AUDITOR'S REPORT

Highlights of Technical Clinic

BY
MAGDALENE ANG

Auditors are appointed to provide an independent opinion to shareholders on the true and fairness of an entity's annual financial statements. An audit opinion can be unmodified or modified, depending on whether the auditor is able to conclude, based on the audit evidence gathered during the course of the audit, if the financial statements as a whole are free from material misstatement. Michael Chin, Managing Partner of PKF-CAP LLP, facilitated this interesting discussion topic among a group of practitioners. The main highlights are presented below.

Q1 WHAT ARE THE TYPES OF AUDITOR'S OPINION AN AUDITOR CAN EXPRESS IN THE AUDIT REPORT, IN THE CONTEXT OF A STATUTORY AUDIT FOR A COMPANY INCORPORATED IN SINGAPORE?

The different types of auditor's opinion are as follows:

a) **Unmodified Opinion**
Clean opinion where the auditor concludes that the financial statements are **free from material misstatement** and prepared in accordance with the applicable financial reporting framework. In certain situations, the auditor may modify the audit report without amending the opinion by putting in additional paragraphs as follows:

(i) **Emphasis of Matter (EOM)**
EOM is used to draw users' attention to specific significant matter that is **fundamental to the users' understanding** of the financial statements. For example, an entity has breached the loan covenants during the financial year, and as at the date of the audit report, the entity is still in negotiation with the bank for the continuing loan facility. The entity was in net current liabilities position as at the financial year-end. Although the auditor has assessed and concluded that the going concern assumption is appropriate, there is still a material uncertainty on the ability of that entity to obtain the loan facility. In such a scenario, even though the entity has disclosed the breach of loan covenants and had reclassified the non-current portion of that loan to current liability, the auditor should include an EOM paragraph and make reference to that material uncertainty.

(ii) **Other Matter (OM)**
OM is used to refer to a matter that is other than those disclosed in the financial statements that is **relevant to the users' understanding** of the audit, the auditor's responsibilities or the auditor's report. For example, an exempt private company with revenue less than S$5million in prior year was exempted from audit. However in the current financial year, the company has expanded its operation with revenue of more than S$5million and is now required to be audited. In such circumstance where the corresponding figures are not audited, the auditor should include an OM paragraph to disclose such information to the users of the financial statements.

b) **Modified Opinion**
There are three types of modified opinion under Singapore Standards of Auditing (SSA) 705, namely a qualified opinion, an adverse opinion, and a disclaimer of opinion (refer to Q2).

Q2 UNDER WHAT CIRCUMSTANCES DOES THE AUDITOR HAVE TO ISSUE A MODIFIED OPINION?

SSA 705 states two specific circumstances where the auditor has to modify the audit opinion:

a) Where there is a material misstatement, commonly arising when there is non-compliance

PHOTO GETTY IMAGES

or inconsistent application of selected accounting policies by the management, or the financial statements disclosures do not include/provide the disclosure required by the applicable financial reporting framework, and

b) Where the auditor is unable to obtain sufficient and appropriate audit evidence, typically arising from limitation of scope.

The table below illustrates the types of modified opinion.

Nature of the matter	Auditor's judgement about the pervasiveness of the matter	
	Material but NOT Pervasive	Material AND Pervasive
Material misstatement	Qualified opinion ("except for")	Adverse opinion ("do not present fairly")
Unable to obtain sufficient appropriate audit evidence	Qualified opinion ("except for")	Disclaimer of opinion ("we do not express an opinion")

Q3 THE ENTITY UNDER AUDIT IS AN INTERMEDIATE HOLDING COMPANY WHICH HOLDS A SUBSIDIARY AND DOES NOT PREPARE CONSOLIDATED FINANCIAL STATEMENTS. THE ULTIMATE HOLDING COMPANY (INCORPORATED IN CAYMAN ISLANDS), BEING THE SOLE SHAREHOLDER OF THAT ENTITY, IS NOT LISTED ON ANY STOCK EXCHANGE. IN SUCH A SCENARIO, SHOULD THE AUDITOR MODIFY THE AUDIT OPINION OF THAT ENTITY'S FINANCIAL STATEMENTS?

It depends on whether the consolidated financial statements of the ultimate holding company (which includes the financial statement of the entity) are available for public use. If the general public has access to the consolidated financial statements of the ultimate holding company, and the way to obtain access is adequately disclosed in the financial statements, then the entity under audit is exempted from preparing consolidated financial statements under Financial Reporting Standards (FRS) 27. Hence modification to the audit opinion is not necessary. An example is when the ultimate holding company uploads its annual consolidated financial statements on its website, which is available to the general public, and the website address for accessing the consolidated financial statements is properly disclosed in the financial statements of the entity under audit*.

Where the consolidated financial statements of the ultimate holding company are not available to the general public, then the entity under audit does not meet the exemption criteria (for not preparing consolidated

*A word of caution: The auditor has to be mindful that in reality, it is not common for a privately-owned company incorporated in a tax haven country to make available its financial statements for public access. Therefore, the auditor needs to exercise professional scepticism and perform appropriate audit procedures to check that the financial statement of the ultimate holding company is publicly available.

financial statements) and this would result in non-compliance with FRS 27. The auditor would need to assess and evaluate whether such non-compliance is material and pervasive to the entity's overall financial statements. For a subsidiary that is dormant, as defined by the Companies Act, Cap 50 Section 205B as having no accounting transactions other than statutory-related expenses, the subsidiary would not be material to be consolidated with the entity's financial statements and therefore a modified opinion is not necessary. Conversely, where the subsidiary is material to the entity, the audit opinion would likely be an "adverse opinion" because the financial impact would be pervasive and not isolated in nature. As any form of modification to the audit report is considered to be of higher risk, a safeguard review or engagement quality control review should be considered (refer to Q4).

Q4 THE ENTITY UNDER AUDIT IS REQUIRED TO PREPARE CONSOLIDATED FINANCIAL STATEMENTS IN ADDITION TO THE STANDALONE FINANCIAL STATEMENTS BUT MANAGEMENT DECIDES NOT TO DO SO, ON THE BASIS THAT THE COST EXCEEDS ITS BENEFIT. THE AUDITOR, HAVING CONSIDERED THE FACTS AND CIRCUMSTANCES, CONCLUDES THAT THE NON-PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS WOULD RESULT IN THE ISSUANCE OF AN ADVERSE OPINION. IF THE ENTITY'S STANDALONE FINANCIAL STATEMENTS ARE FAIRLY PRESENTED, CAN THE AUDITOR ISSUE TWO SEPARATE OPINIONS – (1) AN UNMODIFIED OPINION ON THE STANDALONE FINANCIAL STATEMENTS, AND (2) AN ADVERSE OPINION FOR THE NON-PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS?

No. SSA 705 para 15 states that "when the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole, the auditor's report shall not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts or items of a financial statement. To include such an unmodified opinion in the same report in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole."

The auditor's report is on the financial statements as a whole, and not on a specific component of the financial statements such as the standalone financial statements of the entity. Therefore, where the auditor concludes that an adverse opinion would be appropriate in the circumstances, it would not be appropriate for the auditor to also issue a "clean" opinion on the standalone financial statements as this would contradict the modified opinion issued by the auditor.

Q5 THE MANAGEMENT OF A COMPANY INCORPORATED IN SINGAPORE HAS REQUESTED THE AUDITOR TO ISSUE A CHINESE VERSION OF THE AUDITED FINANCIAL STATEMENTS FOR SUBMISSION TO THEIR HOLDING COMPANY BASED IN CHINA. HOW SHOULD THE AUDITOR ADDRESS SUCH REQUEST?

The management is responsible for the preparation of the financial statements, whereas the auditor is responsible for the audit report. In the context of Singapore-incorporated companies, audited financial statements (including the audit report) are prepared in English for statutory filing purposes. Where the management needs a Chinese version of the audited financial statements for submission to their holding company, they are responsible for arranging the translation of the audited financial statements.

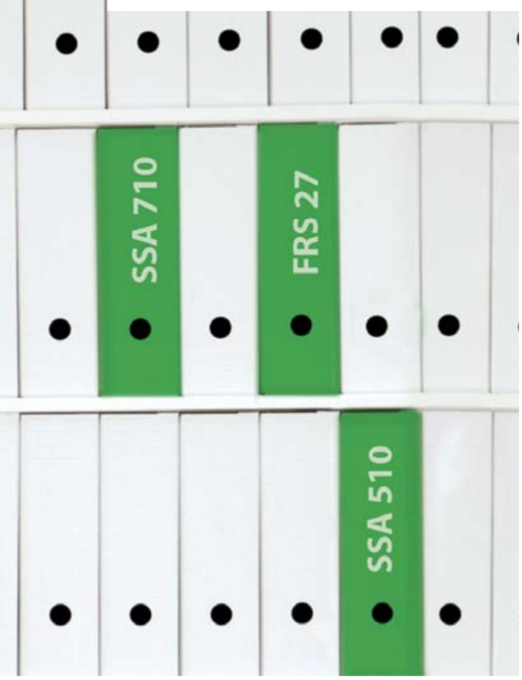
Where the translated financial statements include the audit report (with or without auditor's sign-off), the auditor should check that the translated version is consistent with the audited

PHOTO GETTY IMAGES

financial statements. In addition, the auditor should make inquiry with the management on the parties whom the translated financial statements would be distributed to. If the auditor becomes aware that the translated financial statements are distributed to parties including the Chinese authorities other than the shareholders, the auditor should seek legal advice for any potential implication(s).

Q6 IF THE ENTITY UNDER AUDIT HAS NOT BEEN AUDITED IN THE PREVIOUS FINANCIAL PERIOD BECAUSE THE ENTITY WAS EXEMPTED FROM AUDIT, IS THERE A NEED TO MODIFY THE AUDIT OPINION?

Modification to the audit opinion is not necessary if the auditor is able to perform audit procedures to check that the opening balance for the current period is properly carried forward from prior period. Further guidance on audit procedures relating to opening balance is set out in SSA 510(R). Where the auditor is able to perform checks on the opening balance and conclude that the opening balance is correctly stated, the auditor is required to state in an "OM" paragraph in the audit report that the corresponding figures are unaudited as stated in SSA 710 para 14.



Q7 IF THE ENTITY UNDER AUDIT WAS AUDITED BY ANOTHER AUDIT FIRM IN PRIOR PERIOD, SHOULD THE AUDITOR INCLUDE AN "OM" PARAGRAPH IN THE AUDIT REPORT TO INFORM USER THAT THE PRIOR PERIOD FINANCIAL STATEMENTS WERE AUDITED BY ANOTHER AUDIT FIRM?

The auditor's opinion is on the current period's financial statements rather than on the comparative financial statements. Therefore, it is not necessary for the auditor to refer to the predecessor's audit report in the current period audit report unless he decides to do so. The auditor may decide to refer to the predecessor's audit report in a situation where the auditor identifies numerous prior year adjustments in the current year's financial statements. Should the auditor decide to do so, SSA 710 para 13 requires the auditor to state in an "OM" paragraph in the audit report the following:

a) That the financial statements of the prior period were audited by the predecessor auditor;
b) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reason, and
c) The date of that report.

★

It is uncommon for an entity to prepare its financial statements on a realisation basis unless the management intends to liquidate that entity in the next 12 months. Where the management decides to do so, the financial statements of that entity would have to be prepared on a realisation basis such that its assets and liabilities are measured at market value to be realised in the next 12 months.

Q8 CAN THE FINANCIAL STATEMENTS OF AN ENTITY BE PREPARED ON A REALISATION BASIS? WHAT IS THE IMPLICATION ON THE AUDIT REPORT?

Typically, an entity prepares its financial statements on a going concern basis. It is uncommon for an entity to prepare its financial statements on a realisation basis unless the management intends to liquidate that entity in the next 12 months. Where the management decides to do so, the financial statements of that entity would have to be prepared on a realisation basis such that its assets and liabilities are measured at market value to be realised in the next 12 months. Thus even where adequate disclosure has been made in the financial statements, it is still necessary for the auditor to include an EOM paragraph in the audit report to draw users' attention to the management's intention to liquidate the company in the next 12 months, and that the financial statements are prepared on a realisation basis instead of a going concern basis. ISCA

Magdalene Ang is a Quality Assurance Manager at ISCA. She is a Reviewer under the Quality Assurance Review Programme (QARP). Public accountants who are keen to sign up for or find out more about the QARP can contact her at tel: 6597-5520 or email: qualityassurance@isca.org.sg.