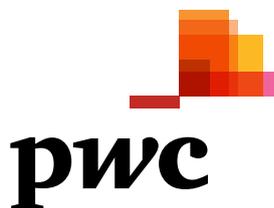

Enhanced auditor's report

Survey of first year experience in Singapore





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Foreword

The independent auditor's report on the financial statements has always been brief. The implementation of enhanced auditor reporting standards in the last reporting season highlights a notable milestone in the history of audit in Singapore.

Addressing the key concerns that, ultimately, previous report on the financial statements of a bank was no different from that of a manufacturing company, the new and revised auditor reporting standards mark a distinct move towards reports that are more informative and insightful. With the increased transparency introduced by the enhanced reporting standards, auditors can now communicate the most significant matters in their audits of the financial statements.

After being on this journey for a year, we take the opportunity in this report to reflect and share our observations from a survey of the longer, more informative auditor's reports issued in Singapore. We believe that the results echo the call for greater clarity in financial reporting and corporate governance in Singapore.



Marcus Lam
Assurance Leader
PwC Singapore



Introduction

In the aftermath of the financial crisis and with growing complexity in financial reporting, investor demands for more informative auditor's reports increased.

The auditing profession has had to respond to investors around the world who expressed dissatisfaction over the auditor's report – a simple 'true and fair' opinion was no longer good enough. Beyond the auditor's pass/fail opinion on the financial statements, the remainder of the report contained mostly standardised wording.

There was a demand for more informative and insightful reports, not only when the auditor's opinion was other than an unqualified one. The auditor's opinion needed to be supplemented with bespoke descriptions of important audit judgements. That is not an unreasonable expectation. After all, even when collecting your car from its regular service routine, you would want to know what work the mechanic has done – giving you a greater degree of comfort and the mechanic a greater degree of credit for his work.

The Financial Reporting Council ("FRC") in the United Kingdom ("UK") responded first, introducing new requirements for auditors of companies subject to the UK Corporate Governance Code for periods commencing from 1 October 2012¹. The International Auditing and Assurance Standards Board ("IAASB") later released its new auditor reporting standards effective for audits of financial statements for periods ending on or after 15 December 2016. The new auditor's report under these standards looks different.

The section on the auditor's opinion is placed first, and standardised wording relating to the responsibilities of the auditor is placed towards the end of the report. The topic on going concern is also given greater prominence in the new auditor's report. When there is a material uncertainty about the entity's ability to continue as a going concern, it will be highlighted in a clearly identified section of the report.

Following the IAASB's action, the standard-setting bodies in a number of countries released their own local equivalents. In Singapore, the Institute of Singapore Chartered Accountants ("ISCA") published the enhanced auditor reporting standards in mid-2015 based on the international standards².

This publication presents the observations from our survey of auditor's reports issued in the first year of implementing the enhanced auditor reporting standards in Singapore. Comparisons have also been made, where appropriate, against the first year experience in the UK, the forerunner in implementing the longer, informative auditor's reports, as well as Hong Kong ("HK"), another Asian country where the profession has adopted the enhanced standards based on the international standards for the same effective period as in Singapore³.

1 There are some differences in auditor reporting requirements between standards in the UK and the international standards issued by the IAASB. The UK standards require an explanation of how the auditor applied the concept of materiality as well as a summary of the audit scope; these are currently not required under the international standards.

2 The standards issued in Singapore are based on the international standards with such amendments as were considered appropriate for local adoption.

3 The observations in this document relating to the UK are based on the information in "Extended auditor's reports – A review of experience in the first year" published in March 2015 by the FRC in the UK and those relating to HK are based on the information in "Enhanced auditor's report – Review of first year experience in Hong Kong" published in July 2017 by PricewaterhouseCoopers Hong Kong.

The Key Changes

Key Audit Matters

While the enhanced standards introduced a number of changes to the auditor's report, the most important change was the reporting of Key Audit Matters ("KAMs") for listed entities.

Singapore Standard on Auditing ("SSA") 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, deals with the auditor's responsibility to communicate KAMs in the auditor's report.

According to SSA 701, KAMs are matters of most significance in the audit of the financial statements and have to be determined from the matters communicated with those charged with governance (i.e. the Audit Committee). SSA 701 requires the auditor to take into account the following in the determination of KAMs:

- (a) Areas of higher assessed risk of material misstatement, or significant risks.
- (b) Significant auditor judgements relating to areas in the financial statements that involved significant management judgement, including accounting estimates that have been identified as having high estimation uncertainty.
- (c) The effect on the audit of significant events or transactions that occurred during the period.

SSA 701 also stipulates the form and content of the report – a separate section should set out the KAMs, each with reference to the related disclosure(s), if any, in the financial statements, and should set out why the matter was determined to be a KAM; and how the matter was addressed in the audit.

Other Information

Significant developments in corporate reporting, as well as the increasing importance ascribed by users to the information included by companies in their annual reports, have led to changes to the auditor's responsibilities relating to other information.

The revised SSA 720, *The Auditor's Responsibilities Relating to Other Information*, requires the auditor to read the other information (i.e. financial or non-financial information included in an entity's annual report) and to conclude whether there is a material inconsistency:

- between the other information ("OI") and the financial statements; and
- between the OI and the auditor's knowledge obtained in the audit, in the context of audit evidence obtained and conclusions reached in the audit.

A separate OI section in the auditor's report is now required when the auditor has obtained some or all of the OI as of the date of the auditor's report. Additionally, for listed entities, a separate OI section is required even when the auditor expects to obtain OI after the date of the auditor's report (i.e. when none of the OI has been obtained as of the date of the auditor's report).



Our observations of first year experience

Survey Scope

Our observations are based on our survey of the auditor's reports issued by auditors in Singapore that were included in the first set of annual reports of entities listed on the Singapore Exchange ("SGX") after the enhanced auditor reporting standards became effective.

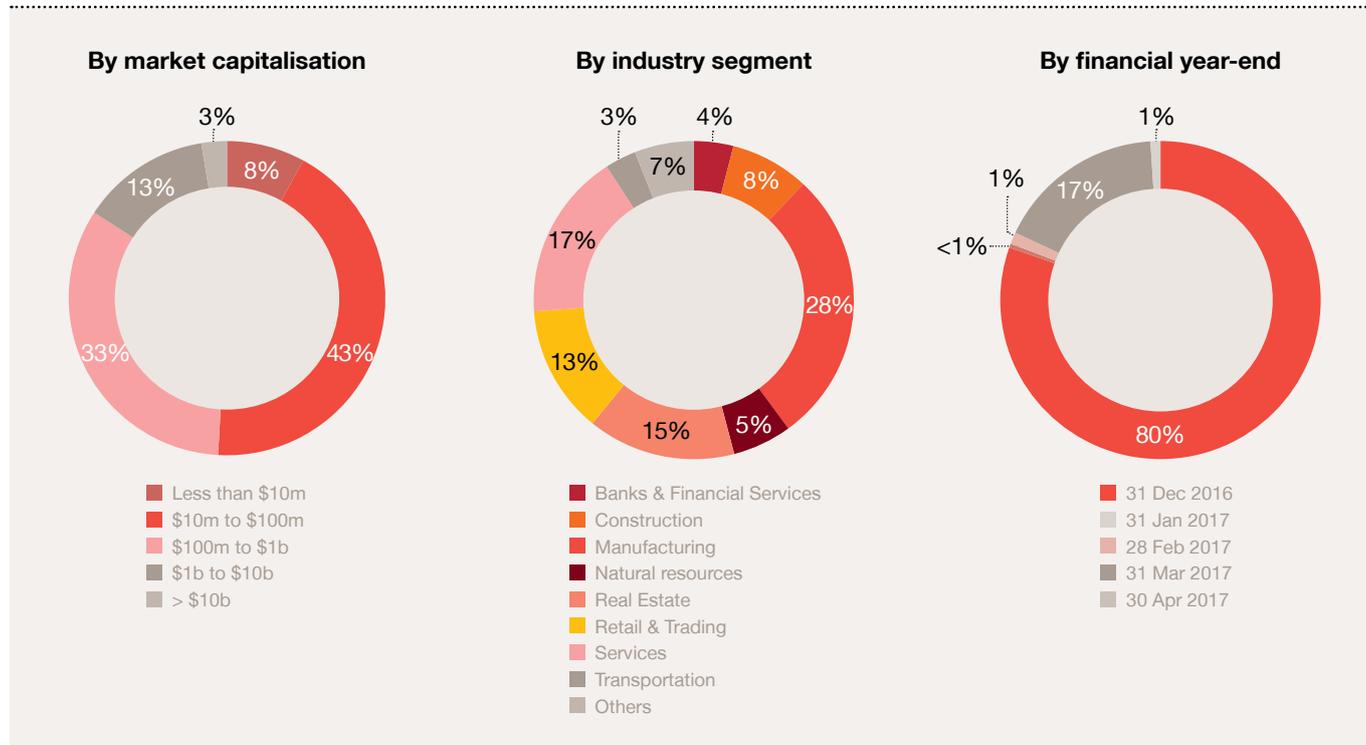
Auditor's reports with disclaimer of opinion have been excluded from our survey as SSA 705, *Modifications to the Opinion in the Independent Auditor's*

Report, prohibits the inclusion of a KAM section or an OI section in the auditor's report when the auditor disclaims an opinion on the financial statements. The survey also did not cover annual reports that were made available on the website of SGX after 31 August 2017.

A total of 499 auditor's reports, that presented 1,163 KAMs in total, were reviewed as part of the survey.

Analyses of the reports reviewed by market capitalisation category, industry segment and financial year-end are presented in Diagram 1. 25 of these reports relate to entities that are among the top 30 entities whose performance is tracked as part of the Straits Times Index.

Diagram 1: Analyses of reports reviewed



Key Audit Matters

The average number of KAMs reported in Singapore of 2.3 per entity compares very closely to the average of 2.2 in HK.

Number of KAMs

Diagram 2 shows the distribution of the number of KAMs across the 499 reports in Singapore in comparison to HK.

It is worth noting that the reports issued in the UK presented an average of 4.2 KAMs in the first year and 3.9 KAMs in the second year of the extended audit reporting.

The experience of a relatively higher number of KAMs reported in the UK may be attributable to the following reasons:

- In the UK, audit committees (“ACs”) of companies with a premium listing of equity shares are required to report on the significant issues that they considered in relation to the financial statements; and the auditors have aligned their reporting of KAMs with the reporting by ACs.
- The companies with a premium listing of equity shares were mostly from the FTSE 250 market, which are relatively larger and more complex than those in this region.

A further analysis of the number of KAMs by market capitalisation, seen in Diagram 3, shows an increasing average number of KAMs with increase in market capitalisation. This is in line with

Diagram 2: Number of KAMs and proportion of reports

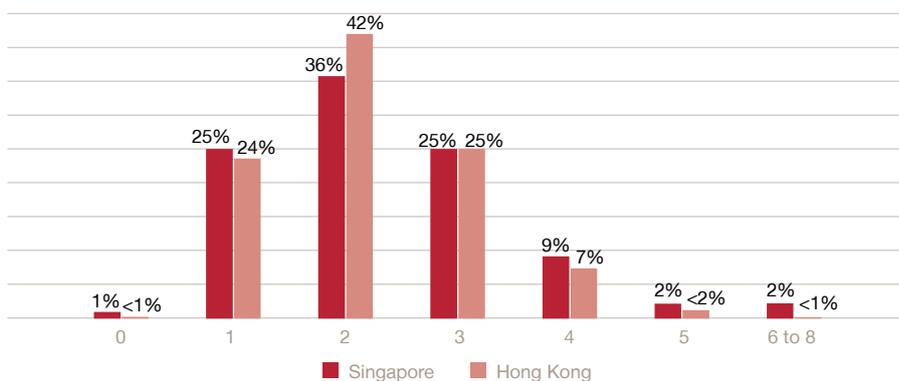
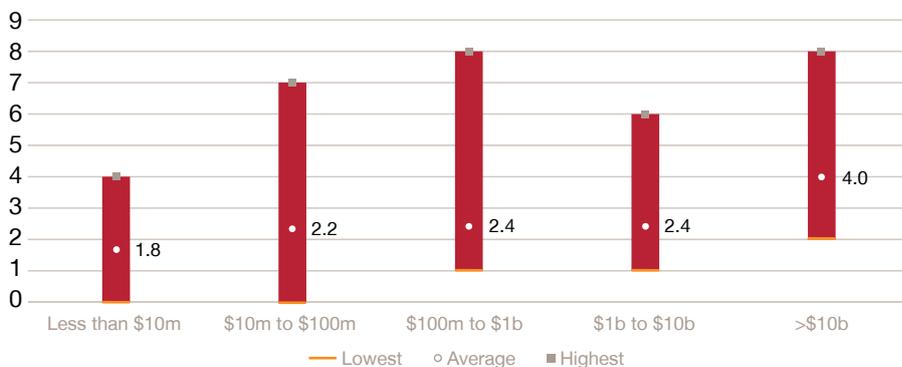


Diagram 3: Number of KAMs by market capitalisation



expectation of more KAMs in respect of larger, more complex businesses.

There were also five reports which reported nil KAMs – two in the “less than \$10m” group and three in the “\$10m to \$100m” group. In three of these reports, the auditor

had explained that the reason for why no KAMs were being reported is because the entity is regarded as a cash company. We believe that the auditor’s explanation in this situation is helpful to the reader although there is no explicit requirement for this in the standards.

Key Audit Matters

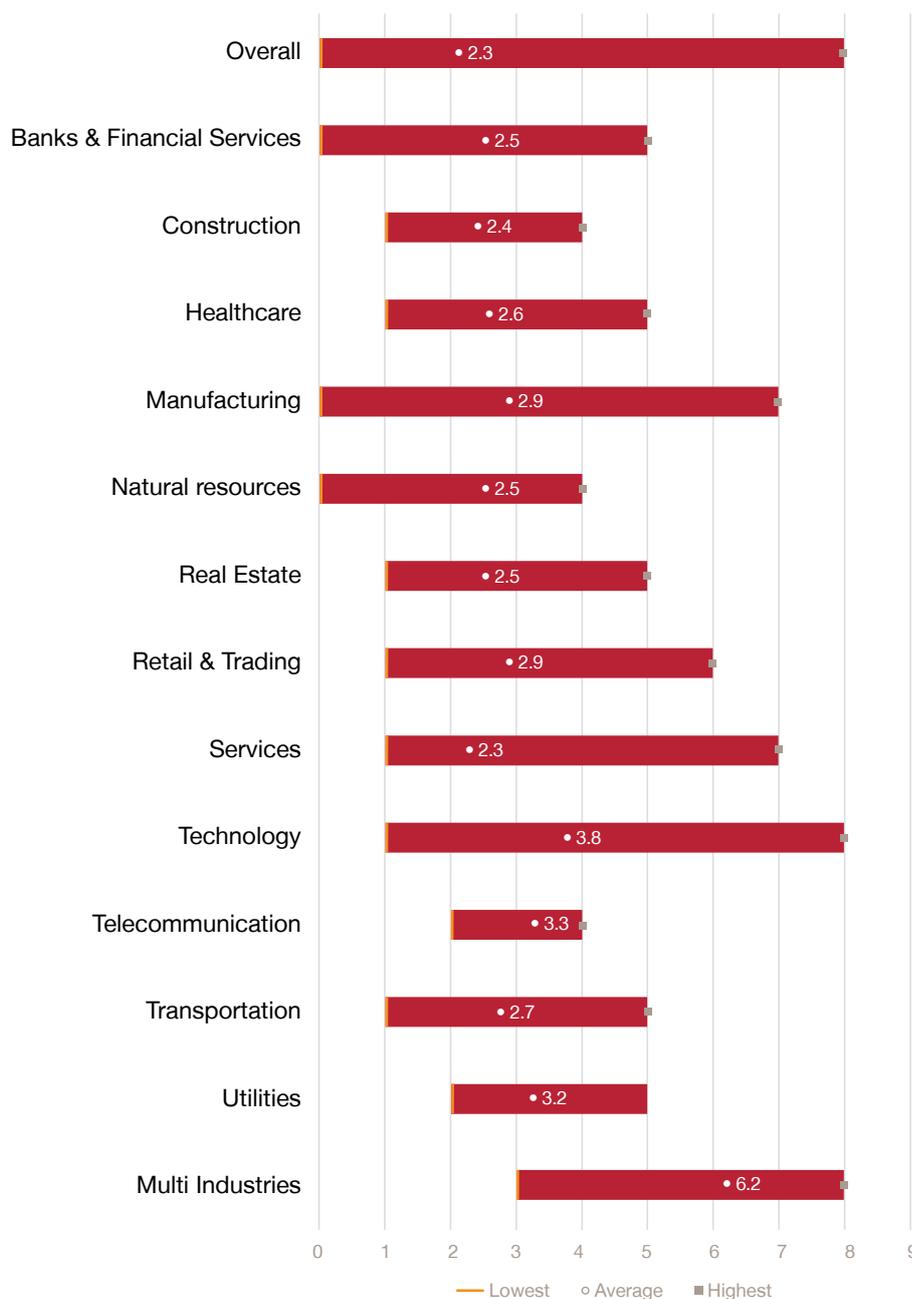
There was no specific industry with a significantly higher number of KAMs per entity.

One may be tempted to draw a conclusion about the influence of the industry on the KAMs – whether the number of KAMs for certain industries was necessarily higher than others. However, Diagram 4 indicates that the nature of the industries did not influence the number of KAMs. This is consistent with the fact that the number of KAMs is dependent on auditor judgement.

Diagram 4 also shows that there can be differences in the number of KAMs reported even for entities within the same industry.

We expect that the number of KAMs will evolve over time to reflect the relative risk profile of the industries. This was also reported in the FRC’s report on the second year experience in the UK. It was observed in the FRC’s analysis of changes in the number of risks that, on average, the number of risks being reported has increased the most in the Utilities sector in the second year and decreased the most in the Oil & Gas sector; this reflected the fact that in the first year, these sectors were at the opposite ends of the spectrum in terms of the average number of reported risks.

Diagram 4: Number of KAMs by industry segment



Key Audit Matters

Topics Reported in KAMs

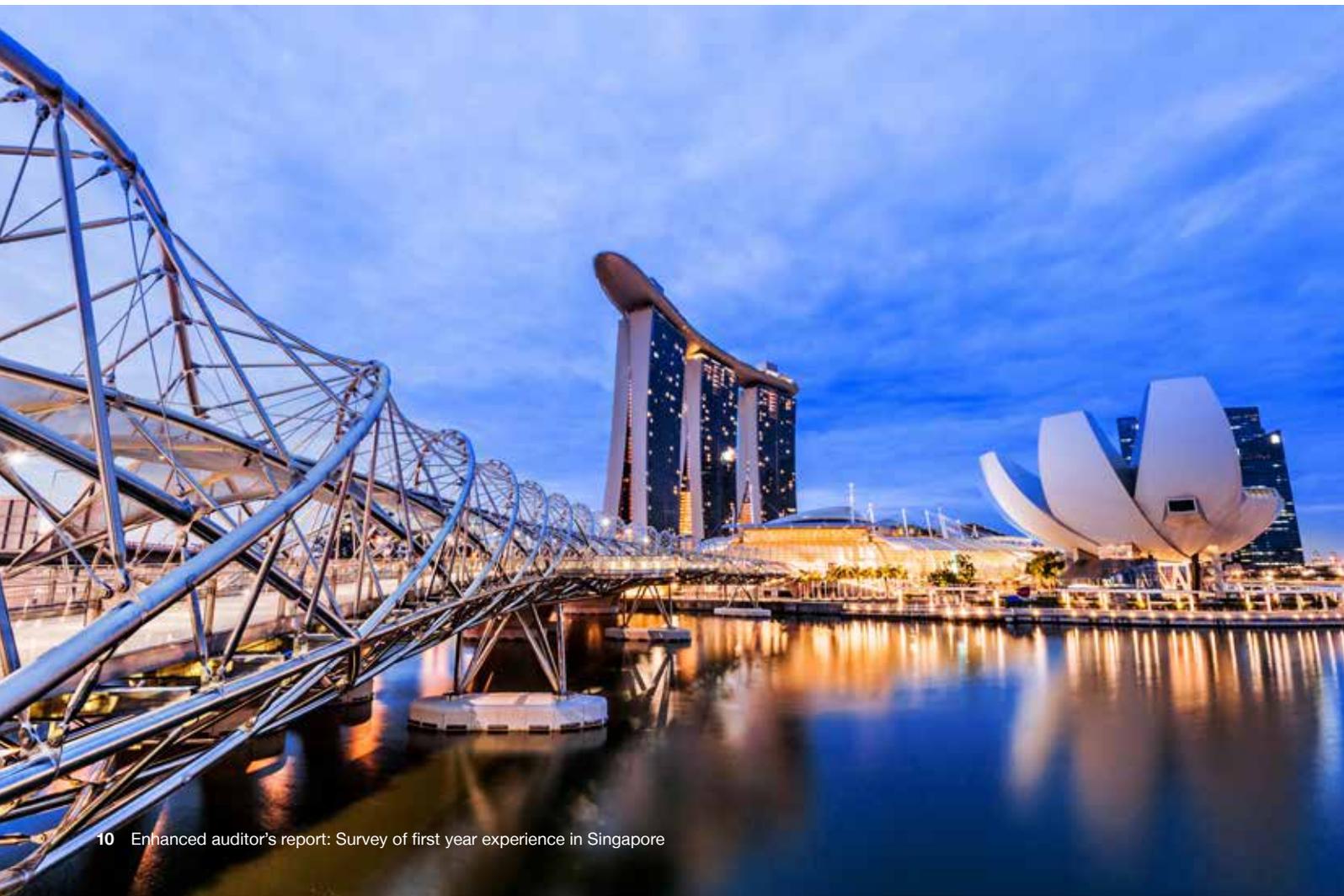
The top 10 topics covered by the KAMs reported in the first year in each of the three countries, Singapore, HK and the UK, are shown in Diagram 5.

It can be seen that the most commonly reported topics in all three countries have been around valuation and impairment assessments, which typically involve significant management judgement, as well as revenue recognition.

In the UK, the “management override of controls” and “fraud in revenue recognition” featured among the top common areas reported in the first year. These presumed risks under the auditing standards were reported by the auditor on the basis that they are significant risks although considered as “standard risks”. The FRC subsequently clarified that the intent of the new auditor reporting requirement is to discuss those risks which had the greatest effect on the audit strategy, resources and effort.

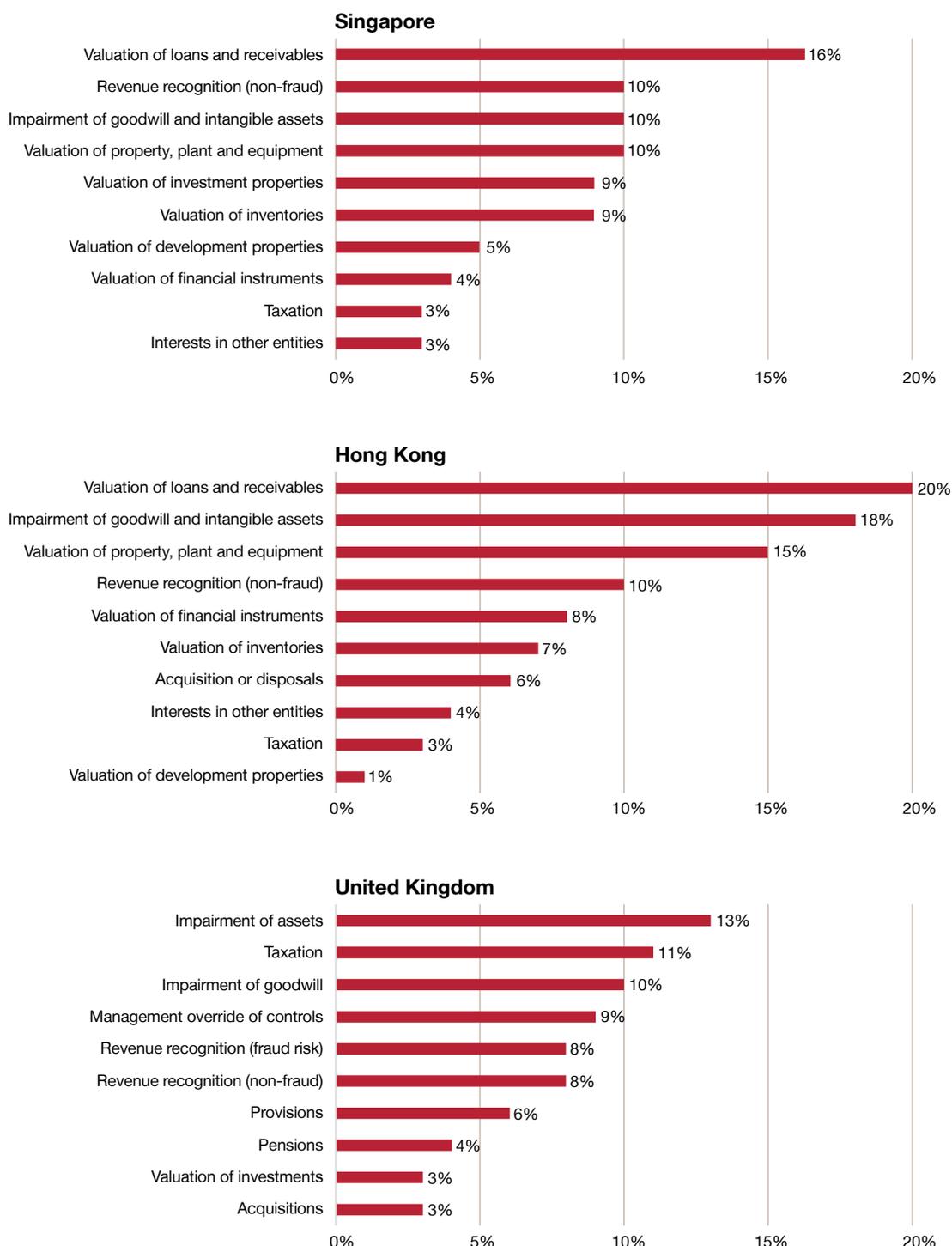
The effect of this clarification was evident in the auditor’s reports issued in the second year; the “standard risks” were included only where they clearly had an impact on the audit strategy.

However, the nature of the topics in the reported KAMs appear to reflect the nature of the industry as seen in Diagram 6 on the top three KAMs reported by entities in each selected industry.



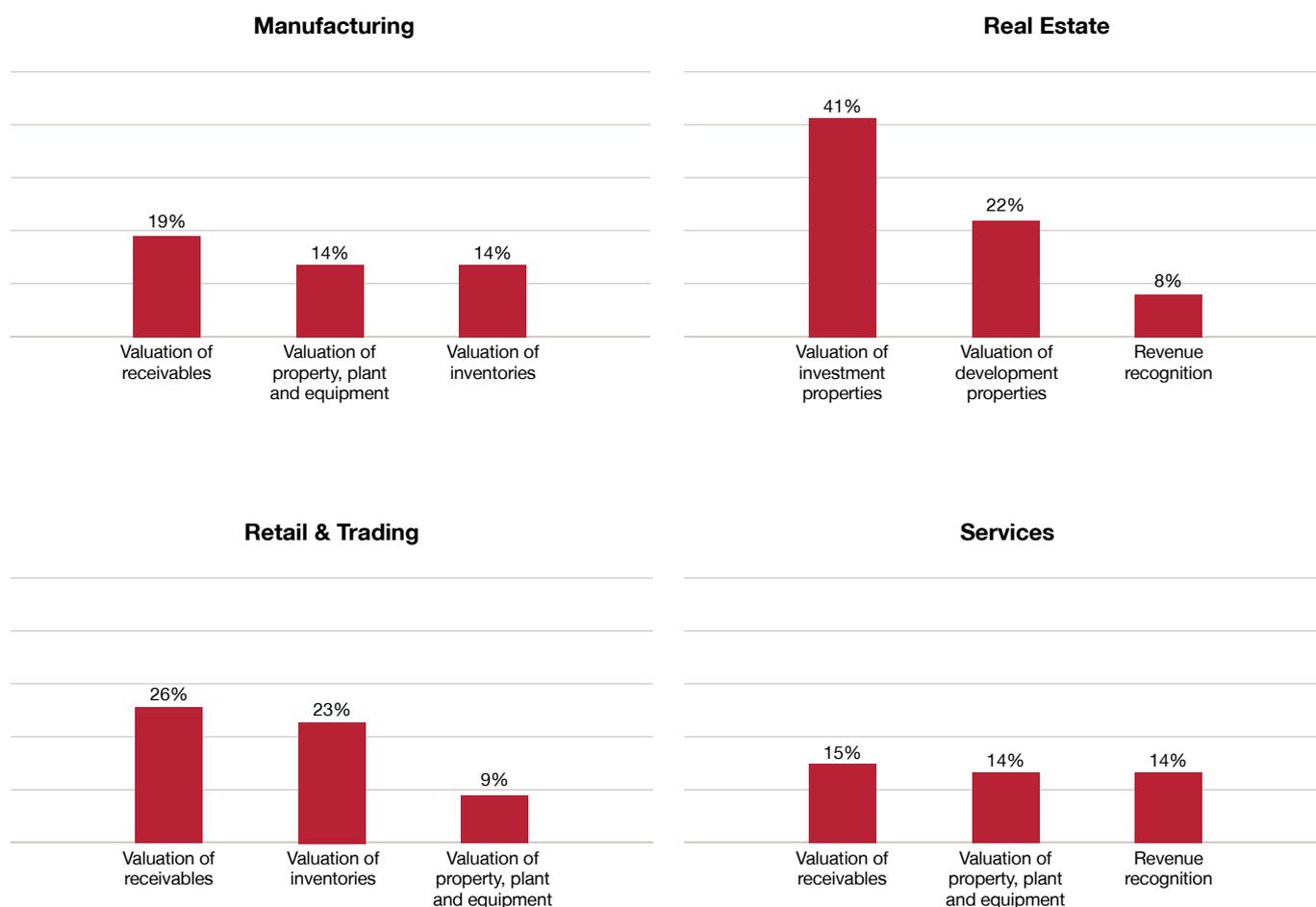
Key Audit Matters

Diagram 5: Top 10 topics reported in KAMs as a proportion of all KAMs reported



Key Audit Matters

Diagram 6: Top three KAMs reported for selected industry segments (% of total number of KAMs in the industry segment)



Key Audit Matters

Diagram 6: Top three KAMs reported for selected industry segments (% of total number of KAMs in the industry segment)



42% of the KAMs reported in Singapore included outcomes or results of the procedures performed, providing some insight on the auditor's resolution of the KAMs.

Key Audit Matters

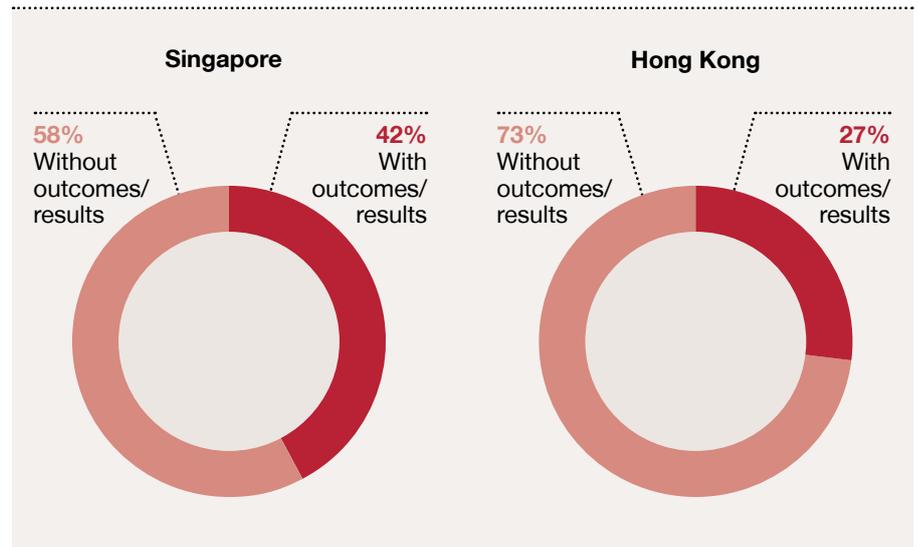
Indication of Outcomes or Results of Procedures

Including the outcome or results of the procedures performed to address the KAM can reduce uncertainty about how the auditor resolved the matter when forming the opinion on the financial statements as a whole. In fact, in the Netherlands, where the enhanced auditor reporting standards were implemented early on a pilot basis, Eumedion⁴ commented that the description of KAM and the description of how the audit addressed the matter should be “supplemented with the auditor’s result, observations or conclusion”.

While not an explicit requirement, the inclusion of outcomes or results of procedures for each KAM seems to be encouraged as set out in the related guidance in SSA 701. This would, of course, be based on the auditor’s evaluation of the circumstances in the audit engagement. The amount of detail in describing how a KAM was addressed in the audit is also a matter of the auditor’s professional judgement.

However, there needs to be careful consideration of the wording used when describing the outcome or results of the procedures. This is to avoid leading a reader to believe that the auditor’s work had been planned and performed to provide a ‘mini-opinion’ with respect to the particular financial statement item mentioned in the KAM.

Diagram 7: % of KAMs with outcomes/results



Overall, 42% of the KAMs reported in Singapore included the outcome or results of the procedures performed to address them compared with 27% in HK as seen in Diagram 7. On further analysing the details, we noted that almost half of those reports which did not have any outcome or results of the procedures performed by the auditor (reflected as 58% in Diagram 7) were issued by one audit firm. This could be a reflection of a stance adopted by that firm at the global network level. Nevertheless, the proportion of reports with outcomes or results included in Singapore and in HK are significantly higher than the experience in the UK where, in the first year, only about 2% of the auditor’s reports had included the

outcome or results and in the second year, about 20%.

We also observed that auditors in Singapore had adopted different approaches in describing the outcomes or results of their procedures as can be seen from the following examples of statements included in some of the auditor’s reports:

- “Based on the work performed, we considered the methodology and assumptions used by management to be appropriate.”
- “We found management to have the relevant controls in place, and that the key assumptions applied by management to be reasonable based on supportable information available.”

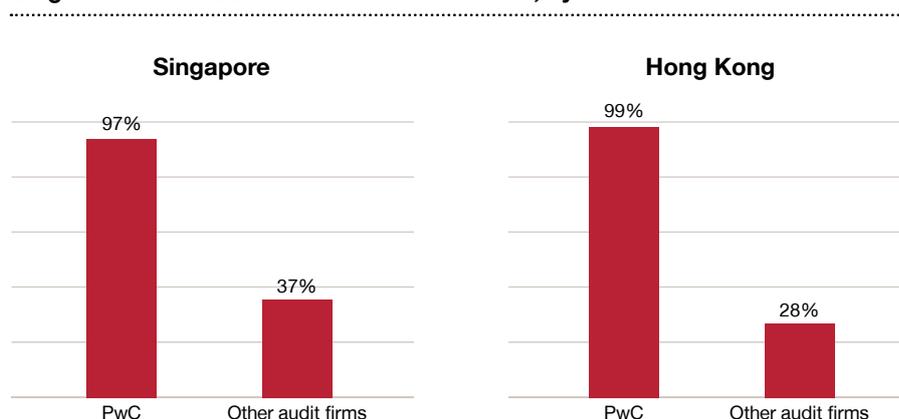
⁴ Eumedion represents institutional investors’ interests in the field of corporate governance and related sustainability performance in the Netherlands.

Key Audit Matters

- “We found that cautious estimates were made in the determination of net realisable values and allowance for foreseeable losses.”
- “Our testing did not find indication of significant management bias nor deviation which would have required us to increase or amend the nature of scope of our planned detailed test work. We found that the assumptions, resulting estimates applied and disclosures to be balanced.”

We expect that, while there will continue to be differences in the wording used by the auditors, like in the UK, auditors in this region will be able to provide greater insight into the audit and include more granular descriptions of outcomes or results from their procedures as they gain more experience in issuing the longer reports.

Diagram 8: % of KAMs with outcomes/results, by auditor



We, at PwC, strive to go beyond the minimum compliance and embrace the change. This follows the recognition that users of financial statements would be interested in not only what auditors did but also what they found. Consequently, we have included the outcome or result of our procedures performed

to address the KAM, where this made sense. Some of the other auditors are also taking a similar approach as can be seen in Diagram 8.



Key Audit Matters

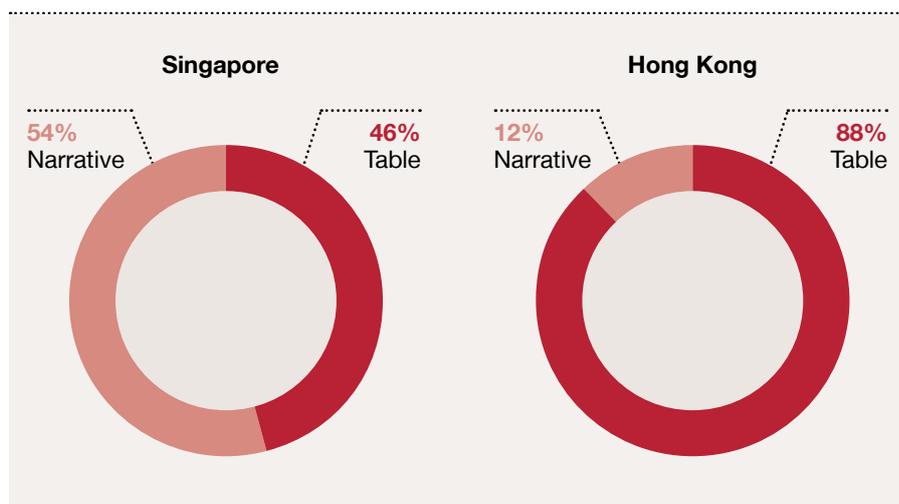
Presentation of KAMs

While the required contents for KAMs are set out in SSA 701, the presentation of the KAMs is not. Auditors, therefore, have the liberty to decide on the presentation of the KAMs – whether to use narrative or tabular style.

In the spirit of enhancing readability of the auditor’s report, a number of auditors adopted the tabular style, presenting the KAM in the left column (i.e. the ‘what’ and ‘why’ of the KAM) and the procedures performed to address the KAM in the right column (i.e the ‘how’ of the KAM). This style is particularly helpful when a lot of information is presented in the auditor’s report, in helping the reader to ‘remain on track’. Nevertheless, we observed that a few firms had consistently adopted the narrative style of reporting KAMs.

Diagram 9 reflects the proportion of reports that had adopted the narrative style and those that had adopted the tabular style of reporting KAMs in Singapore and in HK.

Diagram 9: Distribution of reports with KAM in table and in narrative form of presentation



Involvement of management and audit committees

Based on our survey of PwC audit teams about their experience in the first year of applying the enhanced auditor reporting standards, we note that audit committees were more interested and engaged in conversations with auditors about the audit in general and about KAMs, more than management teams.



Additional Observations

Our survey also observed that some auditors included additional descriptions, although not always in a consistent manner. This is understandable, the auditor having to consider situations where a group of listed entities may be audited by more than one audit firm, each with its own preferences that are permitted by the standards. These firms may have agreed with the relevant group management teams to ensure compliance with the requirements in the auditing standards and exclude any additional disclosure so as to achieve consistency within the wider group.

The voluntary disclosures by PwC, for example, included additional information about materiality and group scoping in the reports it provided on the financial statements of Singapore Exchange Limited and DBS Group Holdings Ltd. These additional disclosures are required in the UK but are currently not required in Singapore.

A more consistently applied voluntary disclosure for PwC's reports was the inclusion of a contextual section on "Our Audit Approach" that precedes the

KAM section; this was seen in more than 80% of its reports. This section is intended to refer readers to the important work done to address the ever present risk of management override of controls and consideration of bias that represents a risk of material misstatement due to fraud and to explain that certain estimates in the financial statements are based on subjective judgments which are inherently uncertain, and that this has been factored into the auditor's risk assessments.

In PwC, we also changed the structure of our reports to make them more focused and user friendly. The opinion on the financial statements is placed right at the top of all our reports.

On the other hand, another audit firm emphasised fulfilment of its responsibilities for the audit of the financial statements, noting that the results of its audit procedures provide the basis for its audit opinion on the financial statements as a whole. This additional information was observed in more than 90% of its reports.

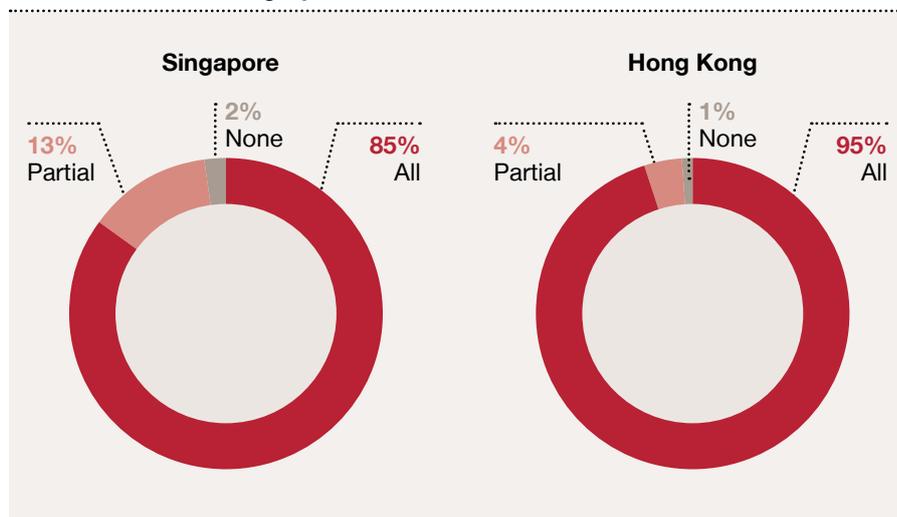


Other Information

85% of the entities surveyed had provided all of the OI by the date of the auditor's report.

Diagram 10 shows the extent of OI that had been provided to the auditor as of the date of the auditor's report:

Diagram 10: OI – All, Partial and None – categories and % of reports in each category



More than 80% of the auditor's reports reflected that all of the OI was obtained by the date of the report on the financial statements. Interestingly, about 2% of the auditors appear to have reported that none of the OI was obtained yet. This may seem odd especially since the Directors' Statement is a common part of OI that is ordinarily prepared and dated as of the same date as the auditor's report and accompanies the financial statements in the case of all entities incorporated

in Singapore. While more of the auditor's reports in HK, almost 95%, reflected that all of the OI was obtained by the date of the report on the financial statements, it is difficult to draw conclusions on the extent of the entities' reporting readiness based on this. This is because the amount of information presented in the annual report that forms OI varies from entity to entity.

In the UK, the full annual report is required to be ready at the date of the auditor's report.

Entities with smaller market capitalisation were more likely to provide all OI by the date of the auditor's report.

Other Information

Further examination of the data for Singapore shows that the smaller entities had provided all of the OI as of the date of the auditor's report as can be seen in Diagram 11.

Furthermore, the longer the time taken to finalise the financial statements, the more likely the provision of all of the OI by entities to the auditor by the date of the auditor's report, as can be seen from Diagram 12.

Of the entities that had provided only part of the OI as of the date of the auditor's report, two – both banks – had reported an update in the annual report that the remaining OI had since been provided to the auditor and that the auditor, having read the remaining OI, had nothing to report. Such an update in the annual report may be an attempt to reassure investors about whether the auditors reported anything about the OI provided *after* the date of the auditor's report.

Diagram 11: % of entities which had provided all of the OI across market capitalisation category

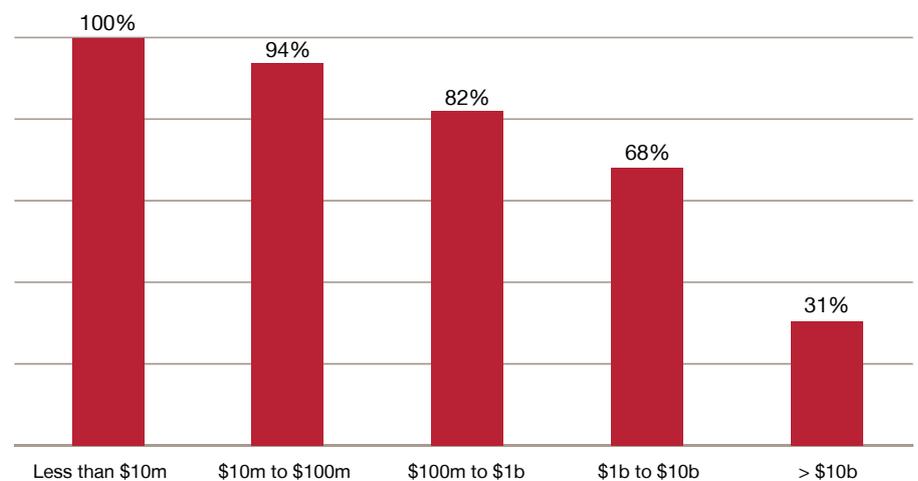
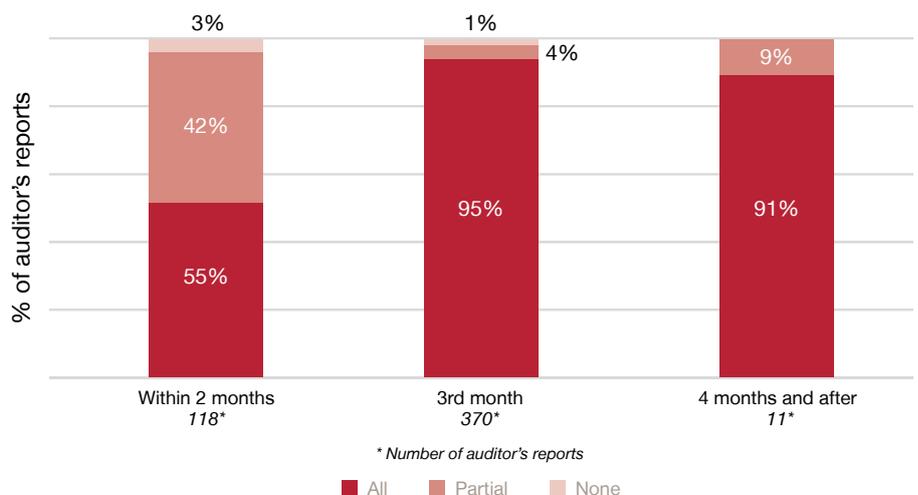


Diagram 12: Timing of auditor's reports, by number of months after financial year-end and analysis of level of completeness of OI



Commentary by Audit Committees

Only 40% of the entities surveyed included AC commentaries in their annual reports.

As the enhanced auditor reporting standards were first implemented in the UK, it was only natural for auditors from the rest of the world to look towards the UK for lessons on implementation. However, the drivers for change that existed in the UK did not exist everywhere.

In the UK, the enhanced auditor's reports were implemented at about the same time as expanded AC reporting requirements. The 2012 version of the FRC's Corporate Governance Code introduced reporting by the AC, which is sub-set of the Board of Directors, of "the significant issues that the committee considered in relation to the financial statements, and how these issues were addressed". These complementary reporting requirements provided a shared agenda for auditors and ACs that helps explain in part why the first year experience in the UK proved to be as successful as it was. The auditor identifies areas of focus and says what procedures were carried out to audit them; and the AC comments on the judgements made by management and why it is comfortable with those judgements. This follows the long-established principle that the auditor reports on the audit and the directors report on the company.

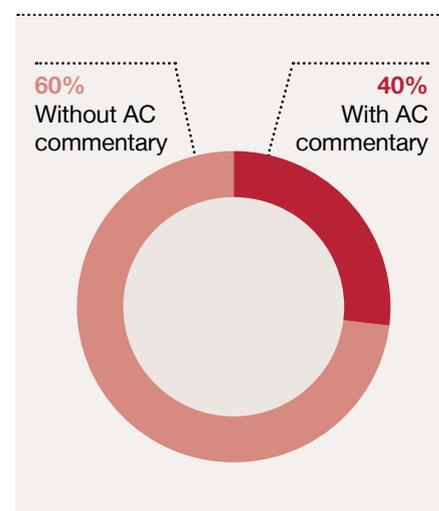
In Singapore, the Accounting and Corporate Regulatory Authority ("ACRA"), the Monetary Authority of Singapore ("MAS") and the SGX sent a joint letter to ACs of all Singapore listed companies asking them to consider disclosing the following in the AC commentary in the Annual Report:

- (a) Significant financial reporting matters specific to their listed company, including their perspectives on the key audit matters reported by the external auditors.
- (b) How they have assessed and concluded on each significant matter, which could include discussions with management, auditors and other subject matter experts.
- (c) Significant judgement calls made, which could include assessments of management's judgements and estimates, and the sources of assurance drawn upon as the bases for their agreement with the management's conclusion.

The letter was sent in early January 2017, more than six months after the enhanced auditor reporting standards were published.

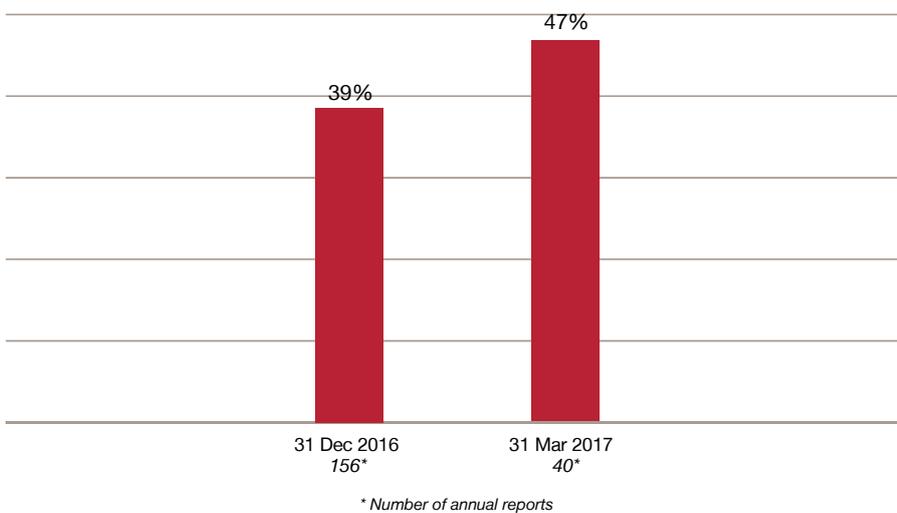
The joint expectation of the three bodies was for each AC to comment on the significant financial reporting matters specific to its listed company, not just what it thought about the KAMs reported by the external auditors. Because of the timing of the communication of the expectation (not a requirement), 60% of the ACs did not provide any commentary on the significant financial reporting matters as can be seen in Diagram 13.

Diagram 13: % of annual reports with AC commentary



Only 11% of the annual reports included AC commentary in accordance with the request from ACRA-MAS-SGX.

Diagram 14: % of annual reports with AC commentary by financial year-end



As can be seen from Diagram 14, the number of annual reports containing AC commentary is not necessarily increasing over time. Given that more time has passed since the issuance of the joint-letter in January 2017, we would have expected a much higher proportion of the annual reports relating to the financial year ended 31 March 2017 to contain commentary by the ACs than the 47% seen in Diagram 14.

More than half of the ACs that had provided any commentary had commented on the KAMs identified by the auditors instead of commenting on the significant financial reporting matters specific to their listed company. Only 48% had identified significant financial reporting matters, as seen in Diagram 15. It is unclear if the thought-process behind the determination of the KAMs by the auditors should be the same as that

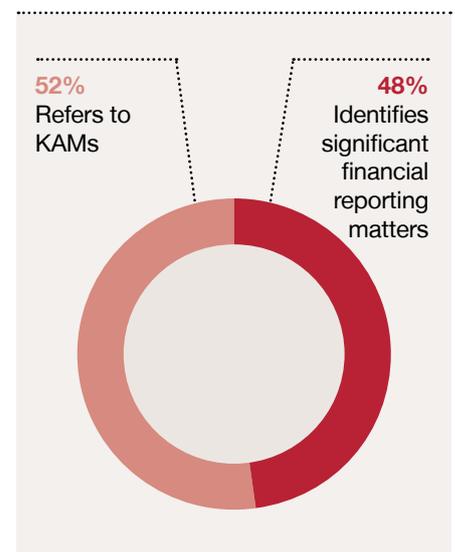
which should be adopted by the directors.

Furthermore, not all of the annual reports reviewed in our survey had AC commentary that met the three-part expectation in the joint letter from ACRA, MAS and SGX; only 11% did. We believe that ACs may appreciate clarity and guidance in this respect from the regulators.

While the intention of getting ACs to provide commentary in the annual reports may have been to raise the quality of financial reporting in Singapore, using the reporting of KAMs by auditors as the driver to push ACs to include their commentary on the significant financial reporting matters considered could cause ACs to confine their consideration of those matters to only the KAMs reported by the auditors.

ACRA, ISCA and the Securities Investors Association (Singapore) jointly released a guide just before the season of annual general meetings (“AGMs”), aimed at providing basic and practical guidance for retail investors when they read auditor’s reports issued by auditors of companies listed on the SGX (“the Guide”). The Guide set out the questions investors should ask at AGMs, among other matters related to the enhanced auditor reporting standards. We understand that some of the matters reported as KAMs by the auditors generated more interest during the AGMs especially when there was little or no related AC commentary in the annual reports, and led to more questions rightly addressed to directors.

Diagram 15: AC commentary making reference to KAMs vs describing significant financial reporting matters



Looking Ahead

The only constant is change

It has taken many years for the auditor's report to change to its current more informative version. We do not believe that the most recent set of changes is a one-off. With technological advancements leading to faster information-sharing, investors and other stakeholders can be expected to provide more prompt feedback to regulators; and regulators can be expected to respond more quickly towards financial reporting and corporate governance matters.

Keeping investors in mind

Learning from early adopters, the FRC's second year survey of extended auditor's reports in the UK reaffirmed the need to bear the investors in mind when developing the auditor's report. With the call for more transparency and corporate governance in Singapore, we have heard anecdotally that investors and other stakeholders in Singapore have similar views.

Moving forward

Progressing towards an environment of bespoke auditor's reports is undoubtedly transforming the long-established culture in the auditing profession. This significant implementation poses many challenges to auditors as well as the management of companies and those tasked with governance. We, at PwC, will continue to keep up with the change and tackle any challenges ahead, as we strive to go beyond the minimum compliance to deliver valuable and insightful reports for investors and other stakeholders.



Contacts

Marcus Lam

Assurance Leader
+65 6236 3678
marcus.hc.lam@sg.pwc.com

Choo Eng Beng

Partner, Assurance
+65 6236 3848
eng.beng.choo@sg.pwc.com

Hans Koopmans

Partner, Assurance
+65 6236 3158
hans.koopmans@sg.pwc.com

Alima Banu

Associate Director, Assurance Risk & Quality
+65 6236 3314
alima.banu@sg.pwc.com



