PRACTICE DIRECTION NO. 2 OF 2014

DIRECTORS' DUTIES IN RELATION TO FINANCIAL REPORTING AND REVIEW AND SANCTION PROCESS OF THE FINANCIAL REPORTING SURVEILLANCE PROGRAMME ADMINISTERED BY THE ACCOUNTING AND CORPORATE REGULATORY AUTHORITY (ACRA)

Aim

1. This Practice Direction sets out:
    (a) The duties of a director in relation to financial reporting; and
    (b) The review and sanction process of ACRA's Financial Reporting Surveillance Programme (FRSP), which involves the review of financial statements to detect and enforce against financial reporting breaches.

Director's Duties in relation to Financial Reporting

2. Sections 201(1A), 201(3) and 201(3A) of the Companies Act, Chapter 50 (the "Act")[1] require directors of a company incorporated in Singapore to present and lay before the company, at its annual general meeting, financial statements that:

    (a) **comply with Accounting Standards[2]** issued by the Accounting Standards Council; and
    (b) **give true and fair view** of the profit and loss, as well as the state of affairs of the company.

3. In addition, sections 199(2A) and 199(1) of the Act require directors to maintain a system of internal accounting controls and keep proper accounting and other records respectively that will enable the preparation of true and fair profit and loss accounts and balance-sheets.

4. A financial reporting breach occurs when a director has failed to comply with sections 201(1A), 201(3) and 201(3A) and/or sections 199(1) and/or 199(2A).

Financial Reporting Surveillance Programme (FRSP)

5. Quality financial information is crucial for strong and vibrant capital markets. It is essential that investors and other stakeholders are assured of the reliability and accuracy of the financial information they receive.

6. Companies incorporated in Singapore and Singapore branches of foreign companies are required by the Companies Act to prepare and present financial statements that comply with the requirements set out in paragraph 2.

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1 The Companies Act, Chapter 50 can be found at http://statutes.agc.gov.sg

2 Accounting Standards refer to Singapore Financial Reporting Standards (SFRS), Singapore Financial Reporting Standards for Small Entities (SFRS for SE) and Charities Accounting Standards.

7. In 2011, ACRA established the Financial Reporting Surveillance Programme (FRSP) where selected financial statements are reviewed to determine if they comply with the requirements set out in paragraph 2. When a financial reporting breach is established, ACRA will impose regulatory sanctions on directors as set out in paragraph 14.

The Review and Sanction Process

(A) Formal Enquiry Letters to Directors and Auditors

8. Where there are matters requiring additional information upon review of the financial statements, ACRA will raise formal enquiry letters to each individual director who authorised the financial statements to request for explanation, supporting documents and other records as necessary. In certain cases, ACRA may also direct the enquiries to the auditors of the financial statements.

9. To provide directors with opportunities to make voluntary corrective changes (if any) to the next set of annual financial statements, ACRA needs to conclude the review promptly. ACRA will therefore request directors and/or auditors to respond to the enquiry letters within two (2) to three (3) weeks from the date of the enquiry letters.

10. ACRA will receive all explanations in writing and will consider requests for physical meetings to provide verbal clarifications on a case-by-case basis. However, such verbal clarifications must be followed by the same explanations in writing and within the same timeline of two (2) to three (3) weeks from the date of the enquiry letters.

11. All information provided to ACRA will be kept strictly confidential.

(B) Types of Financial Statements which will be Prioritised for Review

12. ACRA will adopt a risk-based approach in prioritising the financial statements for review. Emphasis will be placed on financial statements of public and large private companies with:
    (a) modified audit opinions[3] as well as audit opinions with emphasis of matter paragraph, indicating potential non-compliance with Accounting Standards and other requirements of the Act;
    (b) significant public interest risks based on several criteria such as market capitalisation size, revenue size, asset size, and multiple employees, creditors, customers and other stakeholders;
    (c) operations that require subjective judgement in accounting for its transactions, hence increasing the risk of significant misstatement;
    (d) change in listing or trading status (e.g. newly listed, suspended or delisted); and
    (e) significant change in key stakeholders including controlling shareholders, directors, management and auditors.

[3] Modified audit opinions refer to those other than true and fair audit opinions. They comprise audit opinions which are qualified, with adverse opinions and disclaimer of opinions.

The above factors are provided as a general guideline, and ACRA reserves the right to conduct any review of financial statements as deemed necessary.

(C) Range of Sanctions which may be imposed on Directors

13. ACRA may call upon directors for interviews before imposing sanctions depending on the severity of the financial reporting breach(es). Whilst the Act provides for sanctions such as fines and imprisonment, ACRA may employ other sanctions for first time offenders and less severe technical breaches.

14. The range of enforcement actions that will be decided by the Registrar of Companies will include:
    (a) advisory letter;
    (b) warning letter;
    (c) fine by offer of composition; and
    (d) prosecution leading to fines and/or imprisonment.

15. When directors of a listed company have been the subject of regulatory sanctions under paragraph 14, the directors should consider whether the regulatory sanction on the directors constitute "material information" in relation to the Company, where an SGX-net announcement is necessary under Rule 703 of the Singapore Exchange's Listing Manual.

(D) Requirement to Rectify the Deficient Financial Statements

16. Where significant prior period corrections are made in the next set of annual financial statements as a result of ACRA's FRSP, the company may be required to disclose the fact that the correction arises from ACRA's FRSP in the notes to the financial statements explaining the correction.

17. As a result of severe financial reporting breach(es), the company may also be required to rectify the deficient financial statements, have the restated financial statements re-audited and re-file the restated financial statements with ACRA.

(E) Reporting to the Public

18. To enhance transparency, ACRA will publish annual reports summarising the activity and findings of FRSP for the past year. The report aims to help companies improve their financial reporting by enhancing their understanding of the application and interpretation of accounting standards and requirements. The report will include the findings of the financial reporting breaches but will not identify the name of the companies.

19. To guide directors and other financial statements preparers, ACRA will publish in advance the areas of the FRSP's review focus in the coming year. This will serve to remind directors of the risks of misstatements and/or non-disclosures in the financial statements as well as the information needs of shareholders and other stakeholders. Please refer to Financial Reporting Practice Guidance No. 1 of 2014 which details the areas of focus for FRSP reviews to be conducted from <u>1 April 2014 to 31 May 2015</u>.

Commencement date

20. This practice direction applies to the financial statements reviewed under the FRSP with effect from 1 April 2014.

Further Guidance and Support for Directors

21. Directors are advised to read Annex A which provides further guidance to directors on carrying out their duties in relation to financial reporting.

22. Directors are strongly encouraged to attend the Director Financial Reporting Essentials Course[4] organised by the Singapore Institute of Director (SID) in collaboration with the Institute of Singapore Chartered Accountants (ISCA), so as to keep abreast with the financial reporting developments. The first 3,000 directors who voluntarily attend this course before 31 March 2016 will be entitled to subsidies of $300 per individual (about 50% of the course fees) funded by ACRA.

Issued on 23 April 2014

Kenneth Yap Yew Choh (Mr)
Chief Executive and Registrar of Companies
Accounting and Corporate Regulatory Authority

[4] More information on the Director Financial Reporting Essentials Course can be found at http://www.sid.org.sg/web_courses/programmes.

Guidance on Directors' Duties in relation to Financial Reporting

1. **Duties to prepare financial statements** - Directors, whether executive or non-executive, are responsible for ensuring that financial statements prepared by management are true and fair, and compliant with the Accounting Standards issued by the Accounting Standards Council. They should exercise care, competence and diligence in their review of the financial statements that are presented to shareholders and subsequently filed with the ACRA.

2. **Review of financial statements** - Directors should read, understand and enquire into the form and contents of the financial statements to ensure that the financial information presented is clear, complete and consistent with their understanding. Even if they are not accounting experts, directors could question the accounting treatments applied when the treatment does not reflect their understanding of the substance of arrangement. They should also apply professional skepticism when assessing management views' on areas of significant judgement and estimates.

3. **Financial literacy** – Directors are not expected to be accounting experts, but should have sufficient and up-to-date knowledge of the accounting principles and practices to perform an effective high-level review of the financial statements. Otherwise, directors are strongly encouraged to seek help and/or attend training. One suitable training course will be the Director Financial Reporting Essentials Course organised by SID in collaboration with ISCA. The first 3,000 directors who voluntarily attend this course before 31 March 2016 will be entitled to subsidies of $300 per individual (about 50% of the course fee) funded by ACRA.

4. **Appointment of management -** Directors should ensure that senior management of the company, such as the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), has adequate knowledge, competence, experience and integrity to undertake their roles.

   Under the Code of Corporate Governance 2012, directors of listed companies should comment in the Annual Report on whether they have received assurance from the CEO and the CFO:
   (a) that the financial records have been properly maintained and the financial statements give true and fair view of the company's operations and finances; and
   (b) regarding the effectiveness of the company's risk management and internal control systems.

   Whilst the assurance from the CEO and the CFO do not diminish the directors' responsibility in these areas, it can provide directors assurance that management has exercised due care in the financial reporting process.

5. **Competent and adequately resourced finance function** – Directors should ensure that management maintains competent and adequately resourced finance function who can prepare high quality financial statements. Qualified accountants should be recruited and provided with relevant and continuous training to keep them abreast of the financial reporting developments.

6. **Using external help** – Directors could obtain professional accounting advice(s) and/or outsource to professional accounting service providers the keeping of accounting and other records and the preparation of financial statements. However, directors remain responsible and should ensure any such advice(s) and/or service(s) are provided by suitably qualified persons with an appropriate level of expertise and knowledge of the accounting standards, and that such advice is unbiased and objective.

7. **Working with the independent auditors** – The independent auditors are required to communicate with those charged with governance on significant audit findings, including why they consider a significant accounting practice is not appropriate to the particular circumstances of the company, prior to the issuance of the audit reports. Directors should resolve these issues amicably and seek professional help when necessary. Directors should not rely on the independent auditor in forming their own opinion on the financial statements. Doing so will undermine the objective of an independent audit.

8. **Directors' duties to maintain internal control system and keep accounting and other records** – Directors should ensure that management adopts appropriate accounting policies, designs and implements appropriate internal controls and processes, and maintains complete and accurate accounting and other records. This obligation exists regardless of whether books and records are maintained in-house or outsourced to a third party.

The above is meant to guide directors in complying with certain significant duties in relation to financial reporting. They do not exhaustively define the duties applicable to directors under the Act and/or related legislation. When in doubt, legal advice should be sought by directors to clarify the scope of their duties.