in the financial statements, with almost all clients-identified adjustments being accepted or "passed". Where modified opinions were issued, almost all of proposed audit adjustments were passed. In comparison, unqualified opinion had about 71% of proposed audit adjustments reflected in the financial statements.

Impact by account type: Balance sheet items made up the top three accounts having the highest amount of proposed audit adjustments, *with Trade and Other Receivables* accounting for $14,150 million adjustments or 18% of the total adjustments, followed by *Other Assets* at $9,863 million (13%) and *Trade and Other Payables* at $9,013 million (11%).

Impact to income statement / balance sheet: About 44% of total adjustments had an impact on net profit (either through income or expense accounts), translating to a reduction of net income by over $1.1 billion across the 3 years for all companies in the study. The remaining 56% of adjustments featured debits and credits to balance sheet items alone.

What ACs should look out for in audit adjustments

What do all these mean for AC members?

- Identify and address root causes of audit adjustments. Engage your auditors early to discuss potential areas of adjustments, and how to address them before closing the books.
- Have an open conversation with your Head of Finance and auditors about the scale and characteristics of audit adjustments. Review all audit adjustments proposed by auditors in prior years with rigour, particularly those that are recurrent in nature and/or those which were not passed to prevent similar issues from recurring in the current financial year.
- Equip and resource the finance team appropriately so that auditors are not overly relied upon as the last line of defence before financial statements are issued. This should include training for technical areas that are causing errors in the financial statements, as well as improving competencies, processes and controls of the finance functions.
- Set appropriate improvement targets for your finance team.
- Consider engaging a specialist to address matters requiring complex accounting treatments.

Access the full report at:

ACRA's area of review focus for FY2021 financial statements

ACRA's 2021 Practice Guidance gives insight on cases reviewed in the past year under the Financial Reporting Surveillance Programme, including their regulatory outcomes and the material accounting non-compliances detected. The document contains helpful tips and case studies to guide directors in reviewing and approving FY2021 financial statements.

Access the document at:

AC Resources 2022

SID AC Chapter

Established in 2017, the AC Chapter seeks to advance the effectiveness of ACs and provide a platform for active discussion on issues relevant to ACs. Its resources and professional development programmes include:

AC Pit-Stops. Two-hour concise training sessions to equip ACs with fundamental understanding of specific topics to ask pertinent questions of management, external and internal auditors, and other professionals.

Curated articles from a wide variety of sources are available at www.sid.org.sg/ACPublications

2022 Courses and Events Calendar for AC members

12 January	ACRA-SGX-SID Audit Committee Seminar
24 February	AC Pit-Stop: The End of Inter Bank Offered Rates (IBOR)
3 - 4 March	Director Financial Reporting Fundamentals
14 - 16 March	SDP3: Finance for Directors (SID-SMU Directorship Programme)
16 March	LED5: Audit Committee Essentials
20 April	AC Pit-Stop: Valuation in Southeast Asia's Technology Industry
26 May	AC Pit-Stop: Finance Function of the Future
29 June	AC Pit-Stop: Maximising the Value of Internal Audit
30 June - 1 July	Director Financial Reporting Fundamentals
19 July	LED5: Audit Committee Essentials
27 - 29 July	SDP3: Finance for Directors (SID-SMU Directorship Programme)
18 August	AC Pit-Stop: Sustainability Reporting and Assurance
12 October	LED5: Audit Committee Essentials
10 - 11 November	Director Financial Reporting Fundamentals
23 August	SGD6: Financial Management and Accountability
By invitation only	BDC2: Audit Committee Chairman's Conversation

Note: The above are courses by SID which are relevant to AC members. Course dates are subject to change and the latest updates can be found at: www.sid.org.sg/pd

The next AC Seminar will be in January 2023.