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Dear Sir,

## **RESPONSE TO IAASB INVITATION TO COMMENT – IMPROVING THE AUDITOR’S REPORT**

The Institute of Certified Public Accountants of Singapore (ICPAS) appreciates the opportunity to comment on the above Invitation to Comment (ITC) issued by the International Auditing and Assurance Standards Board (IAASB) in June 2012.

To solicit meaningful feedback for this very important project, ICPAS feels that it is essential to seek the views from all key stakeholders who would be affected by the ITC. Hence, ICPAS has organised a number of focus groups to engage diversified key stakeholders, including the preparers and users of financial statements, audit firms and regulators, to obtain their views on the proposals in the ITC. ICPAS has also sought feedback from its members through a month-long public consultation process. Relevant comments have been incorporated in this response.

Generally, the stakeholders are of the view that it is imperative that the auditor’s report is not used to comment on matters that are not disclosed in the financial statements. Auditors may make statements and disclose information about the audit itself, but they should not be put in a position to comment about the entity and its operations or the key assumptions made and significant judgments exercised by the management, which is the responsibility of management and those charged with governance (TCWG). The disclosure of entity-related information in the financial statements should be detailed enough for the auditors to make reference to when highlighting matters of importance in the Auditor Commentary.

In addition, the responsibility for ensuring that the entity carries on as a going concern lies primarily with the management. As such, auditors should not be made to comment on going concern without a corresponding requirement for the management to do likewise as the latter should be the most appropriate party to comment on this matter.

The stakeholders' comments on the specific questions in the ITC are as follows:

**Question 1**

**Overall, do you believe the IAASB's suggested improvements sufficiently enhance the relevance and informational value of the auditor's report, in view of possible impediments (including costs)? Why or why not?**

The stakeholders generally agree that the suggested improvements will, to a certain degree, enhance the relevance and informational value of the auditor's report. It provides auditors an opportunity to draw users' attention to matters of importance to increase their level of focus when reading the financial statements.

Notwithstanding the abovementioned agreement, the more sophisticated investors who rely on sources of information other than the auditor's report to make informed investment decisions may not find the improvements to the report useful. They would perform their own due diligence instead of placing sole reliance on the report.

Furthermore, as described in our response to Question 2, the improvements to the auditor's report should be undertaken as part of a holistic approach to bridge the information and expectations gaps of users.

A possible consequence of the suggested improvements to the auditor's report is that auditors and management may be embroiled in lengthy discussions and protracted debates on the additional information to be disclosed in the report. This will inevitably result in increased time spent and costs incurred for the audit and could potentially lead to a delay in the issuance of the financial statements. The timeliness of issuance of audited financial statements is a major concern of the regulators. Also, there could be higher costs arising from the auditor's increased potential liability from making the additional disclosures in the auditor's report as explained in our responses to Questions 3 and 8. From a cost-benefit point of view, the preparers and users group does not believe that the increased value from the additional disclosures in the auditor's report outweighs the additional costs to be incurred and may therefore, be unwilling to pay for any incremental audit fee.

Increasing audit costs and fees would also be a major concern for charities which are non-profit making by nature. In Singapore, larger size charities are proposed to be included in the definition of PIEs and the proposed amendments to the auditor's report would be applicable to them.

## **Question 2**

**Are there other alternatives to improve the auditor's report, or auditor reporting more broadly, that should be further considered by the IAASB, either alone or in coordination with others? Please explain your answer.**

Generally, the stakeholders support the intent and efforts of IAASB to improve auditor reporting. However, many believe that this response alone would not be adequate to achieve the overall objective of meeting the information needs of users of financial statements and narrowing the expectations and information gaps of users. The achievement of this overall objective calls for a holistic approach of synchronizing the improvements to auditor reporting with improvements to corporate governance and financial reporting. There are concerns that if the improvements to auditor reporting are addressed in isolation, it may attract unintended consequence, i.e. shift of responsibilities and liabilities from management and TCWG to auditors.

For a start, it may be timely for IAASB to now consider the need for a fundamental review of the roles and responsibilities of the auditor, management and TCWG to determine what an audit can and should deliver with the time and costs constraints in mind. While users may be calling for more pertinent information to be included in the auditor's report, it is necessary to reflect on whether such needs can be better met through other means for example, disclosing matters of importance in the Management Discussion & Analysis (MD&A) and appending the MD&A to an Annual Report.

Additionally, bridging the information gap should also be achieved through a more robust corporate financial reporting framework. The suggested improvements to the auditor's report should be made in conjunction with changes to the financial reporting standards to achieve consistency in requirements for both auditors and preparers. IAASB should work with the International Accounting Standards Board (IASB) for this purpose.

Furthermore, instead of just proposing changes to the auditor's report, the relevant stakeholders should also consider narrowing expectations gaps through user education, and through outreach programmes to raise the awareness among the investor and user groups of the role of auditors and the function of audit reports.

### **Question 3**

**Do you believe the concept of Auditor Commentary is an appropriate response to the call for auditors to provide more information to users through the auditor's report? Why or why not? (See paragraphs 35–64.)**

Generally, the stakeholders believe that the concept of Auditor Commentary is an appropriate platform for auditors to provide more information to users but they would like to highlight three key issues for IAASB's consideration.

Firstly, Auditor Commentary may heighten the auditors' exposure to risks. This is because the determining of matters that are likely to be most important to users' understanding of the audited financial statements or the audit are highly subjective. Auditors could potentially be taken to task for failing to highlight in the Auditor Commentary matters which users think are important to them. Users have varying reasons for seeking additional information and have different views about what information is of most value to them. Hence, the auditor's risk exposure would increase with the introduction of the Auditor Commentary.

Secondly, the usefulness of the Auditor Commentary will depend on the nature and extent of information provided. Auditors may face pressure from the management to limit the matters to be disclosed and the extent of their disclosures. On the other hand, the Auditor Commentary may end up being inordinately long if the auditors take an ultra conservative approach and disclose matters without giving due consideration to their importance. Another possible consequence is that boilerplate disclosures would surface over time, which would defeat the purpose of having Auditor Commentary which should disclose only the important matters. Auditors need to be discerning and exercise judgment to strike a balance between the extent of information to be disclosed and the incremental value users can derive from the additional disclosures made.

Thirdly, the stakeholders are strongly of the view that the Auditor Commentary should not be used to comment on matters that are not already disclosed in the financial statements. Management and TCWG are primarily responsible for presenting a true and fair view of the entity's financial results and position for any particular financial year. Hence, they would be in the best position to disclose the relevant information relating to the entity in the financial statements. From this perspective and as an alternative, management and TCWG could disclose information relating to the entity in documents such as the MD&A or the Corporate Governance Report and append them to the Annual Report. Where appropriate, the auditors could draw attention to areas highlighted by management and TCWG and make reference to this information and provide their comments. In short, auditors should only make statements and disclose information about the audit itself, and not comment on the entity and its operations when such disclosures have not been made by management and TCWG.

Auditors should also be mindful not to disclose any confidential information and not to breach any regulations, for example, the Banking Act in Singapore.

#### **Question 4**

**Do you agree that the matters to be addressed in Auditor Commentary should be left to the judgment of the auditor, with guidance in the standards to inform the auditor's judgment? Why or why not? If not, what do you believe should be done to further facilitate the auditor's decision-making process in selecting the matters to include in Auditor Commentary? (See paragraphs 43–50.)**

The stakeholders agree that the matters to be addressed in Auditor Commentary should be left to the judgment of the auditor with appropriate guidance provided in the auditing standards on matters to be disclosed to achieve consistency and comparability.

#### **Question 5**

**Do the illustrative examples of Auditor Commentary have the informational or decision-making value users seek? Why or why not? If not, what aspects are not valuable, or what is missing? Specifically, what are your views about including a description of audit procedures and related results in Auditor Commentary? (See paragraphs 58–61.)**

Whether or not the matters highlighted in the Auditor Commentary are valuable to users really depend on the information the users are seeking and the decisions they are making. For example, the illustrative disclosure on the audit strategy relating to a new system to record revenue, accounts receivable and cash receipts may be useful to regulators of charitable organizations that receive donations, grants, etc. but may not be useful to institutional investors. In addition, where specific matters of importance are highlighted, for example, on outstanding litigation, goodwill and valuation of financial instruments, users tend to expect conclusion in the form of positive assurance to be made by the auditors on each of those matters to close the loop.

Notwithstanding the above comments, generally, users could extract some values out of disclosures on significant, complex and highly judgmental areas or transactions (eg. goodwill and valuation of financial instruments).

Most stakeholders agree that description of audit procedures and related results should not be disclosed in the Auditor Commentary especially for routine audit procedures and in a

jurisdiction with robust regulatory oversight of the auditing profession like in Singapore. Stakeholders generally do not wish to read an inordinately long Auditor Commentary which would distract them from the important matters. Initiatives to educate users of financial statements would be a better platform to provide information on auditor's work and procedures rather than through the auditor's report. The view that audit strategies and procedures should only be included for very material transactions or very exceptional circumstances (such as material mergers, acquisitions or restructuring of the entity) is widely supported. Such disclosures could enhance users' understanding of the impact of these transactions to the financial results and position of an entity and how they have been addressed by the auditors.

On the disclosure of other auditors' involvement, it is not meaningful to merely disclose the measurement of these auditors' involvement by hours without discussing what this measurement means to the audit and how these other auditors' involvement impact the work of the principal auditors.

#### **Question 6**

**What are the implications for the financial reporting process of including Auditor Commentary in the auditor's report, including implications for the roles of management and those charged with governance (TCWG), the timing of financial statements, and costs? (See paragraphs 38 and 62–64.)**

If IAASB's proposal on Auditor Commentary was to be implemented, there is the danger that auditor's report would be wrongly regarded as the primary source of information about the entity and its operations which is not desirable. Certain users may think that since all matters of importance would have been highlighted in the Auditor Commentary, there is no longer the need to read the financial statements or other accompanying documents prepared by the management and TCWG.

Notwithstanding that the Auditor Commentary is in the auditor's report, auditors should expect that the management and TCWG would want to have a certain influence over the drafting of the Auditor Commentary. The preparers and users expressed concerns over the possible subjective contents and level of details that would be disclosed in the Auditor Commentary. This group shared that they are not comfortable with auditors highlighting and commenting on their use of assumptions and their exercise of judgments in critical areas lest they attract unnecessary attention and challenge to those areas. It would not be surprising that management and TCWG may even engage lawyers to review the contents of the Auditor Commentary to assess the entity's potential exposure to contests by certain stakeholders and to liability arising from certain disclosures. Another concern expressed is that instead of

focusing efforts on addressing risks and key issues, both the preparers and auditors would potentially be embroiled in protracted debates on the nature and extent of disclosures in the Auditor Commentary and the choice of words to be used. All of these would lead to unintended consequences of delay in the issuance of the financial statements as well as inevitably, increased time and costs for the audit.

Additionally, while making the additional disclosures in the Auditor Commentary, auditors would have to be cognisant of maintaining confidentiality of information. Certain industries such as banking and finance may have specific secrecy rules or confidentiality restrictions such that auditors would have to be careful not to breach any of these rules. Auditors of listed companies would also have to be wary of disclosing any price-sensitive information in their disclosures.

### **Question 7**

**Do you agree that providing Auditor Commentary for certain audits (e.g., audits of public interest entities (PIEs)), and leaving its inclusion to the discretion of the auditor for other audits is appropriate? Why or why not? If not, what other criteria might be used for determining the audits for which Auditor Commentary should be provided? (See paragraphs 51–56.)**

The stakeholders agree that providing Auditor Commentary for audits of PIEs and leaving its inclusion to the discretion of the auditor for other audits is appropriate. The Auditor Commentary should not be made mandatory for non-PIEs but the auditor of non-PIEs should be given the discretion to include it in the auditor's report where circumstances require. It is viewed that such discretion would provide non-PIE auditors additional bandwidth in terms of communicating matters of significance to users where currently, under the existing standards, only matters of material uncertainty can be included in the Emphasis of Matter paragraph in the auditor's report.

In addition, the definition of PIEs should be left to the respective jurisdictions to determine but it should include all entities that require independent governance or entities of a certain size and stature that receive monies from the public.

### **Question 8**

**What are your views on the value and impediments of the suggested auditor statements related to going concern, which address the appropriateness of management's use of the going concern assumption and whether material uncertainties have been identified? Do you believe these statements provide useful information and are appropriate? Why or why not? (See paragraphs 24–34.)**

Financial statements are prepared on a going concern basis if not otherwise stated. If a clean audit opinion is rendered on these financial statements, it would mean that the auditor agrees with the appropriateness of the going concern assumption used by the management. Had the auditor not agreed with the going concern assumption used, a modified audit opinion would have been issued by the auditor. Hence, an explicit statement to be made by the auditors on the appropriateness of the going concern assumption used by the management adds little or no informational value to the users.

Similarly, in regard to the suggestion for auditors to state whether or not they have identified material uncertainties that may cast significant doubt on an entity's ability to continue as a going concern, we are also of the view that this statement may not add informational value to the users as explained in the following two paragraphs.

Currently, if the management, in making its assessment, is aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, it is required by International Accounting Standard (IAS) 1 *Presentation of Financial Statements* to make these disclosures in the financial statements, and if such disclosures are not made or not adequately made, the auditor would render a modified audit opinion. Hence, if there is no disclosure of material uncertainty, and the audit opinion issued is not modified, it would mean that the auditor agrees that no material uncertainty exists. An explicit statement does not therefore, add informational value.

If material uncertainty exists but is adequately disclosed and where the auditor concludes that the use of the going concern assumption by the management is still appropriate, the auditor would, in accordance with International Standard on Auditing (ISA) 570 *Going Concern*, highlight this material uncertainty by way of Emphasis of Matter in the auditor report; and to draw attention to the relevant note in the financial statements. The stakeholders are of the view that the current requirement is adequate and should be kept.

In fact, requiring auditors to make explicit statements on appropriateness of going concern assumption and that no material uncertainties exist would create impediments rather than adding value as explained below:



1. Currently, there is no requirement in the accounting standards for management to make a statement on the entity's going concern unless in making its assessment, the management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. Hence, requiring the auditors to make statements on the entity's going concern when there is no corresponding requirement for the management to do so would result in the unintended consequence of shifting the onus of going concern assessment from the management to the auditors. This goes against the principle that the primary responsibility for ensuring the financial viability of an entity lies with the management. To emphasise this primary responsibility, the statements should be made by the management instead of the auditors.
2. Requiring auditors to make such statements would widen expectations gap and compound the current incorrect market perception that a clean audit opinion is some form of "guarantee" of the financial health and viability of an entity which would lead to disastrous consequences for the auditing profession. This is notwithstanding the explicit clarification made in the auditor's report that the "no material uncertainties" statement is not a guarantee as to the entity's ability to continue as a going concern.

If it is desirable to achieve greater transparency in the going concern disclosure, it would be more appropriate for the management to make the required going concern statements instead of the auditors. IAASB should work with IASB to review and amend the accounting standards to require management to make disclosures on going concern instead of the auditors. The disclosures should include any material uncertainties, how the going concern assessment is made, why the going concern assumption is appropriate and the conclusion arrived at by the management. The auditors could then refer to the management's disclosure and comment on its appropriateness and adequacy.

### **Question 9**

**What are your views on the value and impediments of including additional information in the auditor's report about the auditor's judgments and processes to support the auditor's statement that no material uncertainties have been identified? (See paragraphs 30–31.)**

The stakeholders expressed concern over IAASB's proposal to require an auditor to disclose his judgments made and audit procedures performed, in reaching a conclusion that no material uncertainty exists where they have identified certain events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. Whilst such disclosure may provide greater transparency to users, it comes with a disproportionately high

cost. As it stands, there is already considerable debate between the preparers and auditors on what constitutes a “material uncertainty”. Having to now grapple with identifying and disclosing “event or condition that may cast doubt on the entity’s ability to continue as a going concern” and disclosing the auditor’s judgments and processes to support the statement that no material uncertainties have been identified would be unduly burdensome on the auditors. Auditors may find it difficult to avoid disclosing entity-specific information that has not been disclosed by the management, thereby running the risk of lawsuit. This is especially so if such disclosures result in unintended consequences to the entity.

### **Question 10**

**What are your views on the value and impediments of the suggested auditor statement in relation to other information? (See paragraphs 65–71.)**

Currently, ISA 720 *The Auditor’s Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements* requires the auditor to read the other information to identify material inconsistencies, if any, with the audited financial statements. Where the auditor considers it necessary to draw users’ attention to the other information, ISA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report* contains provisions for the auditor to communicate these matters in the auditor’s report. Hence, the stakeholders are of the view that the suggested auditor statement in relation to other information is consistent with the audit procedures currently required by the ISAs and by explicitly requiring the inclusion of a statement in the auditor’s report, it serves to enhance the transparency of the auditor’s work in this area.

### **Question 11**

**Do you believe the enhanced descriptions of the responsibilities of management, TCWG, and the auditor in the illustrative auditor’s report are helpful to users’ understanding of the nature and scope of an audit? Why or why not? Do you have suggestions for other improvements to the description of the auditor’s responsibilities? (See paragraphs 81–86.)**

The stakeholders believe that the enhanced descriptions of the responsibilities of management, TCWG and the auditor in the illustrative auditor’s report are helpful to users’ understanding of the nature and scope of an audit. In addition, public education to users of financial statements may offer another platform to provide further clarity on the responsibilities of the respective parties.

### **Question 12**

**What are your views on the value and impediments of disclosing the name of the engagement partner? (See paragraphs 72–73.)**

The current Singapore Exchange Limited Listing Rules already require the disclosure of the name of the engagement partner in the listed entity’s annual report. Hence, this is unlikely to result in any significant impact in Singapore.

### **Question 13**

**What are your views on the value and impediments of the suggested disclosure regarding the involvement of other auditors? Do you believe that such a disclosure should be included in all relevant circumstances, or left to the auditor’s judgment as part of Auditor Commentary? (See paragraphs 77–80.)**

While this may appear to be useful information for investors and regulators, this run counter to the “sole responsibility” principle in ISA 600 *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)* as disclosure on the involvement of other auditors could potentially be interpreted as diluting the principal auditor’s responsibility. ISA 600 states that the auditor’s report on the group financial statements shall not refer to a component auditor, unless required by law or regulation. Even where reference is made, the auditor’s report shall indicate that the reference does not diminish the group engagement partner’s or his firm’s responsibility for the group audit opinion.

Also, to re-iterate our comment to Question 5, it is not meaningful to merely disclose the measurement of these other auditors’ involvement by hours without discussing what this measurement means to the audit and the impact of involvement of these other auditors on the work of the principal auditors.

### **Question 14**

**What are your views on explicitly allowing the standardized material describing the auditor’s responsibilities to be relocated to a website of the appropriate authority, or to an appendix to the auditor’s report? (See paragraphs 83–84.)**

The stakeholders are of the view that auditor’s responsibilities should be clearly set out in the auditor’s report and not be relocated to a website or to an appendix of the auditor’s report as it is essential for users to fully understand the auditors’ responsibilities and the basis of audit opinion.

### **Question 15**

**What are your views on whether the IAASB's suggested structure of the illustrative report, including placement of the auditor's opinion and the Auditor Commentary section towards the beginning of the report, gives appropriate emphasis to matters of most importance to users? (See paragraphs 17–20.)**

The stakeholders agree with IAASB's suggested structure of the illustrative report.

### **Question 16**

**What are your views regarding the need for global consistency in auditors' reports when ISAs, or national auditing standards that incorporate or are otherwise based on ISAs, are used? (See paragraphs 21–23 and 87–90.)**

With companies increasingly venture overseas in search of international markets, the stakeholders believe there is merit in having global consistency which enhances comparability. This will benefit the investment community and users of financial statements. The stakeholders propose that those sections with the need for global consistency be presented towards the beginning of the auditor's report, with any local variations to be presented in the later part of the report.

### **Question 17**

**What are your views as to whether the IAASB should mandate the ordering of items in a manner similar to that shown in the illustrative report, unless law or regulation require otherwise? Would this provide sufficient flexibility to accommodate national reporting requirements or practices? (See paragraph 17 and Appendix 4.)**

Generally, the stakeholders support proposal for mandating the ordering of items as this will help achieve global consistency in auditor's reports. Should there be national reporting requirements, they propose to present these in the later part of the auditor's report.

**Question 18**

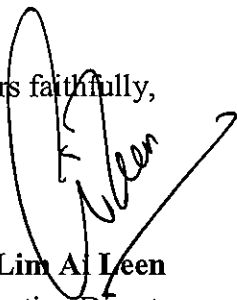
**In your view, are the IAASB’s suggested improvements appropriate for entities of all sizes and in both the public and private sectors? What considerations specific to audits of small- and medium-sized entities (SMEs) and public sector entities should the IAASB further take into account in approaching its standard-setting proposals? (See paragraphs 91–95.)**

The stakeholders are of the view that the suggested improvements should be made mandatory for the larger listed companies and charitable organisations and not SMEs as the impediments are likely to outweigh any benefits for the SMEs. The demands for change which largely arise from the needs of users of financial statements of bigger entities, inevitably come with increased costs and may not be justifiable for SMEs. The additional reporting requirements may be unduly burdensome for the SMEs.

For public sector entities, the needs of the users of their financial statements may vary across different jurisdictions. While the suggested improvements may be useful for some public sector entities due to public interest reasons, it may not be appropriate for other public sector entities due to confidentiality issues. The stakeholders are of the view that this should be dealt with at the national level and hence, it should be left to the respective jurisdictions to determine if the suggested improvements should apply to public sector entities or not when they are implemented. In Singapore, more discussions would be required between ICPAS, the regulators and relevant agencies to determine the applicability of the improved auditor’s report to public sector entities.

Should you require any further clarification, please feel free to contact Mr Kang Wai Geat, Deputy Head, Technical Standards Development and Advisory, or Ms Fua Qiu Lin, Manager, Technical Standards Development and Advisory, at ICPAS via email at [waigeat.kang@icpas.org.sg](mailto:waigeat.kang@icpas.org.sg) or [qiulin.fua@icpas.org.sg](mailto:qiulin.fua@icpas.org.sg) respectively.

Yours faithfully,



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