



Disclose, or what and how to disclose – That is the question

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Recent changes in the Singapore Exchange (SGX) Listing Rules and Singapore Code of Corporate Governance 2012 (revised Code) have encouraged the establishment of robust processes and more transparency for stakeholders. This is particularly so in relation to remuneration, risk management and internal controls.

Over the past few months, many Singapore listed companies with financial years ending 31 December 2013 released their annual reports.

While some demonstrated great strides in implementing more robust processes and disclosures in their annual reports, others lagged behind.

When you consider how many queries SGX made to companies for disclosures failing to meet requirements, it becomes clear that better education surrounding the changes are needed.

Typical queries related to why companies were 'silent' (i.e. made no mention of the requirement), had omitted key components or did not sufficiently explain departures from the requirements.

To explore this issue, KPMG conducted a study of all SGXNET company queries issued in April 2014. During this period, SGX queried 123 companies, of which 98 percent were listed on the Mainboard. Of these,

- 53% were from manufacturing related sectors
- 15% were from real estate while companies from other sectors made up the balance.

Looking at the results of the study,

- 37% of total queries related to *Principle 9 Remuneration Disclosures* of the revised Code; and

In Singapore, while transparency in disclosure is improving, this is only the tip of the iceberg.



- 31% of total queries related to *Principle 11 Risk Management and Internal Controls* of the revised Code and SGX Listing Rule 1207(10) related disclosures.

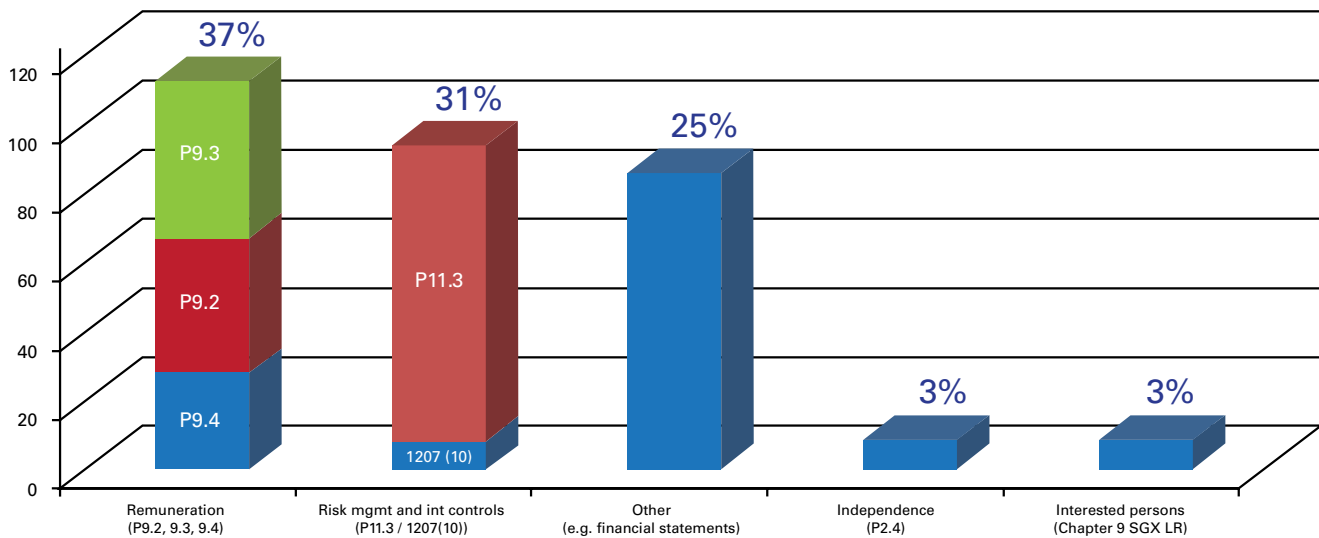


Figure 1:

Breakdown of SGXNET queries by type, number and percentage (for the period 1-30 April 2014)

Source: KPMG Risk Consulting Analysis 2014

If we look at these results, a pattern starts to emerge. Companies appear to fall into one of three categories – those which do not support fuller disclosure, those that want to disclose more but don't know how and those that don't know what to disclose.

“I Don't Want to Disclose”

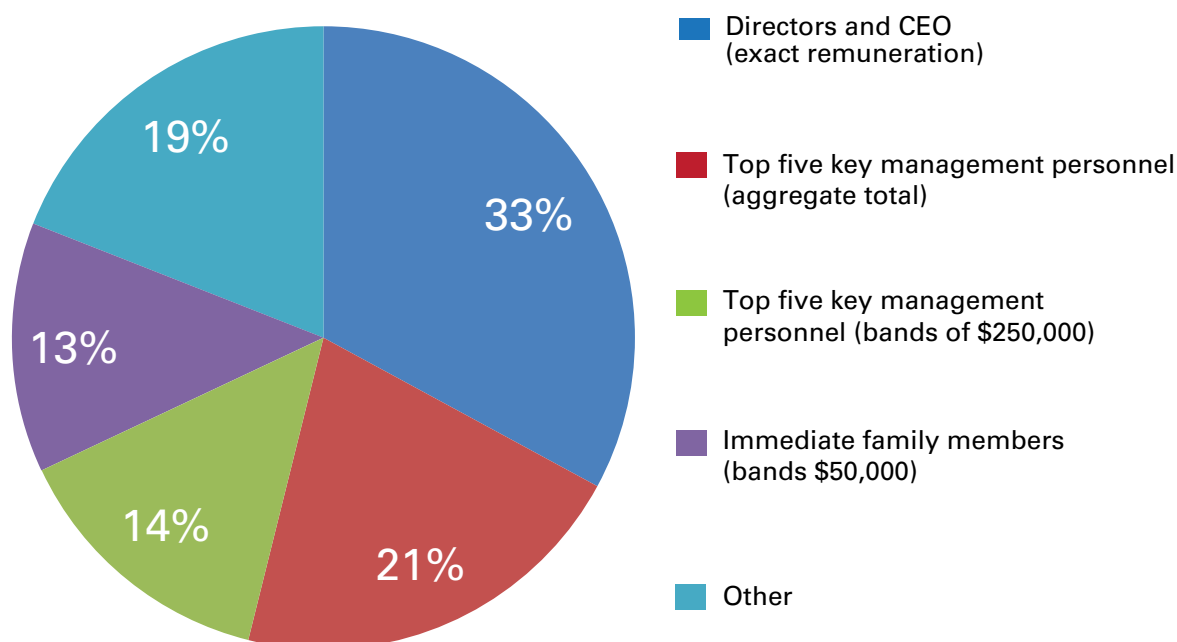
Looking at the queries related to remuneration, risk management and internal control disclosures, 27% were resolved through 'explanations'.

By choosing the route of exception rather than compliance with the requirements even in the face of an SGX query, many companies signal they preferred less disclosure. This is especially so in relation to queries surrounding disclosing remuneration.

Among the total remuneration related queries made, as highlighted in Figure 2, the most significant deficiencies related to:

- 33% not disclosing exact remuneration for directors or their CEO
- 21% not disclosing the aggregate of total remuneration paid to the top five key management personnel
- 14% not disclosing remuneration of the top five key management personnel in bands of \$250,000

Figure 2: Breakdown of SGXNET queries categorising remuneration related deficiencies



Source: KPMG Risk Consulting Analysis 2014

Understanding that disclosures of remuneration related to directors, senior executives and relatives can be sensitive, most companies provided a brief explanation for non-compliance with the revised Code. They typically cited confidentiality and the risk of competitors poaching talent as reasons.

Others appeared to be adopting a 'wait and see' approach to remuneration disclosure.

As stakeholder activism increases, companies may need to enhance transparency in disclosing remuneration.

How effective a 'comply or explain' regime will ultimately be, remains to be seen. Some countries, in particular the UK, have opted for legislation to ensure consistency and transparency.

"I Want to Disclose but Don't Know How"

At the same time, our study found that many companies were willing to take on board the new requirements.

Among the total remuneration, risk management and internal control related disclosure queries, 62% were resolved by compliance.

Many companies were thus willing to disclose more, but initially unaware of the requirements

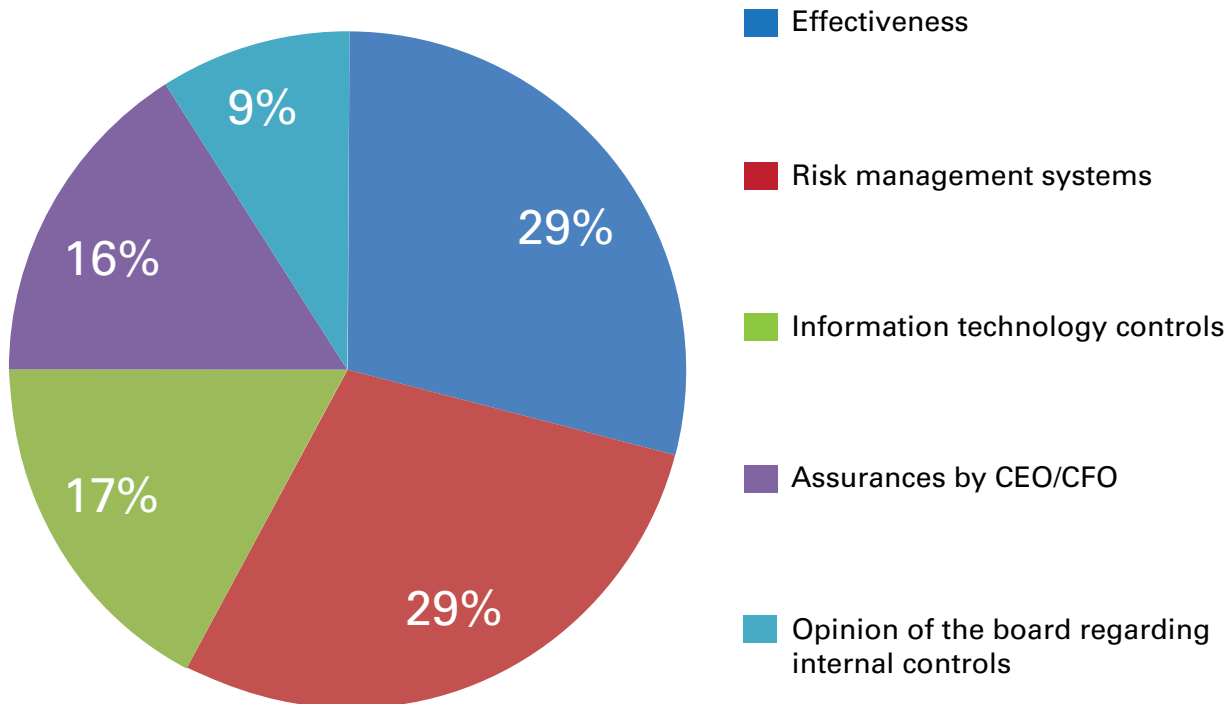


or unsure how to do so.

We found that the most common queries, of the risk management and internal control related queries, related to pertinent omissions found in initial disclosures, as shown in Figure 3:

- 29% did not to disclose 'effectiveness'
- 29% did not disclose 'risk management systems'
- 17% did not disclose 'information technology' controls

Figure 3: Breakdown of SGXNET queries categorising risk management and internal control related deficiencies



Source: KPMG Risk Consulting Analysis 2014

This is not surprising given the difference in terminology between SGX LR 1207(10), a mandatory SGX listing rule introduced in 2011, and *Principle 11.3* of the revised Code, a 'comply or explain' requirement introduced in 2012.

SGX LR 1207(10) requires a company board, with a concurring audit committee, to provide an **opinion** regarding the adequacy of internal controls covering financial, operational and compliance risks.

In comparison, *Principle 11.3* of the revised Code requires the board to **comment** on the adequacy and effectiveness of the risk management and internal control system. This covers the financial, operational, compliance and information technology controls.

Another example of an area causing confusion is the drafting of the board's opinion, as required in SGX LR 1207(10), and the board's comment as required in *Principle 11.3* of the revised Code.

Some 44% of companies with risk management and internal control related queries separated the board's **comment** from the board's opinion. This is in line with both existing rules.

However, 56% of total queries were met with the provision of a combined opinion of the board.

This means one opinion capturing all requirements of SGX LR 1207(10) and the revised Code *Principle 11.3*. This opinion covered the adequacy and effectiveness of risk management and internal controls. It covered financial, operational, compliance and information technology controls.

When opting for a combined board 'opinion', companies should not forget the greater legal liability associated with an opinion. The onus to be accurate also falls more heavily on them.

"I Don't Know What to Disclose"

Despite some companies receiving an SGX query highlighting gaps in their disclosures, 11% of total remuneration, risk management and internal control disclosure related queries were not satisfactorily revised.

The most common area where revised disclosures were unsatisfactory related to companies not disclosing the effectiveness of their risk management and internal controls.

This is critical, as it amounts to failing to disclose the validation of controls operating as intended in practice. At a minimum, an explanation as to why a company had not assessed its effectiveness is needed.

An emerging area where boards and audit committees are increasingly requesting further guidance relates to disclosing control deficiencies and material weaknesses.

Interestingly, the study did not find any disclosures highlighting reportable weaknesses in the risk management and internal control systems.

This finding is consistent with a recent 2013 ISCA-KPMG study which found only one percent of 250 listed companies on the SGX disclosing a "negative opinion". That is, inadequate controls (supported by an explanation).

Many boards and audit committees are finding it difficult to develop a framework that

- clearly defines deficiencies, whether individual or at an aggregated level
- enables timely identification and the escalation of deficiencies
- allows for mitigation within the period and / or clear mitigation plans to be endorsed; and
- provides thresholds and explanations for disclosing deficiencies where required.

To encourage more companies to develop control deficiency oversight programmes and prepare meaningful disclosures, further guidance is needed.



Conclusion

In Singapore, while transparency in disclosure is improving, this is only the tip of the iceberg.

That tip, above water, is the primary means by which disclosures to stakeholders of governance practices are made.

Naturally, it must reflect the substance that lies beneath the surface. While companies can easily edit the wording in an annual report to satisfy current requirements, more needs to be done to ensure that the words reflect the reality.

Stakeholders are depending on this information. Directors therefore have a duty to disclose this, with confidence and integrity.

A recent scenario we have encountered demonstrates an emerging development in the role of directors, particularly independent directors, in challenging the underlying practices within an organisation.

As part of the annual report review process, an independent director was reviewing the risk management and internal control disclosures section prepared by management. The disclosures contained certain descriptions of internal controls activities.

Rather than accepting the disclosures at face value, the independent director asked management to confirm that the internal control activities were being practiced and requested that the CEO confirm this in person.

This incident highlights the critical role that independent directors play in challenging information presented to the board and setting an appropriate tone-at-the-top that values adequate and effective risk management and internal controls within the organisation.

As this was the first time that disclosures complying with the revised Code were made, there is a natural learning and adoption curve to establish robust underlying processes and disclose in accordance with requirements.

Now is the time for directors, audit committee members and management to take heed of the lessons learned in time to prepare for annual disclosures for financial year 2014 reporting. ■

The views expressed in this article are the views of the author.