BANE OR BOON?
FACELIFT FOR THE AUDITOR'S REPORT

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In today's competitive business environment, everyone wants more information about companies. And in two years' time, if the proposed initiatives by the international auditing standard-setters bear fruit, that information will be available in at least one form – the independent auditor's report. But will the potential issues with providing this information outweigh its usefulness?

THE NEED TO CHANGE

Even before the most recent global financial crisis brought the spotlight to bear on the audit sector's role in corporate governance, the auditor's report was coming under scrutiny. As early as 2006, the International Auditing and Assurance Standards Board (IAASB) had jointly commissioned international academic research on how stakeholders view the auditor's report. This report typically 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. However, the IAASB's research found that this is not enough to satisfy stakeholders. Users of the audited financial statements – particularly institutional investors and financial analysts – want more transparency and relevance in the auditor's report, and calls for these intensified after the financial crisis.

This June, the IAASB released a proposal for improving the auditor's report, covering the direction future reporting should take. The IAASB is going full steam ahead with this project and is expected to release the exposure drafts of relevant auditing standards governing the auditor's report by next June. 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 FEEDBACK GATHERED BY ICPAS HIGHLIGHTED ISSUES WITH SOME OF THE IAASB'S KEY PROPOSED IMPROVEMENTS, SPECIFICALLY THE POTENTIAL SHIFTING OF RESPONSIBILITIES AND LIABILITIES."

THE IMPACT OF CHANGES: TIME AND EXPENSE

Singapore's auditing and assurance standards closely follow international standards, and so the proposed changes to auditor reporting will almost certainly be implemented here come June 2014. To prepare for the changes, the Institute of Certified Public Accountants of Singapore (ICPAS) issued a public consultation paper on the IAASB's proposal in July. Following that, three focus group sessions were held in August to seek the views of key stakeholders – the users and preparers of financial statements (largely investors and management), regulators and public agencies, and the auditors themselves.

According to the feedback received, most stakeholders approve of the IAASB's intent and efforts, which draw users' attention to specific areas of audit significance. Investors and regulators alike say that the additional information and clearly defined structure will be useful to them.

On the other hand, almost every stakeholder group has expressed reservations about the changes. More sophisticated investors say that the proposed improvements may be nice to have, but are not necessary for them. Regulators, auditors and management, meanwhile, are more concerned about the impact on audit costs and the timeliness of issuing audited financial statements. For example, auditors and management may become embroiled in lengthy discussions on the additional information to be disclosed, potentially delaying the issuance of the audited financial statements; there is also the question of increasing audit costs. On top of this, making the additional disclosures exposes auditors to greater potential liability, which could lead to yet more costs.

Most tellingly, stakeholders feel that the increased value from the additional disclosures in the auditor's report may be offset by the additional costs to be incurred. If the changes to the report result in higher audit fees, companies may not be willing to foot the additional bill.

ISSUES WITH SHIFTING RESPONSIBILITIES

The feedback gathered by ICPAS highlighted issues with some of the IAASB's key proposed improvements, specifically the potential shifting of responsibilities and liabilities. For a start, stakeholders feel that the auditor conclusion on the appropriateness of the going concern assumption blurs the boundaries of auditor responsibilities. It would wrongly shift the onus of going concern assessment from the management to the auditors, because under current accounting standards, management need not make a statement on the company's going concern unless it has significant doubts about it. Requiring auditors but not management to make such statements would go against the principle that management is responsible for ensuring the financial viability of a company. Auditors making such statements would also widen the expectation gap and compound the current incorrect market perception that a clean audit opinion is some form of "guarantee" of a company's financial health and viability. In fact, a clean audit opinion only provides reasonable assurance that the company's financial statements fairly present its financial position and results.

For similar reasons, stakeholders are strongly of the view that the auditor commentary should not be used to comment on matters that are not disclosed in the financial statements. The role of the auditors is to audit the financial statements, and information beyond that should be presented by management and the group overseeing corporate governance. If this line is crossed, there is a danger that the auditor's report would be wrongly regarded as the primary source of information about the company and its operations.

Stakeholders also pointed out that while the auditor commentary would be an appropriate platform to provide useful information, it exposes auditors to increased risk because it requires them to decide what matters are most important to users' understanding of the audited financial statements or the audit. Importance, however, is highly subjective, and if users differ with the auditors' judgement on what is important, there may be issues of liability.

A BROADER VIEW

Changing the auditor's report alone may not be sufficient to address stakeholder needs and expectations. A more holistic approach should be taken, one that synchronises improvements to auditor reporting, corporate governance and financial reporting all in one. Such an approach would not only better help to bridge the information gap, but also achieve consistency in requirements for both auditors and preparers.

For example, if greater transparency in the going concern disclosure is desirable, IAASB should work with the International Accounting Standards Board (IASB), which sets accounting standards internationally, to review and amend the accounting standards to require management to make the necessary disclosures. Auditors could then refer to the management's disclosure and comment on its appropriateness and adequacy.

In tandem with this, relevant stakeholders should look into raising awareness about the auditor's role and the function of audit reports among investor and user groups. Education and outreach programmes would help to narrow expectation gaps.

It may even be timely to consider the need for a fundamental review of the roles and responsibilities of the auditor, management and parties responsible for governance. It would be worthwhile to determine what an audit can and should deliver, bearing in mind time and cost constraints. Users may be calling for more pertinent information to be included in the auditor's report, but before we jump on the bandwagon, it is essential to reflect on whether such needs can be better met through other means.

Whatever form the final changes may take, they do appear inevitable. The IAASB is now reviewing stakeholders' feedback on its proposed improvements, and it is to be hoped that the final outcome will be sensible and acceptable to most, if not all, stakeholders affected by the changes. CPA

This article was written by Kang Wai Geat, Deputy Head, and Fua Qiu Lin, Manager, Technical Standards Development and Advisory, ICPAS.

PROPOSED KEY IMPROVEMENTS TO THE AUDITOR'S REPORT BY IAASB

Auditor commentary
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.

Auditor conclusion on going concern
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.

Auditor statement on inconsistencies
The report will include a statement as to whether the auditor has identified any material inconsistencies between the audited financial statements and other information, and specific identification of that other information.

Placement of information
The auditor's opinion and other company-specific information will be more prominently located in the report.

Transparency and clarification
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.