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Responding to Financial Reporting Surveillance Reviews

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Many directors continue to be surprised to receive letters from the Accounting and Corporate Regulatory Authority (ACRA) querying the accounting treatment and disclosures in their companies' financial statements.

These letters are being sent as part of the regulator's expanded Financial Reporting Surveillance Programme (FRSP) which selectively reviews the financial statements of companies for compliance with the prescribed Accounting Standards in Singapore.

Although the FRSP has been around since 2011, it was only in early 2014 that ACRA moved to include not just qualified accounts but also those with "clean" audit reports, and to directly engage with directors on the results and questions it may have on the financial statements.

Why me and not the CFO?

Invariably, the initial reaction of most directors is that the letter should not have been sent to them, but should have gone to management or, more specifically, the chief financial officer (CFO) who was responsible for preparing the financial statements.

Unfortunately, it is the directors, and not management, who are responsible for ensuring that the financial statements "comply with the requirements of the Accounting Standards and give a true and fair view of the financial position and performance of the company".

While the statutory responsibility has always been there, directors have not been made so acutely aware of their duty until recently, when the expanded FRSP was launched.

The query letter from ACRA will usually include an explicit reminder to directors of:

- 1) their responsibilities to ensure that the company's financial statements comply with the Accounting Standards; and
- 2) the consequences of failing to comply.

The latter can take various forms: a warning; a composition fine; or, in "very serious cases", prosecution of the directors, which could lead to higher fines and/or jail sentences.

How should directors respond

After the initial flurry of "what's going on?" e-mails among the board members, the audit committee will usually be tasked to look into ACRA's query letter and to respond appropriately.

The audit committee chairman should convene a meeting with the company's finance team and external auditor. The finance team should be required to draft its response to ACRA's queries prior to this meeting.

Obviously, ACRA's queries and the company's responses will be specific to each company. However, from my discussions with peers in other audit committees, there are some common management responses that the regulator has found unacceptable and, quite frankly, they should not be considered acceptable by the audit committee either:

- *The amount is immaterial and thus no further information is needed.* If ACRA had not deemed the item to be material, it would not have raised the query in the first place. At the minimum, there needs to be a satisfactory explanation of the qualitative and quantitative considerations that determine the company's definition of materiality.
- *The matter is confidential and the company is therefore unable to provide further information.* In the current environment of greater transparency, a response like this suggests that the company may have something to hide, and this would only serve to make the regulator even more inquisitive.
- *The estimated amount is a matter of judgement and that was our judgement.* ACRA and the accounting standards call for the company to have a proper basis and rigour in amounts that involve estimation and valuation. That basis and the detailed work undertaken to arrive at the estimates and valuation should be fully disclosed.

The audit committee should ensure that the proposed response to ACRA is comprehensive and appropriate, and that it fully answers and "closes off" further correspondence on the query. Otherwise, the risk is the arrival of a second letter requiring further clarification - or, worse, a warning, a composition fine, or prosecution.

Once the draft response is finalised by the audit committee, it should go to the board for its review and approval prior to submission to ACRA. The company's official response can be sent by the board chairman or audit committee chairman on behalf of the board.

How to not have to respond

Instead of scrambling to reply to ACRA within the usual three-week deadline, companies are much better off ensuring that the financial statements are prepared in a way that avoids a query in the first place.

This means having a competent finance team that prepares the financial statements, and a diligent external auditor who ensures that the Singapore Financial Reporting Standards (SFRS) are complied with.

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All these actions need to start at the top with a board that sets the tone for "doing the right thing, the right way, all the time". It is important that internal management structures and personnel are in place to effect this.

In addition, all directors, not just audit committee members, should be financially literate so as to be able to read financial statements in an effective way. They should also have the courage and persistence to keep asking the right questions until they receive satisfactory answers from both the finance team and the external auditors.

Going forward

For many directors, the ACRA letters have been a much needed wake-up call not just about their responsibilities but also the quality of their companies' financial statements.

Now that the message has been sent, ACRA may wish to consider, going forward, addressing the FRSP enquiries in the first instance directly to the CFO while copying the board and the auditor.

If and when the responses are deemed wanting and further enquiries follow, the directors may then be asked to respond. This change would likely make the process more efficient and effective.

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