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Company Law Update

Areas of review focus for FY2018 financial statements under ACRA's Financial Reporting Surveillance Programme

Overview

The Accounting and Corporate Regulatory Authority of Singapore ("**ACRA**") established the Financial Reporting Surveillance Programme ("**FRSP**") as a guide for companies to adhere to the requirements in ACRA's prescribed accounting standards.

On 1 February 2019, ACRA released its Financial Reporting Practice Guidance No. 1 of 2019, with the focus areas for FY2018 financial statements under its FRSP. These focus areas were selected in light of the significant changes in accounting standards in 2018 and 2019, including but not limited to the SFRS(I) 15 / FRS 115 *Revenue from Contracts with Customers,* the SFRS(I) 9 / FRS 109 *Financial Instruments,* and the SFRS(I) 16 / FRS 116 *Leases.*

New accounting standards

A. SFRS(I) 15 / FRS 115 *Revenue from Contracts with Customers*

The new revenue standard requires directors to exercise significant judgments and estimates in deciding when and how much to recognise as revenue. Therefore, ACRA has recommended directors to keep in mind and possibly bring up the following factors to management:

For customer contracts where the performance obligations straddle beyond one year:

i. The criteria to decide whether revenue is recognised 'at a point in time' or progressively 'over time' have changed. Particularly, revenue is recognised 'over time' only when the company's performance does not create an asset with alternative use to the company and when the company has an enforceable right to payment for performance completed to date.

ii. With the new changes, only costs that meet the definition of an asset are recognised as assets. Therefore, a company that recognises revenue 'over time' is precluded from deferring or accruing costs to achieve a constant profit margin from one period to another.

iii. For assets that take a long time to construct but are ready for sale, the International Accounting Standards Board (IASB) issued a tentative view that the related borrowing costs should not be capitalised for both sold and unsold units. Therefore, where applicable, ACRA recommends directors to consult their auditors before authorising the financial statements for issuance to assess if adjustments or additional disclosures are required.

Further, for companies that sell bundled products and/or services, the new revenue standard requires companies to identify separate distinct performance obligations, and allocate the total contract sum to each performance obligation.

Lastly, for companies that require customers to pay a one-off non-refundable activation or initiation fee at the start of a contract, the new revenue standard requires companies to assess whether these fees are payments for goods or services to be delivered at the start of the contract or in the future. If the latter applies, then the revenue is only recognised when the goods or services are delivered in the future.

B. **SFRS(I) 9 / FRS 109 *Financial Instruments***

The new financial instruments standard recognises more financial instruments at fair value, as compared to the previous financial instruments standard. Under the new standard, companies may now carry their investments in unquoted equities at their fair values, unless their costs approximate the fair values.

Further, companies that are not financial institutions should take note of the new expected loss impairment model, and all companies should pay attention to the new disclosures relating to judgements and estimates.

C. **SFRS(I) 16 / FRS 116 *Leases***

The new lease standard will likely affect companies that are lessees of office, retail, warehouse space and property, plant and equipment. ACRA encourages directors of these companies to take note of the implications of having more amounts recognised on the balance sheet as financial liabilities, like compliance with loan covenants. Further, ACRA encourages directors to ensure that there are adequate disclosures of known or reasonably estimate information relevant to assessing the possible impact of adopting the new lease standard.

Impairment assessment and valuation

In light of the fact that more items are now required to be recognised at fair value, ACRA states that directors should critically assess the assumptions used by management in valuations. This is particularly so if the underlying estimates of future cash flows do not appear to conform with the company's circumstances.

ACRA further encourages directors to obtain independent professional valuations for significant assets, or where in-house expertise is not available. Directors are also advised to assess the final valuation results with respect to their understanding of the market, business model and asset attributes of the company.

Major transactions

In respect of major transactions that require approval from directors, ACRA encourages directors to evaluate if the accounting treatment of such transactions reflects the economic reality of the arrangement.

Statement of cash flows

Additionally, ACRA advises directors to look at operating cash flow as a key metric of short-term health and performance and take note of when a company's profit is not substantially realised in cash. Further, directors should ensure that there are adequate disclosures of significant non-cash investing and financing transactions to facilitate readers' understanding.

Significant judgments and estimates

ACRA further encourages directors to disclose critical judgements and significant estimates that may be complex, to facilitate investors' understanding. Directors should also refrain from approving boilerplate disclosures that do not differentiate across different industries, transactions or a company's circumstances.

When there are indications of financial difficulty such as substantial operating losses, negative operating cash flows and breaches of loan covenants, directors must assess whether the company is able to continue as a going concern. In doing so, directors should evaluate the key assumptions for a period covering at least 12 months from the financial year-end. Adequate disclosures should also be made in respect of the significant judgements and key estimates applied.

Conclusion

The FRSP areas of review focus as discussed above are meant to serve as a guide for directors in reviewing the upcoming financial statements of companies, particularly to prevent possible reporting misstatements. Therefore, directors should ensure that the guidelines provided by ACRA are adhered to and seek professional advice where necessary.

If you have any queries on the above, please contact us at:

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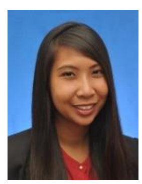

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This article is intended to highlight ACRA's FRSP areas of review focus for FY2018 financial statements. It is not intended to be comprehensive nor should it be construed as legal advice. This article is updated as of 27 February 2019.