Embracing Transparency | Enhancing Value

A first year review of the enhanced auditor’s report in Singapore

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ACCA Think Ahead

ACRA Accounting And Corporate Regulatory Authority

ISCA Institute of Singapore Chartered Accountants

Nanyang Technological University Singapore

Development of EAR

2009

Project first started by IAASB[1]

2014

ISAs[2] approved by IAASB

2015

Standards issued in Spore (Jul 15)

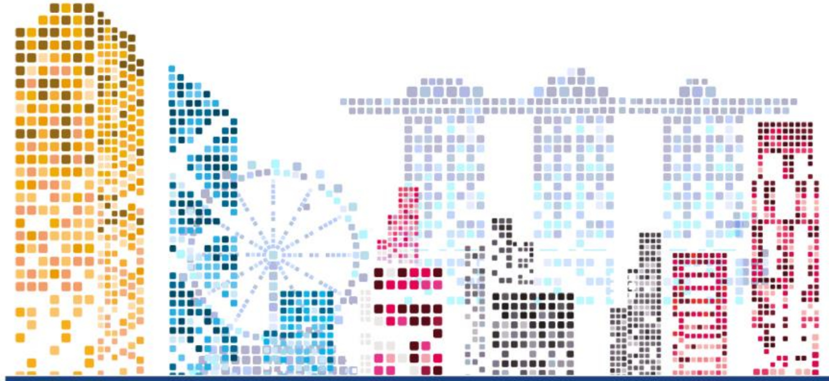
2016

9 early adopters

Effective date (15 Dec 2016) - 17 months after issuance

2017

First year review



[1] International Auditing and Assurance Standards Board

[2] International Standards on Auditing

What are Key Audit Matters?

The most significant change –

Public sharing of key matters

that auditors discussed with audit committee

Areas involving **significant management judgement**

Significant risk areas **most susceptible to misstatements**

Significant events or transactions during the year

Our study covers …

180

EARs and annual reports

242

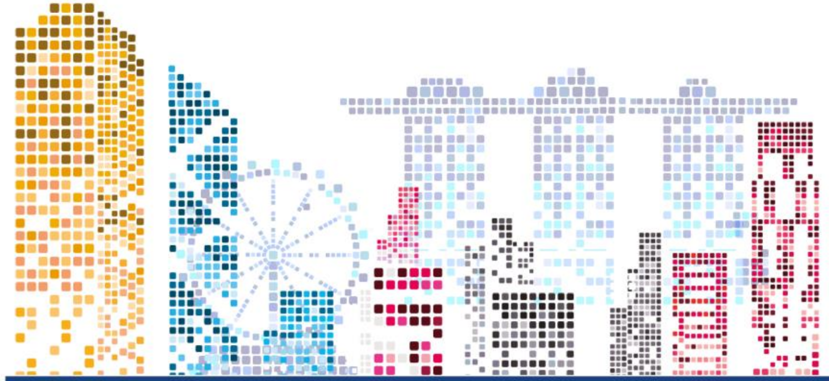
survey respondents

(109 audit committees[1], 133 investors)

35

focus group participants

(24 audit committees[1], 11 investors)



[1] Refers to individuals who are audit committee chairs and members

Average number of KAMs

Singapore

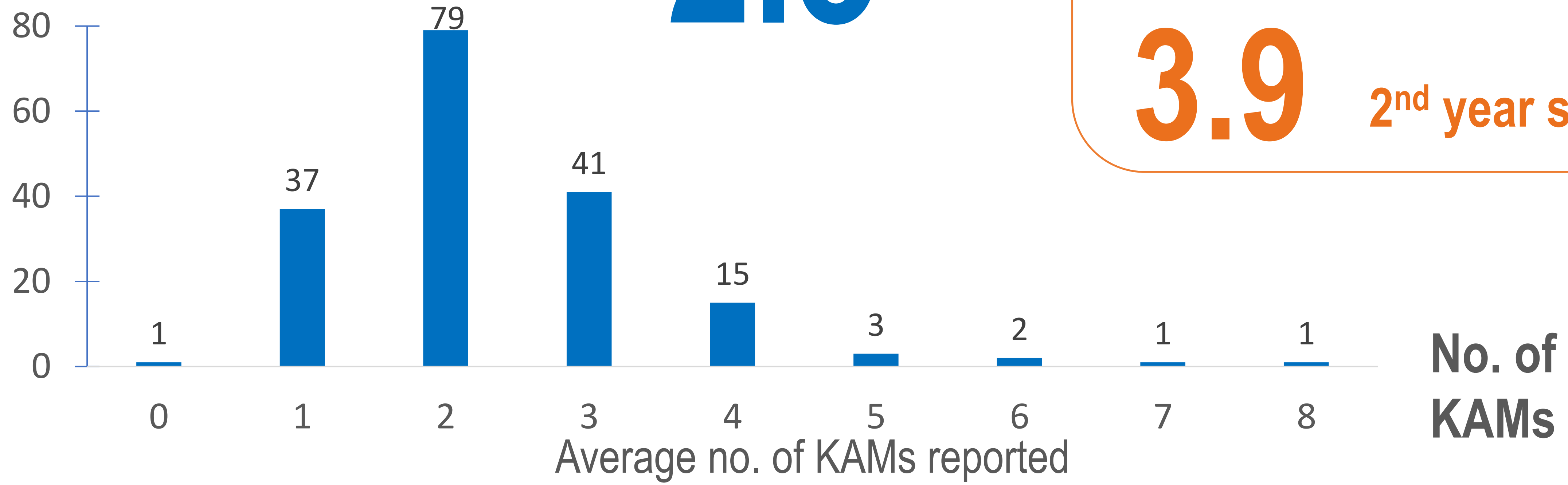
2.3

United Kingdom

4.2 1st year study

3.9 2nd year study

No. of entities



Key Finding #1 – EARs boost the value and confidence over audit

Investors’ experience

89%

of investors will read EAR before the financial statements

“KAMs made it easier for me to identify key investment risks.”

“KAMs help me understand the hidden risks and… how and what measures management had taken to address the issues.”

Both ACs and investors preferred EAR

Which best **represents your views?**

Investors

EAR is **an improvement** over the old auditor's report — **65%**

EAR is **less preferred** than the old auditor's report — **5%**

I do not have a preference between EAR and old auditor's report — **30%**

Both ACs and investors preferred EAR

Which best represents your views?

Audit Committees		Investors
76%	EAR is **an improvement** over the old auditor's report	65%
5%	EAR is **less preferred** than the old auditor's report	5%
19%	**I do not have a preference** between EAR and old auditor's report	30%

Ambivalence about value of audit?

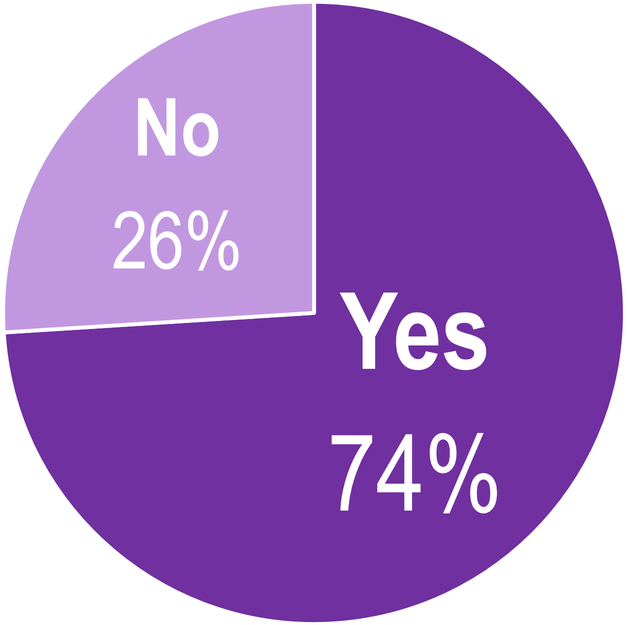
Both ACs and investors gained deeper insights

Did EAR result in you having moderately to significantly ...

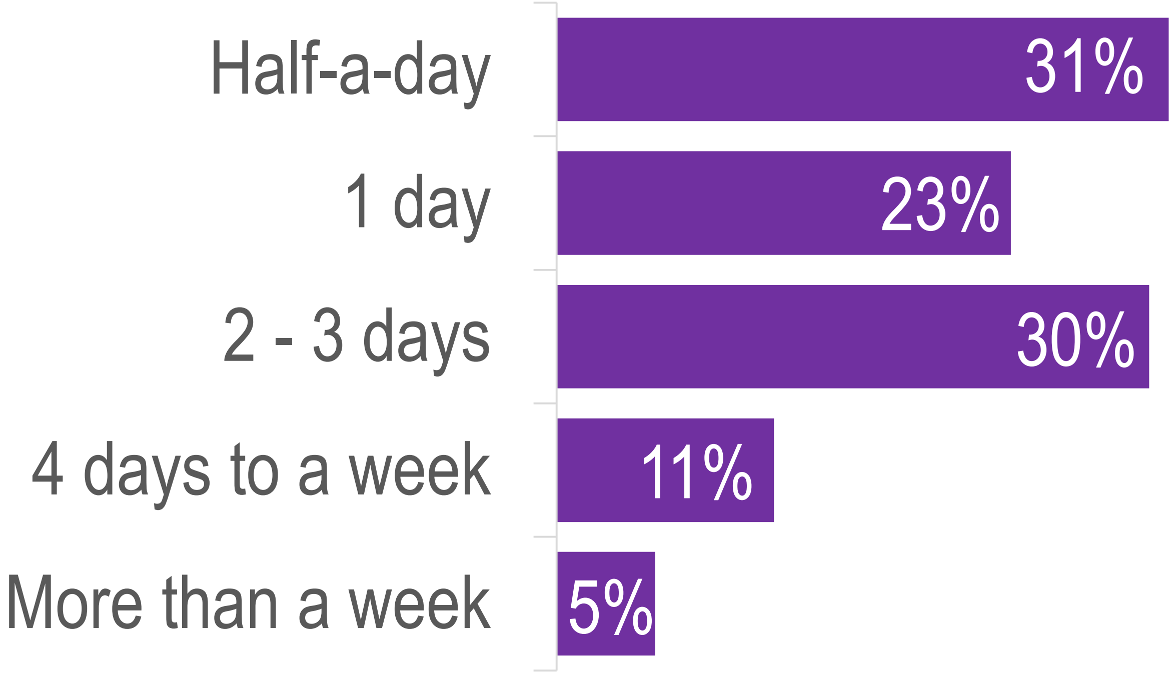
Audit Committees		Investors
57%	deeper insights into **financial reporting risks?**	64%
64%	deeper insights into **how auditors conduct audits?**	60%
56%	more confidence in the **quality of audits** in Singapore?	57%

Audit Committees' experience

KAMs led to more robust discussions with management and auditors



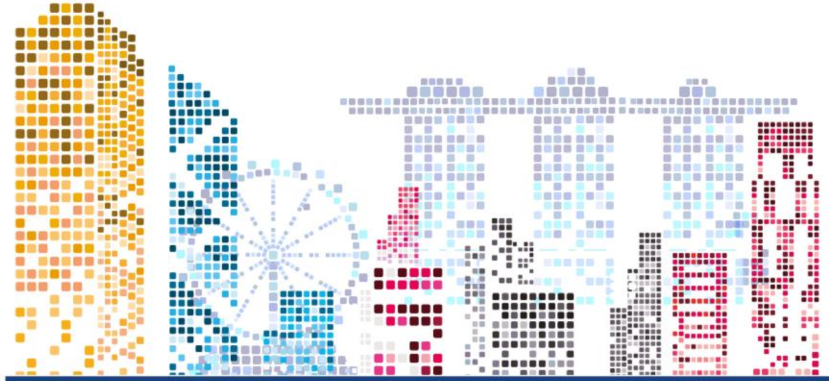
Significant time was spent in considering KAMs and reviewing EARs



Key Finding #2 – Corporate disclosures were enhanced, following EARs

Management added disclosures in FS (1)

40% of financial statements (FS) disclosed **more and in greater depth** those areas covered by KAMs



Examples:
- Judgement applied by management (see next slide)
- Key assumptions used in impairment testing
- Sensitivity analysis of key assumptions
- Description of valuation techniques

FY2015

Management added disclosures (2)

Management has performed cost studies, taking into account the costs to date and costs to complete each project.

Management has reviewed the status of such projects and is satisfied that the estimates to complete are realistic and reasonable.

FY2016

The key judgements and accounting estimates relate to (1) the estimation of total estimated cost to completion which impacts the total budgeted cost and the % of completion; and (2) the appropriate allocation of land and development cost between the commercial and residential components.

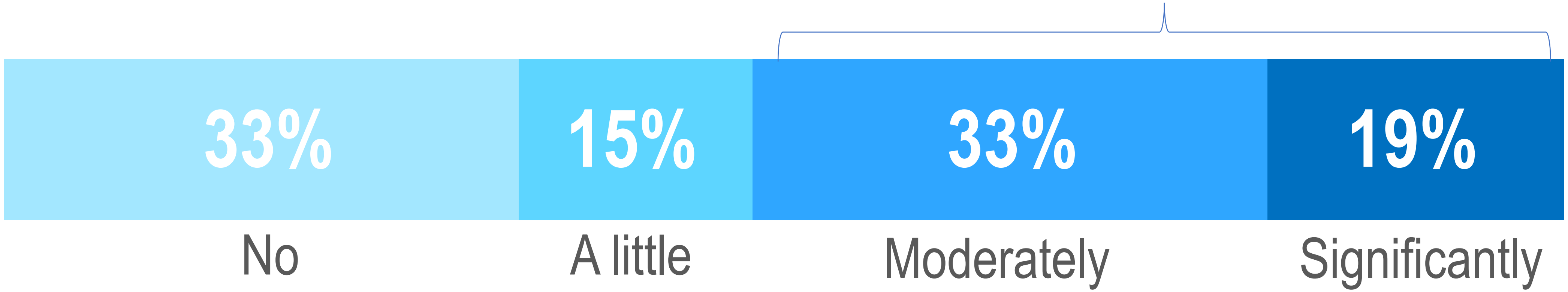
The cost to completion have been estimated by management after considering the remaining work to be done and the estimated total cost based on contracts awarded or experience from comparable past projects.

The allocation of land cost to residential and commercial components within the same development is based on relative estimated sales value of the finished commercial and residential components. Development costs have been allocated between the two components based on specific cost as determined by quantity surveyor or by floor area.

ACs noted improvements to FS

Did the EAR process result in board/management **making improvements to disclosures in financial statements (FS)**?

Survey of Audit Committees: **52%**



Purpose of reporting by different stakeholders

Financial statements prepared by management

EAR issued by auditors

Reporting by audit committee

Financial statements prepared by management

- Presents financial information on **company's financial health**

EAR issued by auditors

- Gives assurance that financial statements are **"true and fair"**
- Highlights **key audit matters** for greater transparency

Reporting by audit committee

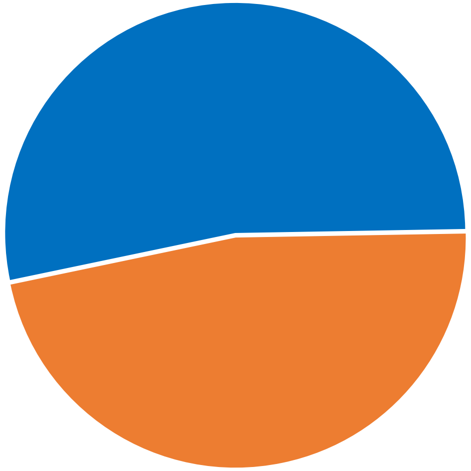
- Provides audit committee's **views** on significant accounting issues, and **responses to KAMs**

ACs also voluntarily reported their views

Letter by **ACRA, MAS and SGX** on 24 Jan 2017
Encourage audit committees (ACs) to **disclose their views on issues**

33%

of 180 annual reports have **voluntary reporting by audit committees**



53% provided further insights beyond KAMs

47% were similar to KAMs

An example of complementary reporting

Audit committee's report

The audit committee considered and evaluated the appropriateness of the Group's revenue recognition policies. The audit committee, with the assistance from internal auditors, oversaw the implementation o... put into effect in t...

The audit com... performance each quarter and compared the performance with that for the corresponding period of the preceding year and quarter. Management has given reasonable and satisfactory explanations on the variances observed.

…

To allow holistic representation of issues

Auditor's Report

We performed the following audit procedures amongst others:

- Obtained an understanding of the Information Technology (IT) and manual controls surrounding revenue systems and processes such as capturing and recording revenue transactions, authorisation of rate changes and the ... changes and the
- ... cash received
- ... to accounting system including verifying material revenue adjustments passed into the accounting system;
- Tested the allocation of revenue to separately identifiable components of multiple element arrangements, particularly in relation to transactions that include the delivery of handset combined with a service element in the contracts, as well as the timing of the revenue recognised;
- Evaluated appropriateness of revenue recognition policies

Both investors and ACs welcomed AC reporting

Is it important to you that audit committee (AC) report its views on KAMs?

Investors

No	A little	Moderately	Significantly
8%	25%	40%	27%

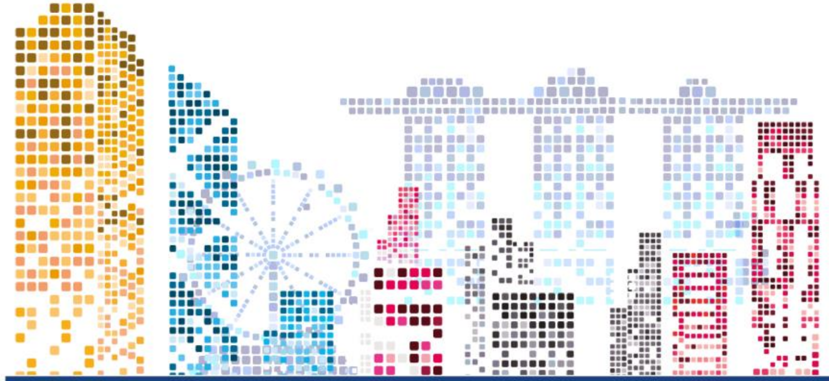
67%

Audit Committees

"I think it's very important for AC to put in their commentary on the KAM, because it's a way to show how they (have) discharged their duties."

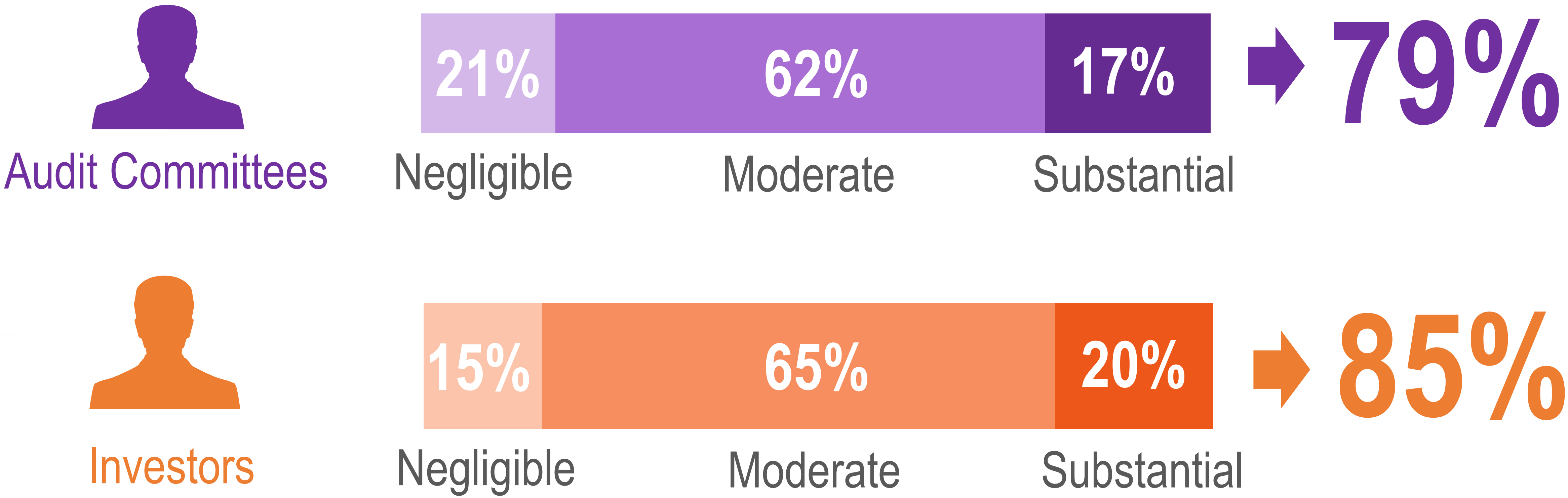
"I looked at an AC report for a UK-listed company and quite liked it. It shows you what they have done, which are extensive…"

Key Finding #3 – Auditors spent more time engaging audit committees



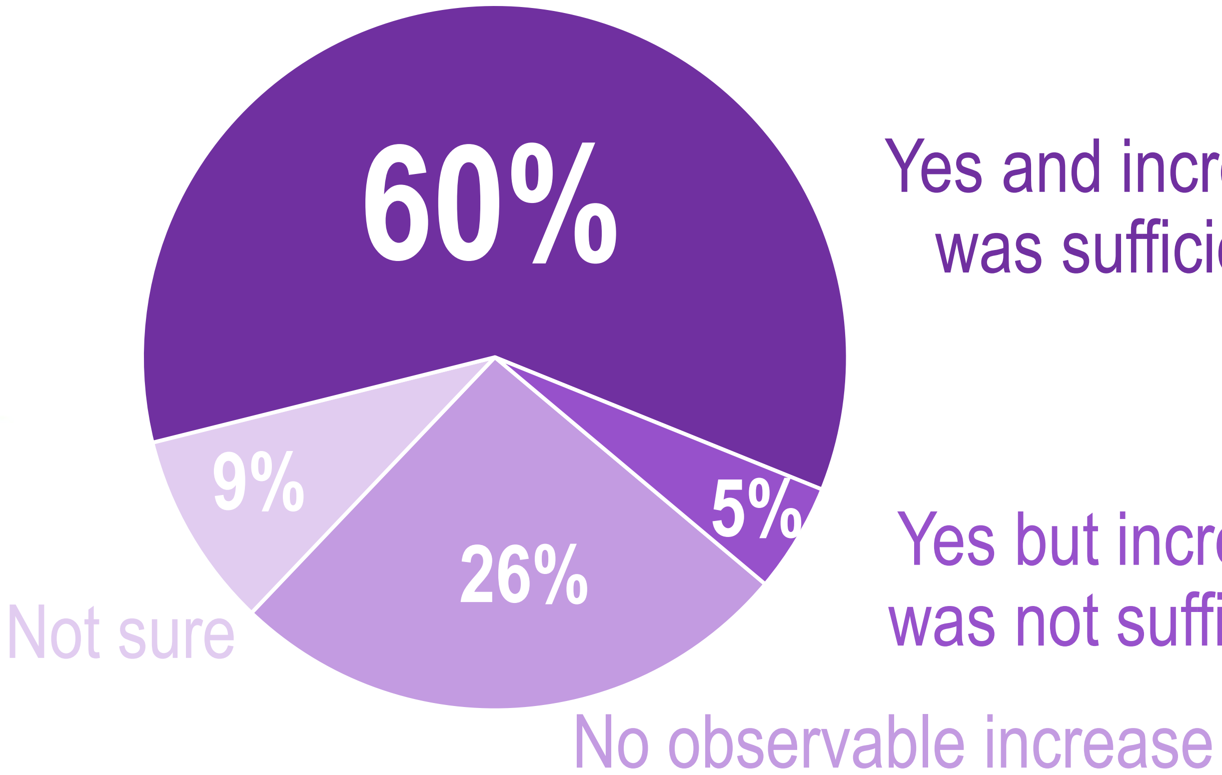
Auditors' efforts were affirmed (1)

What was the extent of **auditors' incremental efforts** in reporting KAMs?



Auditors' efforts were affirmed (2)

Did you observe an increased involvement of audit partners as a result of KAMs reporting?



Yes and increase was sufficient

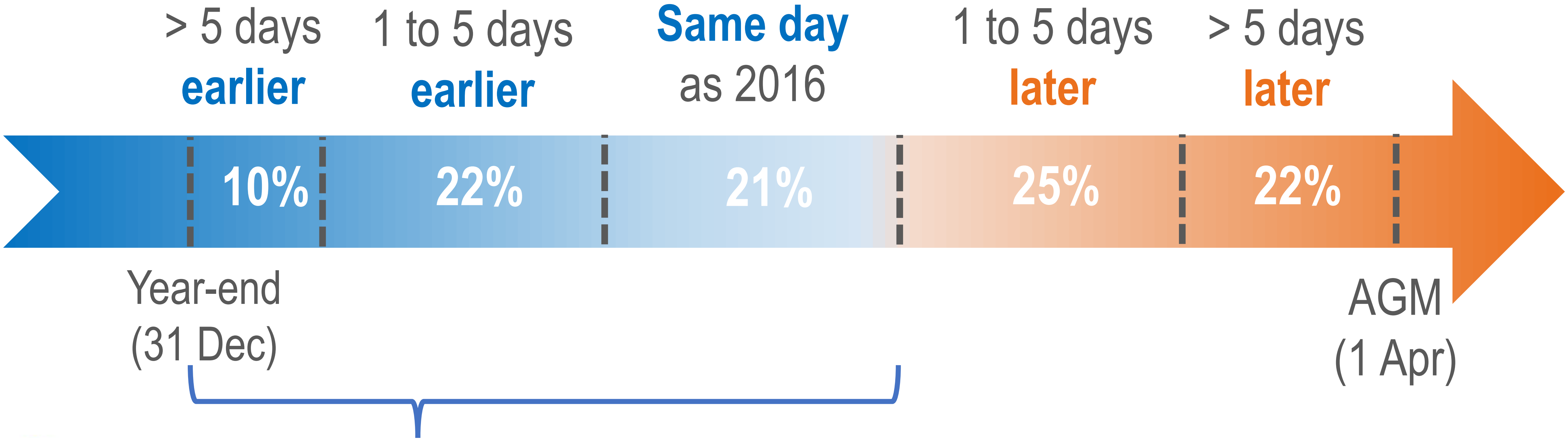
Yes but increase was not sufficient

Audit Committees

65%

saw increased involvement of audit partners

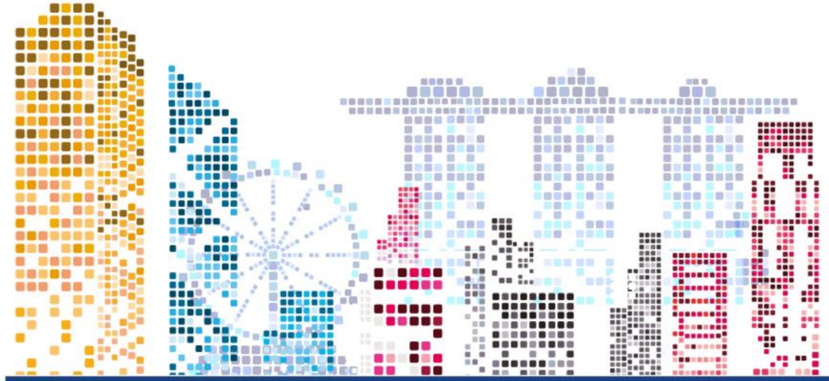
EARs were issued within deadlines



53% of audit reports were signed off

earlier or on the same day as the previous year

Key Finding #4 – EARs could be further tailored to give more insights



KAMs were understandable

Are KAMs drafted in a way that is **easily understood** by investors?

Audit Committees

91%

"Considering the skills set of auditors… there is definitely expected to be a gap in communication skills. So there is a need to sharpen the ability to communicate to the target audience."

Investors

80%

However, some felt…

Too many jargons used

Report too lengthy

But KAMs could be tailored further

Are KAMs **sufficiently tailored** to help investors understand the challenges faced by the auditor?

Audit Committees

92%

DIVERGENCE

Investors

62%

Wanted bolder insights

Sample of generic vs tailored KAMs

Generic

We have identified sales cut-off to be significant because of the higher level of risk that revenue is recognised before the transfer of risks and rewards of ownership of goods to the customers, particularly when the sales transactions are close to the year end.

Tailored

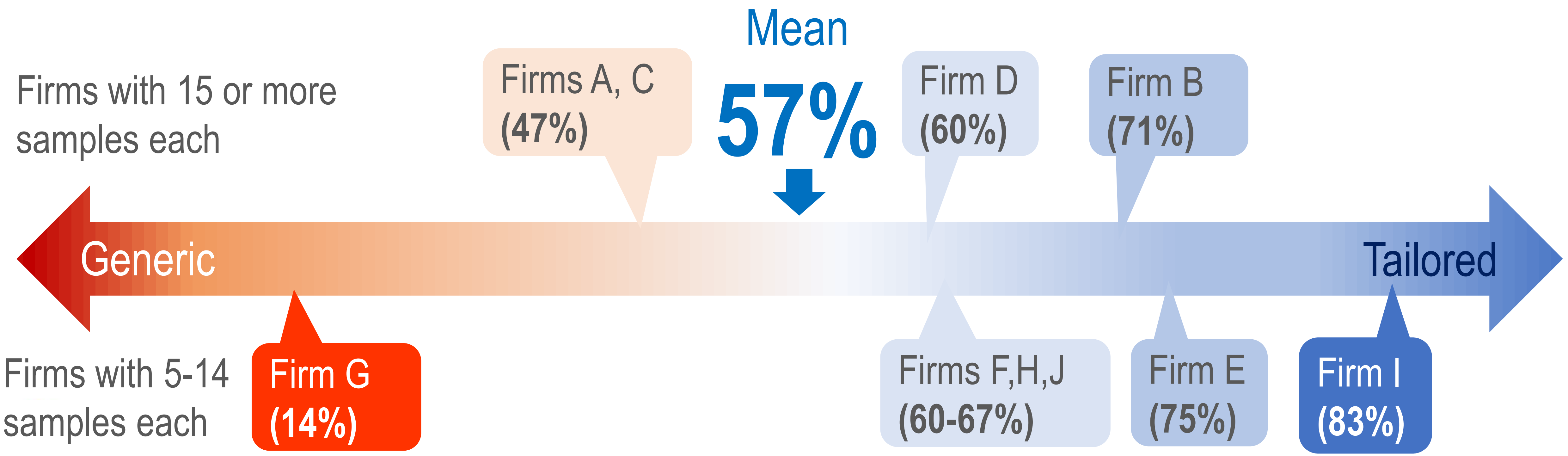
The Group's revenue recognition policy is to recognise the revenue upon the transfer of significant risks and rewards of ownership of the goods to the customer, which generally coincides with delivery and acceptance of the goods sold. This policy also applies to the sale of consignment goods.

The timing of the transfer of the risks and rewards of the goods to the buyers (including products sold by consignees to end customers) is defined by the specific delivery terms agreed upon with the customers. As the Group arranged shipment under various shipping terms across its operating markets, any lapse or delay in the monitoring of the shipment status will affect the timing of revenue recognition, resulting in misstatement of revenue recorded in the financial statements. In addition, part of the remuneration of directors and key management personnel of the Group was based on the performance-related profit-sharing bonus scheme. Accordingly, as there is a risk that revenue could be overstated resulting from pressure to achieve performance targets, we have identified this matter as a key audit matter.

Analysed top 3 KAMs

(151 KAMs across 10 audit firm[1])

The extent to which KAMs were tailored varied



The extent to which KAMs were tailored varied <u>within the same firm</u>

[1] Firms are arranged alphabetically by the size of samples. Firm A had the most samples analysed (47) while Firm J had the least (5).

Outcomes voluntarily disclosed

Analysed KAMs

50% voluntarily disclosed 'outcomes' of audit procedures

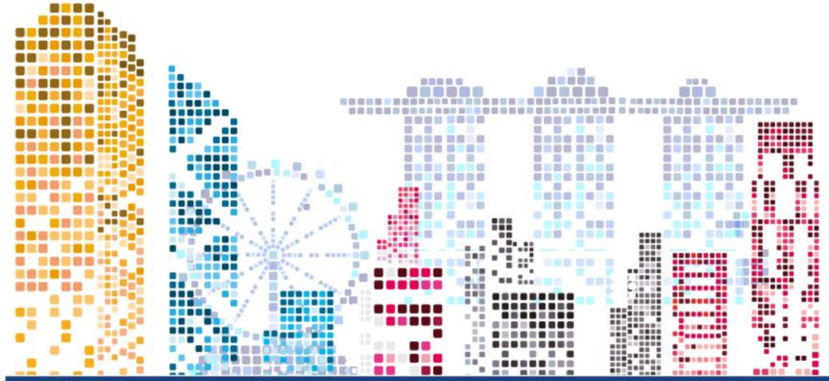
96% **General Outcome**

(e.g. "We found the estimates to be reasonable and the disclosures to be appropriate")

4% **Bolder insights**

(e.g. "We found the discount rate to be at lower end of range"….

"We found ….growth rate exceeded the historical performance. We have recomputed using reduced growth estimates and agree with management that no impairment is required.")



Voluntarily Disclosing Outcomes

Should auditors voluntarily disclose **conclusions or findings** on each KAM?

	Audit Committees		Investors
Yes	62%		82%
No	38%		18%

"(Disclosing outcomes to the KAMs is) tremendously useful, because (otherwise) it's almost like reading a book, but skipping the final chapter"

KAMs were fewer than areas with critical estimates

Average no. of areas with critical judgements and estimates disclosed in financial statements by management

4.8

Average no. of KAMs in EAR

2.3

ACs to ensure differences are reasonable and justifiable

What lies ahead for EARs?

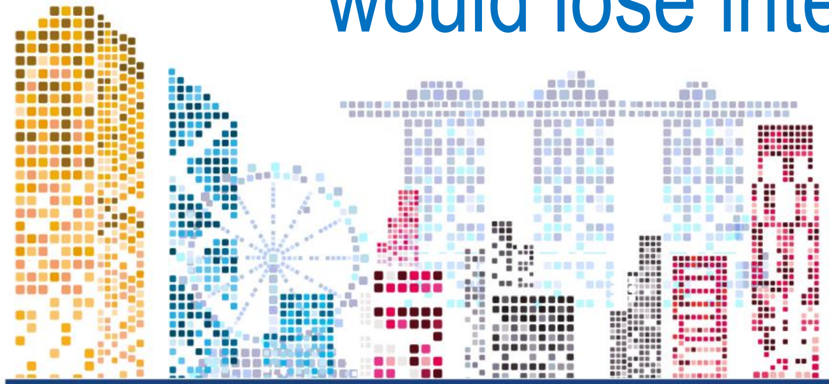
Which scenario is likely to happen in 5 years' time?

A

EARs will turn into boilerplates and investors would lose interests

B

Investors will make better use of EARs to engage auditors, directors and management



Looks like EARs are here to stay

Audit Committees **71%**

Investors **81%**

B

Investors will make better use of EARs to engage auditors, directors and management

Report can be downloaded at:

Acknowledgements

imas INVESTMENT MANAGEMENT ASSOCIATION OF SINGAPORE

MAS Monetary Authority of Singapore

SGX

SIAS Securities Investors Association (Singapore)

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Thank you!