

WINDS OF CHANGE SWEEPING THROUGH AUDITOR'S REPORT

A WELCOME BREEZE!

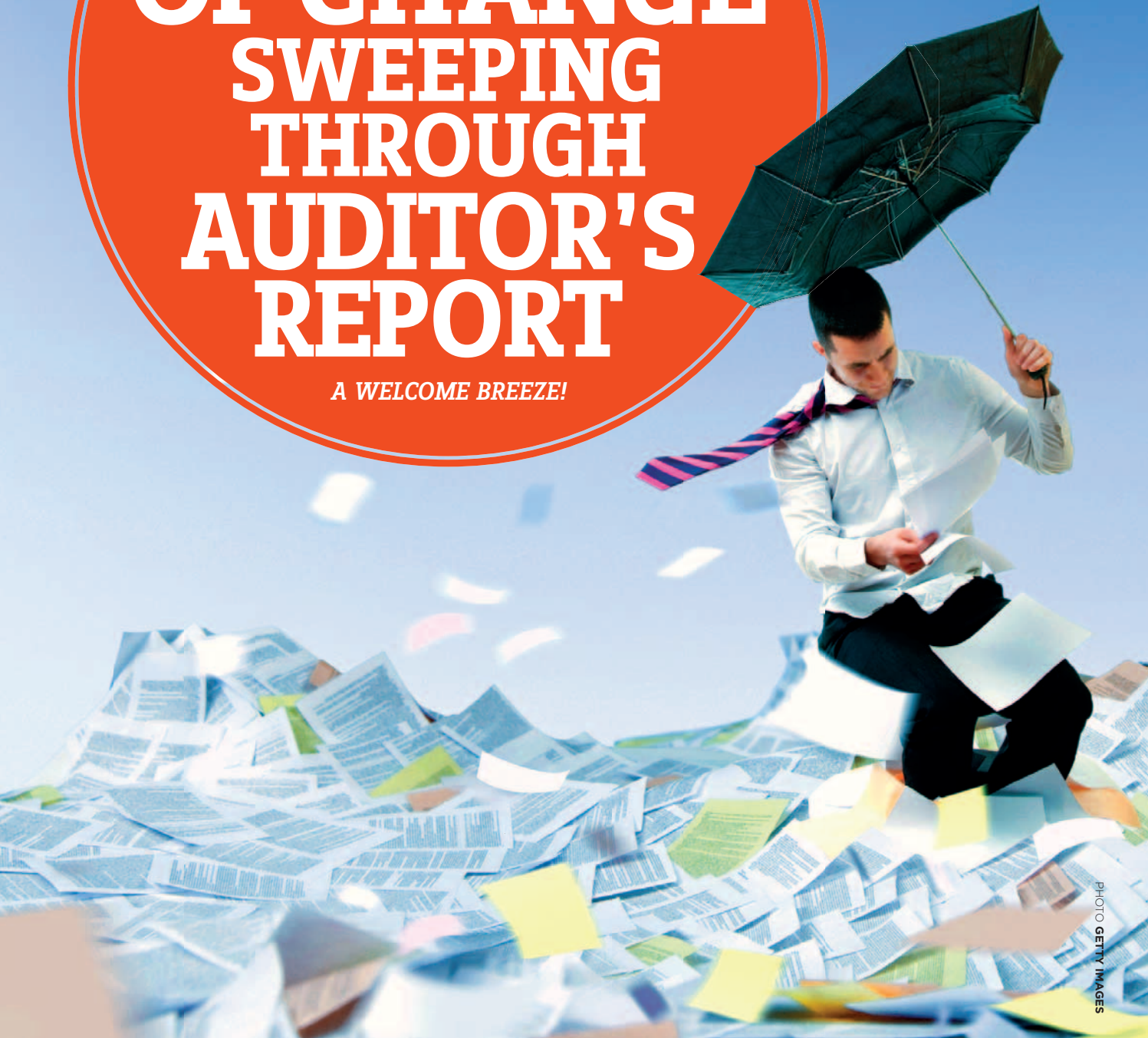



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**THE FINAL REVISED
STANDARDS ARE EXPECTED
TO HIT THE STREETS IN
JUNE 2014, AT WHICH POINT
STAKEHOLDERS CAN EXPECT
TO SEE SIGNIFICANT CHANGES
IN THE AUDITOR'S REPORT.**

The auditor's reports may no longer be a standard one-page letter to members of companies in two to three years' time, judging from the views and perspectives aired at the last International Auditing and Assurance Standards Board (IAASB) Roundtable on Improving the Auditor's Report. Taking place in the last quarter of 2012 in Kuala Lumpur, Malaysia, the subject saw robust discussion and debate on the proposed improvements to the auditor's report by the participants. They include various professional bodies, regulators and representatives of large public accounting firms from Australia, Hong Kong SAR, Indonesia, Japan, Malaysia, New Zealand, People's Republic of China, Singapore and Thailand. The Accounting and Corporate Regulatory Authority (ACRA) and Institute of Certified Public Accountants of Singapore

(ICPAS) also shared their thoughts at the event. Although the views were somewhat mixed, the message from IAASB was clear – the *status quo* is definitely not the way forward.

Even before the global financial crisis shone the spotlight on the role of audit in corporate governance, the auditor's report was already coming under scrutiny. As early as 2006, IAASB had commissioned research on how users view the auditor's standard report which contains the auditor's opinion on an organisation's financial statements, the way the audit was carried out, and the responsibilities of the management and auditor. IAASB's research found that users of the audited financial statements, particularly institutional investors and financial analysts, do not find a standard report to contain informational value, and want the audit report to reveal more

Proposed Key Improvements to the Auditor's Report by IAASB

Here is a list of the proposed key improvements to the auditor's report, with comments from practitioners who will be affected by the changes. Sharing their views are:



SHARIQ BARMAKY

Assurance and Advisory Partner, Deloitte Singapore



KON YIN TONG

Managing Partner, Foo Kon Tan Grant Thornton LLP



LEE SZE YENG

Audit Partner and Chair, Audit Practice Committee, KPMG in Singapore



JOHN LIM

Partner of Assurance and Advisory, PKF-CAP LLP



MAK KEAT MENG

Head of Assurance, Ernst & Young LLP



SIM HWEE CHER

Singapore Assurance Leader, PwC LLP

AUDITOR COMMENTARY

1 THIS NEW SECTION IN THE AUDITOR'S REPORT WILL CONTAIN ADDITIONAL INFORMATION ON MATTERS THAT, IN THE AUDITOR'S PROFESSIONAL JUDGEMENT, ARE LIKELY TO BE MOST IMPORTANT TO USERS' UNDERSTANDING OF THE AUDITED FINANCIAL STATEMENTS OR THE AUDIT.

MR BARMAKY: We support the concept of auditor commentary that in the auditor's judgement (1) identifies and draws attention to those disclosures in the financial statements that are most important to users' understanding of the financial statements, and (2) highlights the significance of these matters to the performance of the audit when it could be important to users' understanding of the audit.

MR KON: The proposed improved auditor reporting is a great initiative to enhance the value of audit. However, we should be mindful that

this does not result in an unintended widening of the audit expectation gap. In addition, costs of completing the audit are likely to increase, as well as costs of legal services from increased legal action in certain environments.

MR MAK: The concept of auditor commentary allows the auditor to provide additional contextual information about important matters that would be helpful for users in their decision-making process. However, to operationalise this concept, there are significant implementation challenges for auditors.



ABOVE: Representing ICPAS at the IAASB Roundtable on Improving the Auditor's Report were Dr Ernest Kan (centre), President, ICPAS, and Ms Lim Ai Leen, Executive Director, Technical Knowledge Centre and Quality Assurance, ICPAS. (right) Mr Neil Cherry, Chair, New Zealand Auditing and Assurance Standards Board

about the entity and the audit itself. The call for change intensified after the financial crisis, especially with the collapse of corporations after a clean audit opinion had been issued. Similar calls have occurred in many parts of the world including the US and Europe.

IAASB is now going full steam ahead with the proposal it released in June 2012 which set out the broad direction proposed for the auditor's report in future. It had invited stakeholders to comment on the proposed changes to the report, and the exposure drafts of the relevant auditing standards governing the auditor's report are expected to be released by June 2013. The final revised standards are expected to hit the streets in June 2014, at which point stakeholders can expect to see significant changes in the auditor's report.

REACTIONS TO THE PROPOSED CHANGES

As Singapore's auditing and assurance standards closely follow the international standards, the winds of change will surely blow onto our shores. Hence, it is wise to monitor the developments leading to the revised standards on the auditor's report. To prepare for the change and ensure that views from Singapore are taken into account by IAASB in the development of the revised standards, ICPAS carried out public consultation and feedback

AUDITOR CONCLUSION ON GOING CONCERN

2 THE REPORT WILL INCLUDE THE AUDITOR'S CONCLUSION ON THE APPROPRIATENESS OF MANAGEMENT'S USE OF THE GOING-CONCERN ASSUMPTION. IN ADDITION, THERE WILL BE AN EXPLICIT STATEMENT AS TO WHETHER MATERIAL UNCERTAINTIES IN RELATION TO GOING CONCERN HAVE BEEN IDENTIFIED.

MR BARMKY: We support the auditor statements related to going concern. However, going concern is an area in which existing financial reporting frameworks differ. Mandatory auditor reporting on going concern will likely result in the auditor providing original information without the necessary assessment and disclosures imposed on management. To preserve management's responsibility, the IAASB should collaborate with the IASB to ensure that explicit requirements are

imposed on management to assess and disclose going-concern-related matters.

MS LEE: It would be more meaningful for the statement on going concern to be delivered from the management's perspective, as the management holds the primary source of information about an entity. The auditor can then comment on this statement, based on the results of the audit.

IAASB'S RESEARCH FOUND THAT USERS OF THE AUDITED FINANCIAL STATEMENTS, PARTICULARLY INSTITUTIONAL INVESTORS AND FINANCIAL ANALYSTS, DO NOT FIND A STANDARD REPORT TO CONTAIN INFORMATIONAL VALUE AND WANT THE AUDIT REPORT TO REVEAL MORE ABOUT THE ENTITY AND THE AUDIT ITSELF.

sessions involving the users and preparers of financial statements (largely investors and management), regulators and public agencies, and the auditors themselves.

Generally, the stakeholders support the intent and efforts of IAASB to improve auditor reporting, but when it comes to the individual proposed changes, reactions are mixed. It is interesting to note that more sophisticated investors and financial analysts said that the proposed improvements may be nice to have, but are not necessary for them. This runs counter to the common belief that institutional investors are the main group clamouring for changes to the auditor's report.

Most stakeholders consulted expressed reservations about the changes, especially in relation to the inclusion of matters in a new Auditor Commentary section that are, in the auditor's judgement, likely to be most important to the users' understanding of the financial statements, and making explicit statements on the appropriateness of

management's use of the going-concern assumption and whether any material uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern have been identified.

INCREASED AUDIT COSTS

Regulators, auditors and management alike agreed that the changes would potentially lead to higher audit cost and delay in the issuance of audited financial statements. Auditors expressed concern over greater potential liability, which could push the costs even higher. Tension could also arise between the management and auditors as to who should absorb the additional audit cost.

One would question the potential increase in audit cost given that the additional information to be included in the audit report merely reflects what the auditors have done and should not require additional audit work to be carried out. However, there are various reasons why audit cost could go up, and a few are discussed here.

Firstly, determination of matters considered most important to users' understanding of financial statements and determination of whether material uncertainties in relation to going concern have been identified are highly subjective. One would expect protracted debates to take place between the auditor and management on these matters, and the audit report to go through many rounds of revision before it is finally issued. There are also concerns over issues of liability should the auditors disclose information deemed to be sensitive or worse, if the disclosure results in an unfavourable position being taken by the investors and leads to the downfall of the entity.

"WITH THE CHANGE, THE MARKET WILL COME TO APPRECIATE THE INFORMATIONAL VALUE OF AUDIT AS IT GOES BEYOND THE STANDARD AUDIT REPORT."

Dr Ernest Kan
PRESIDENT, ICPAS

Secondly, explicit statements by auditors on going-concern matters would inadvertently create an incorrect market perception that auditors are no less responsible

perform because of the inaccurate perception created.

The need for auditors to make such statements might also widen the expectation gap and reinforce the incorrect perception that a clean audit opinion is some form of "guarantee" of a company's financial health and viability. In fact, certain practitioners argue that the going-concern assumption is merely the basis used in the preparation of financial statements and should not be taken to mean that the entity is financially viable.

The aforementioned concerns expressed by the various stakeholders in Singapore were echoed by the participants at the IAASB Roundtable in Kuala Lumpur.

Besides increased costs and liability, many participants at the Roundtable

than the management in ensuring financial viability of the entity and in making the going-concern assessment. It is almost certain that the amount of work auditors would perform in this area would be beyond what the auditors currently



Moving Towards Changes in Auditor's Report

2006 IAASB commissioned research on views about auditor's standard report

JUNE 2012 IAASB released proposal for changes in auditor's report

JUNE 2013 ED of relevant auditing standards expected to be released

JUNE 2014 Final revised standards expected to be rolled out

AUDITOR STATEMENT ON INCONSISTENCIES

3 THE REPORT WILL INCLUDE A STATEMENT AS TO WHETHER THE AUDITOR HAS IDENTIFIED ANY MATERIAL INCONSISTENCIES BETWEEN THE AUDITED FINANCIAL STATEMENTS AND OTHER INFORMATION IN THE DOCUMENT CONTAINING THE FINANCIAL STATEMENTS, AND SPECIFIC IDENTIFICATION OF THAT OTHER INFORMATION.

MR KON: Adding on to the already complex financial statements, we may question whether the enhanced auditor's report will be understood by users, or will it serve to confuse even more? I guess it is about striking a balance. Sometimes, less is more.

MS LEE: The suggested auditor statement in relation to "other information" is making what is currently implicit, explicit. We are therefore supportive of auditors acknowledging their responsibility to read the information and to communicate any material inconsistencies between the information and the audited financial statements.

However, one must take note that readers should be informed that such information is not audited, so as not to widen the expectation gap.

MR SIM: We support the proposal but we are concerned that stakeholders may presume that greater involvement by auditors means other information has been audited. Therefore, this statement should also clarify both the nature and limitations of the auditor's procedures. Regarding other information, we need to also meet the expectations of the investment community, many of whom value assurance over metrics that "move markets".

PLACEMENT OF INFORMATION

4 THE AUDITOR'S OPINION AND OTHER COMPANY-SPECIFIC INFORMATION WILL BE MORE PROMINENTLY LOCATED IN THE REPORT.

MR LIM: I support the view on placement of opinion and information more prominently in the report so as to give significance to it. This would draw attention to the reader in terms of the value added by the auditor.

MR SIM: We are supportive

of proposals to improve the communicative value of the auditor's report. There is certainly merit in placing the auditor's opinion at the beginning of the report as this is what users tell us is of greatest importance to them. In fact, this has been a common reporting practice in certain territories for many years.

were also concerned that, over time, the auditor's report would evolve into a boilerplate, thereby defeating the purpose of the proposed improvements.

A CHANGE FOR THE BETTER

Is it all gloom and doom then? Surely there should be some good coming out of the improvements?

There could be. For one, the "veil" between the auditor's report and auditor's working papers is lifted. In the past, even if documentation on significant matters is not adequate, there is less urgency to remedy it especially

when the significant matters are known to only the management and those charged with governance (TCWG). On the other hand, if the auditors are required to bring to light matters of most importance to users, they can no longer hide behind the "veil". All users, including the regulators, would

know and may be interested in those matters highlighted and there is definitely a lot more motivation for the auditors, particularly the practitioners, to make sure that there is robust documentation to support the resolution of issues. This is not a bad thing as greater practitioner involvement would contribute to an overall improvement in audit quality.

Likewise, the statements on going concern would result in more robust assessment and documentation to be made by the auditors. However, whether or not such increased robustness will help to warn investors against throwing away good money into financially-unsound

companies remains to be proven. What is plausible is that such disclosure may hasten a corporate collapse because financial institutions may pull the plug on entities whose auditor's reports include comments on material uncertainties.

A more informative

auditor's report could well help public accountants show the value of their work and even lift their business model to one based on high quality service. Many practitioners in Singapore lament that their clients see audits as a piece of paper to be bought at a minimum cost rather than as a service that can range in quality and value. This view is said to be behind persistent low audit fees in Singapore.

A BOOST TO THE VALUE OF AUDIT

A number of public accounting firms appear to be bogged down by a high-

BELOW: (from left) Mr Daniel D Montgomery, Deputy Chair, IAASB; Prof Arnold Schilder, Chair, IAASB; Mr James Gunn, Technical Director, IAASB

AUDITORS EXPRESSED CONCERN OVER GREATER POTENTIAL LIABILITY, WHICH COULD PUSH THE COSTS EVEN HIGHER. TENSION COULD ALSO ARISE BETWEEN THE MANAGEMENT AND AUDITORS AS TO WHO SHOULD ABSORB THE ADDITIONAL AUDIT COST.



TRANSPARENCY AND CLARIFICATION

5 THE AUDITOR'S REPORT WILL PROVIDE TRANSPARENCY ABOUT THE AUDIT ITSELF, AND CLARIFY THE RESPECTIVE RESPONSIBILITIES OF THE AUDITOR, MANAGEMENT AND THE PARTIES RESPONSIBLE FOR GOVERNANCE.

MR LIM: In my view, the wordings in the present format of the auditor's report provide sufficient clarification on the respective responsibilities of the auditor, management and parties responsible for governance.

MR MAK: This will also allow users to better appreciate the differences in the respective responsibilities

between the auditor and management and those charged with corporate governance, which is that management and those charged with corporate governance are ultimately responsible for ensuring that they have prepared the financial statements in accordance with the reporting framework to faithfully represent a true and fair view of the company's financial results and affairs.

volume, low-fee business model, which makes it difficult for them to perform high quality audits because the auditor does not have the time or resources to do the necessary work. This issue has been highlighted in recent years by ACRA when reporting on the findings of its auditor oversight activities. Julia Tay, Assistant Chief Executive, ACRA, sees a more informative auditor's report as something that could help turn around this trend. "Public accountants should seize this opportunity to differentiate themselves in terms of audit quality; how much they understand the business, the risks and how they had addressed audit issues that will lend assurance to investors. This way, clients will better understand the value of an audit, and be more prepared to pay more to an auditor who can provide it," said Ms Tay.

Dr Ernest Kan, President, ICPAS, shares this view. "Yes, it is understandable that practitioners would initially feel uncomfortable with the additional disclosures in the auditor's report given the increased risks and the potential liability. However, I would urge practitioners to look beyond the cost and liability to embrace change in the right

spirit. With the change, the market will come to appreciate the informational value of audit as it goes beyond the standard audit report. Also, audit will no longer be in danger of being marginalised or commoditised. I believe that in the long run, the standing of the auditing profession will be elevated. Additional risks arising from the change would just have to be managed along the way," said Dr Kan.

Most stakeholders want a more

holistic approach to addressing users' needs and expectations, one that comprehensively synchronises improvements to auditor reporting, corporate governance and financial reporting. It is believed that such an approach would not only better help to bridge the information gap, it would also achieve consistency in requirements for both auditors and preparers. Proponents of this approach argue that management should be making all the necessary disclosures and auditors should then refer to the management's disclosures and comment on its appropriateness and adequacy. Some call for a fundamental review of the roles and responsibilities of the auditor, management and parties responsible for governance to better

BELOW: (from left) Ms Juthika Ramanathan, CE, ACRA, and Ms Julia Tay, Assistant CE, ACRA



A MORE INFORMATIVE AUDITOR'S REPORT COULD WELL HELP PUBLIC ACCOUNTANTS SHOW THE VALUE OF THEIR WORK AND EVEN LIFT THEIR BUSINESS MODEL TO ONE BASED ON HIGH QUALITY SERVICE.

address the gaps. Whatever approach one wishes to take, one thing is certain. The winds of change are blowing onto Singapore shores and it would be wise for all affected stakeholders to brace themselves for the change. **CPA**

By Lim Ai Leen, Executive Director, Technical Knowledge Centre and Quality Assurance, ICPAS