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Achieving Quality Financial Statements

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In July 2014, the Accounting and Corporate Regulatory Authority (ACRA) extended the reach of its Financial Reporting Surveillance Programme (FRSP) to include the review of "clean" audited financial statements of listed companies for compliance with the Singapore Financial Reporting Standards (SFRS).

A year later, ACRA published the results of its review of the first batch of statements. The results were not pretty. Of the 49 listed companies reviewed, only 12 showed no material non-compliance with the accounting standards. There were four instances of severe non-compliance, 54 instances of other non-compliance, and 74 areas for improvement.

In 2016, ACRA published the results of its second review. This time, 17 of 50 companies had no enquiries. There were 21 non-compliances and 19 areas for improvement. While matters have improved, the results raise important questions. Specifically, what can directors do to ensure financial statements are of an appropriate standard that will avoid getting an ACRA query in the first place? I suggest we start with ensuring financial competence, getting help when needed, and reviewing smart.

FINANCIAL COMPETENCE

From the outset, it is crucial that all board members, and not just the audit committee (AC), be financially literate. The ability to read basic financial statements is a bare minimum for any director. In this regard, directors without a financial background should attend courses such as the Directors Financial Reporting Essentials Course conducted jointly by SID and the Institute of Singapore Chartered Accountants (ISCA) with the support of ACRA. Meanwhile, directors need to keep up with the latest ACRA Practice Guidance and SFRS.

Secondly, errors in financial reporting can be avoided if the directors ensure that a technically competent and adequately staffed finance team is in place to prepare the financial statements. The quality of a good finance team can be measured by the number of corrected/uncorrected audit adjustments proposed by the auditors, the number of versions of the financial statements produced before being finalised, and the annual hours of accounting training attended by finance staff.

The directors should increase their involvement in the accounting team's recruitment and selection process to ensure that only candidates who possess the right level of skills and competencies are recruited. As an adjunct, ISCA and other professional organisations offer year-long accounting training programmes to upgrade the skill sets of finance teams.

GETTING HELP

Directors and management should, where appropriate, seek the views of external specialists. This would help ensure that accounting assumptions and judgements are realistic and acceptable, given the complexities in the details of many transactions.

For example, in a business combination, companies should engage specialists to identify and value the assets acquired and liabilities assumed. This includes the identification and valuation of separately identifiable intangible assets currently not recognised in the books of the acquiree.

Companies should also seek help from qualified valuers on the valuation of businesses or non-current assets in their impairment assessments, especially when the headroom between the recoverable amounts of the assets and their carrying values is small. The specialists can provide assurance that appropriate methodologies have been adopted in the discounted cash flow model for valuation or impairment assessment.

REVIEWING SMART

A number of elements are involved here.

First, it is important to know the external environment – the political, economic, technological and legal factors that affect the company's performance. Directors should be satisfied that financial statements correctly reflect the impact of these factors on the company.

At the same time, the directors should also be alert to the impact of internal factors. The board should therefore ensure that business decisions have been correctly and completely accounted for in the financial statements.

Directors should be more rigorous in their reviews. This would likely mean spending more time reading the documents, understanding the key transactions, and asking questions to clarify areas of concern. This is especially where the areas involve new business transactions, complex or new accounting standards; areas highlighted by regulators; areas where audit adjustments were raised previously; and areas where significant judgements, assumptions and estimates are required.

The review process is ongoing. Although the work can be time-intensive, directors must realise and accept that their input, especially on accounting decisions, is essential. They should ensure that the accounting outcome reflects the true substance of the business transactions.

In its review, the directors should focus on areas of significant judgements, assumptions and estimates. These are areas that are subjective. However, subjectivity does not justify wrong accounting. Directors should challenge management's judgements if there are reasonable grounds to suspect potential bias and errors.

The directors should not hesitate to ask management to support accounting conclusions taken. They should not hesitate to go beyond management to consult accounting literature, industry practices and, as mentioned earlier, the views of experts and external auditors. They should also refer to ACRA's Financial Reporting Practice Guidance.

If it is not already clear, directors have an important duty to ensure that financial statements comply with accounting standards, and give a true and fair view. This duty cannot be delegated. ■