
Time to step up: building momentum for progress

The Singapore second year experience





Contents

Foreword	4
Introduction	5
Survey Scope	6
Key Audit Matters	7
Other Information	12
Commentary by Audit Committes	13
Call to Action	18
Contacts	19

Foreword

Similar to auditors via the enhanced auditor's report, audit committees can play a vital role in elevating the level of transparency of information provided to readers through the audit committee commentary. Both the enhanced auditor's report and the audit committee commentary can, and should, complement each other.

As we embark on the third reporting season under the enhanced auditor reporting standards, we are optimistic that the observations from the first two seasons will be instrumental not only in helping the audit profession develop more insightful auditor's reports, but also in facilitating audit committees in the production of more meaningful commentaries. These will be extremely valuable to interested stakeholder groups such as the investors.

In this report, we share our key observations from a survey of the enhanced auditor's reports and audit committee commentaries in Singapore from the second reporting season. We believe there are some interesting insights which warrant deeper consideration by stakeholders.



Marcus Lam
Assurance Leader
PwC Singapore



Introduction

Last year, we concentrated our study on the long-form auditor's reports issued in the first year of implementing the enhanced auditor reporting standards in Singapore. Comparisons were made to the United Kingdom and Hong Kong ("HK"), where applicable.

This year, in addition to identifying key observations from the second year of implementing the standards, we focused on determining whether there were notable trends when compared with the first year. Where appropriate, we compared against HK to assess if such trends prevailed over there as well, or if the trends were unique to Singapore. Both Singapore and HK are global financial centres in Asia that adopted the enhanced auditor reporting standards for the same effective period.

Furthermore, we took a closer look at the commentaries produced by audit committees published in the annual reports, in particular the qualitative aspects, to establish how useful the commentaries are to readers.



Survey Scope

Our observations are based on our survey of the auditor's reports issued by auditors in Singapore for entities listed on the Singapore Exchange ("SGX"), with financial year ended on 31 December 2017.

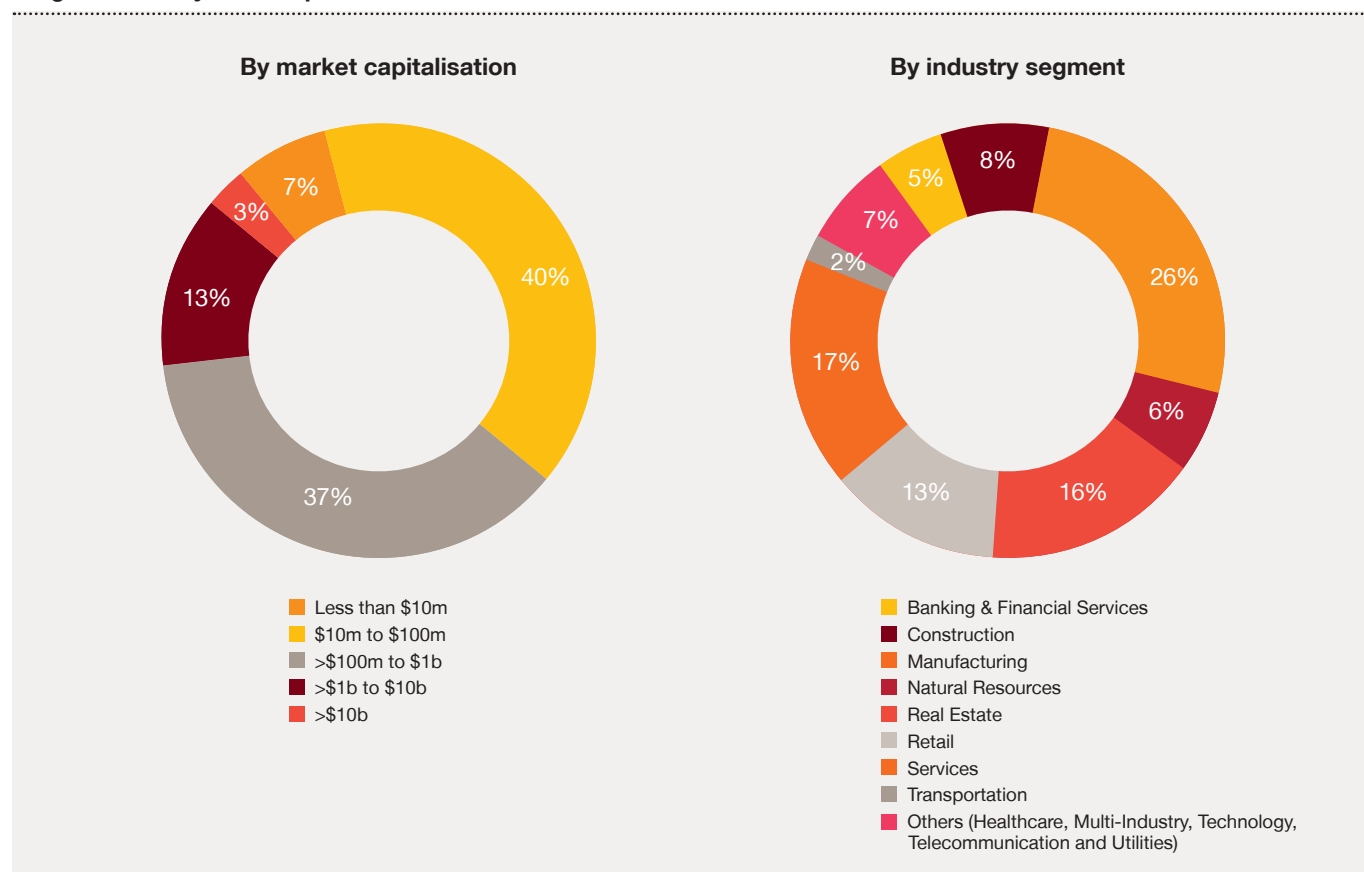
Similar to the first year ("Year 1"), auditor's reports with disclaimer of opinion have been excluded from our survey as SSA 705, *Modifications to the Opinion in the Independent*

Auditor's Report, prohibits the inclusion of a Key Audit Matters ("KAMs") section or an Other Information ("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 10 July 2018.

A total of 392 auditor's reports with 860 KAMs in aggregate, as well as 236 commentaries by audit committees ("ACs"), were reviewed as part of the Year 2 survey.

Analyses of the auditor's reports reviewed by market capitalisation category and industry segment are set out in Diagram 1. 75% of these reports related to entities listed on the Mainboard.

Diagram 1: Analyses of reports reviewed



Key Audit Matters

Early signs of predictability in number and topics of KAMs emerging

Diagram 2 shows the average number of KAMs and range of KAMs by industry segment.

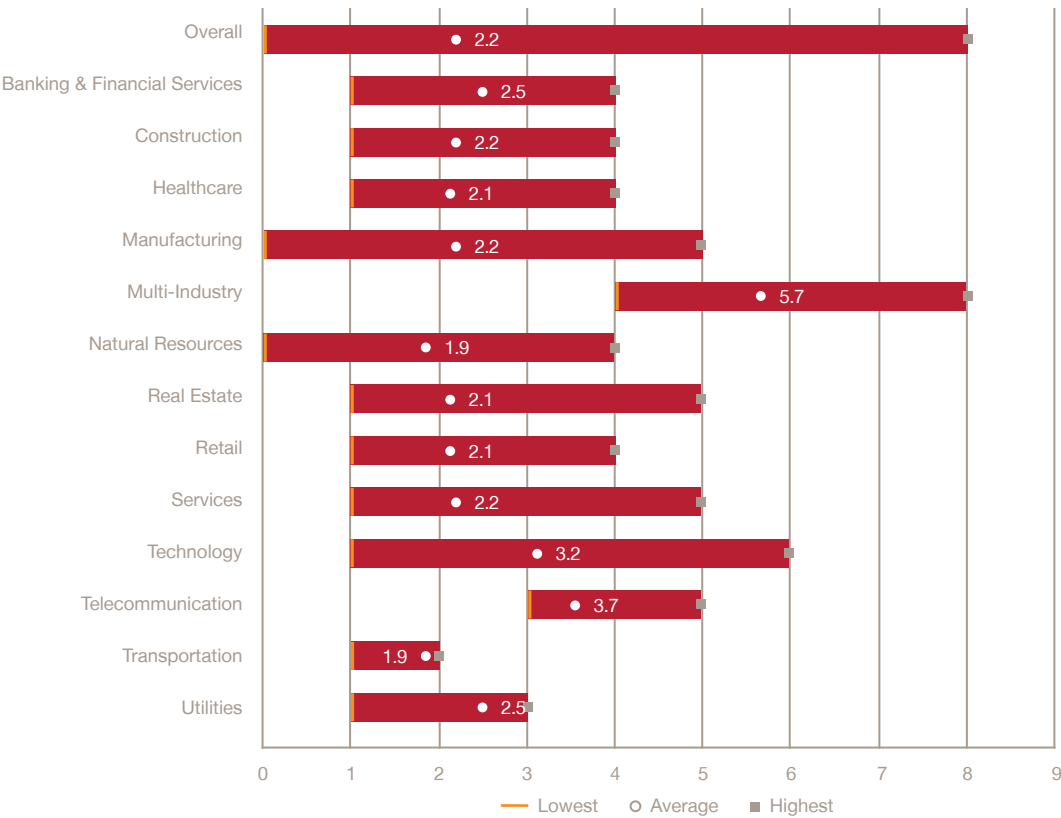
Compared with Year 1, there was no significant difference in the average

number of KAMs on an overall basis. The average in Year 1 was 2.3 whereas Year 2's average was 2.2, just a marginal decline.

The same can be said of the average number of KAMs by industry segments. Across the different industries, the average number of KAMs ranged from 1.9 to 3.7. This is not too dissimilar to the range of 2.3 to 3.8 in Year 1.

This would seem to suggest that auditors have reported around the same number of KAMs in both Year 1 and Year 2. Differences, if any, would not be considerable. One plausible explanation is that there were no significant changes in the nature and scale of business operations for most of the entities. Hence, it is perfectly logical that the number of key issues encountered by the auditors will likely be about the same year on year.

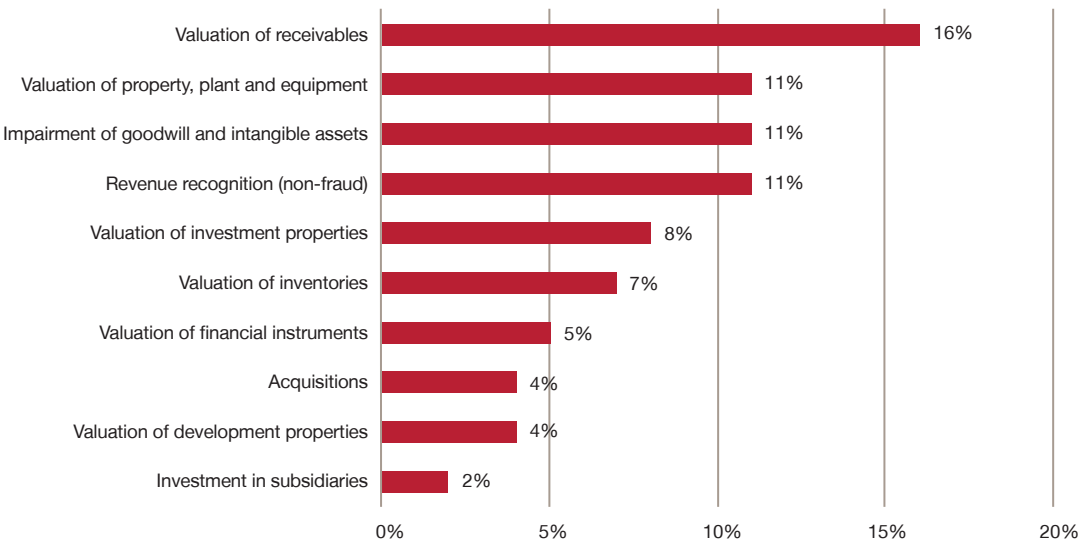
Diagram 2: Number of KAMs by industry segment – Singapore



Key Audit Matters

This rationale can likewise be applied to the observation regarding the topics reported in KAMs. Diagram 3 below, presents the top 10 topics covered by the KAMs reported in Year 2.

Diagram 3: Top 10 topics reported in KAMs as a proportion of all KAMs reported – Singapore



The top five KAMs in Year 2 are the same as those in Year 1, except for the order. This indicates that auditors are mostly reporting the same type or nature of KAMs as in Year 1. If

the operations of the entities have remained relatively stable over the years, it is hardly surprising that there are no new KAMs to be discussed and reported.

Notwithstanding that there are reasonable bases to rationalise the aforementioned observations, if the quality of the narrative of the KAMs is not refreshed annually, it will undoubtedly diminish the communicative value of KAMs and hence the auditor’s reports. If the situation exacerbates, KAMs may eventually become boilerplate disclosures of little value to readers. To address this, auditors should consider increasing the granularity of their KAM descriptions by including information that is specific to the year of audit. While the nature of issues may remain the same across different years, the narrative of the KAMs should always include information, perhaps new information, that is specific to the relevant year.



Key Audit Matters

How does this compare with Hong Kong (“HK”)’s Year 2 experience? Diagram 4, shows the average number of KAMs and range of KAMs by industry segment in HK for Year 2 while Diagram 5 displays the top 10 topics covered by those KAMs.

Diagram 4: Number of KAMs by industry segment – Hong Kong

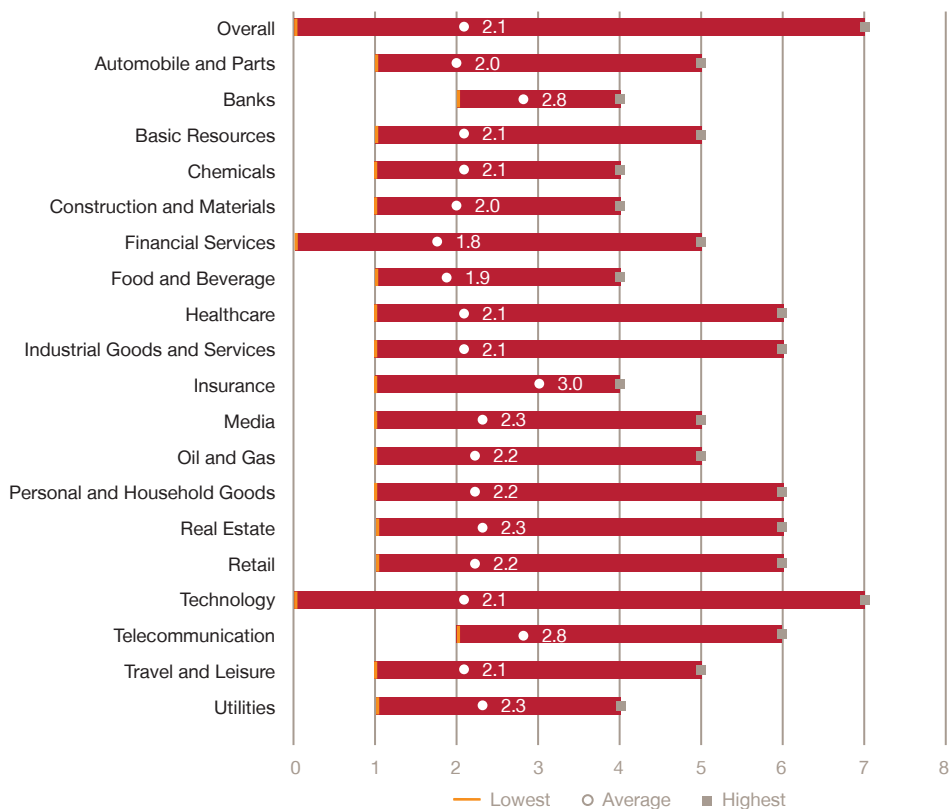
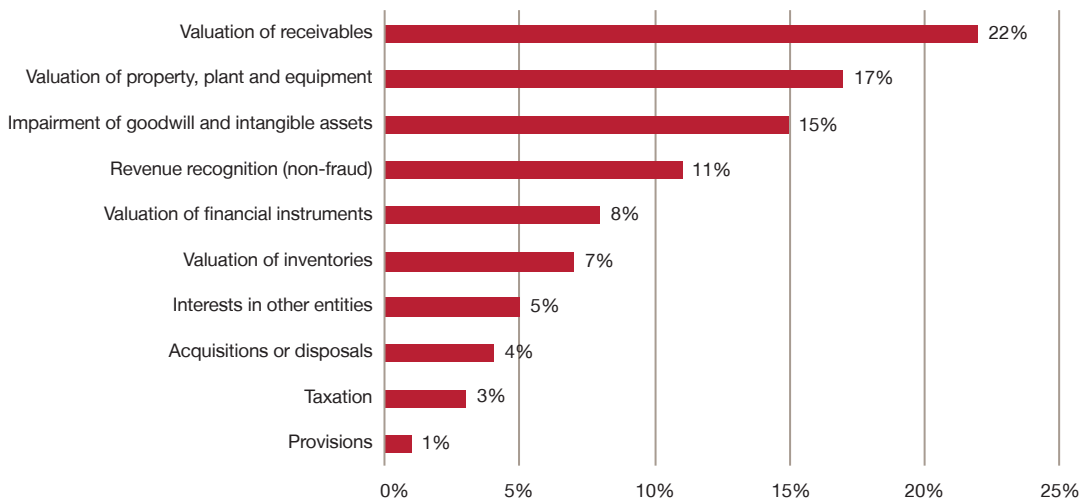


Diagram 5: Top 10 topics reported in KAMs as a proportion of all KAMs reported – Hong Kong





We noted that the experience in HK and in Singapore are similar in many ways:

- HK has an overall average number of KAMs of 2.1, almost identical to Singapore's 2.2;
- the average number of KAMs by industry segments in HK of 1.8 to 3.0 is not too far off Singapore's 1.9 to 3.7; and
- of HK's top five KAMs, four are the same as Singapore's: valuation of receivables, valuation of property, plant and equipment, impairment of goodwill and intangible assets and revenue recognition (non-fraud).

The trend we noted for Singapore in terms of predictability of KAMs is also evident in HK, with respect to the average number of KAMs and top five KAMs reported.

In addition to the number and the type of KAMs reported, the granularity of the reporting should also be considered in assessing the communicative value of the KAMs, provided that the "right" issues are being reported. The International Auditing and Assurance Standards Board ("IAASB") should understand the reporting trends and identify and address early any perceived issues.

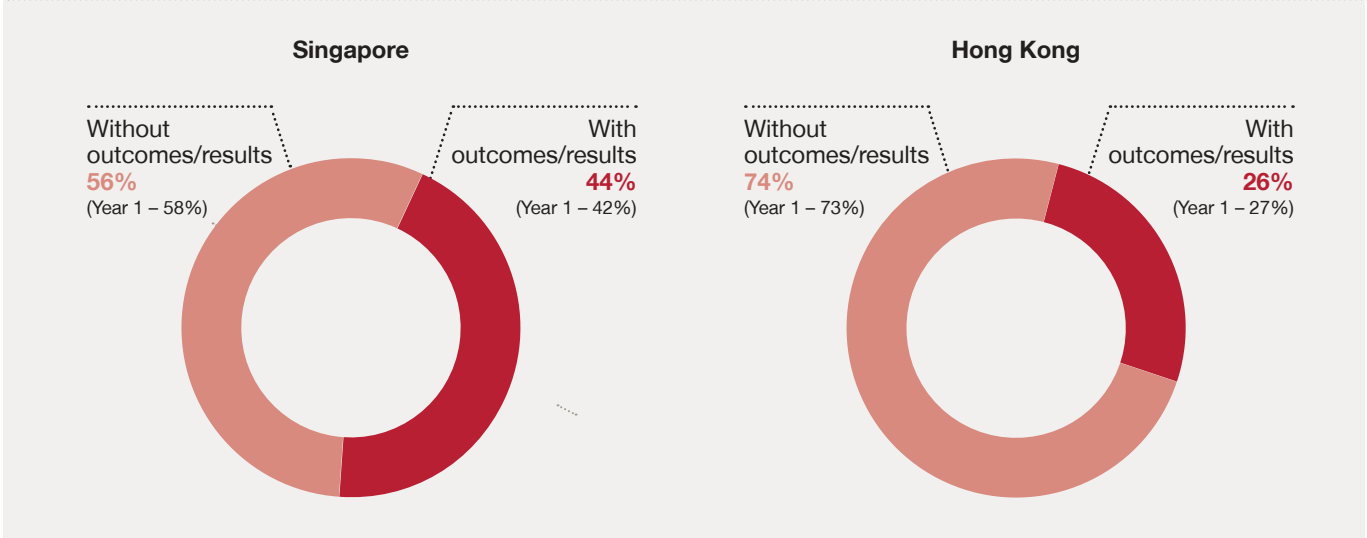
Key Audit Matters

Auditors are still not keen on disclosing outcomes or results of procedures addressing the KAMs

Despite the apparent benefit of enhancing the clarity on how auditors resolved the KAMs with the inclusion of the outcomes or results of their procedures, auditors seemed

quite contented to leave the KAMs open and not include any outcomes or results.

Diagram 6: % of KAMs with outcomes/results in Year 2



As seen in Diagram 6 above, there was only a small increase in the proportion of KAMs reported in Singapore in Year 2 (44%) which included the outcomes or results of the procedures performed, compared with Year 1 (42%).

Perhaps auditors are cognisant that the disclosure of outcomes or results is not an explicit requirement in SSA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*, and do not see the need to go beyond the requirements in the auditing standards or may be concerned about the risk of such outcomes being perceived as piecemeal opinions. Nevertheless, according to a 2017 survey by Accounting and Corporate Regulatory Authority (“ACRA”),

Institute of Singapore Chartered Accountants (“ISCA”), Association of Certified Chartered Accountants (“ACCA”) and Nanyang Technological University (“NTU”), majority of the ACs and investors surveyed were of the view that auditors should include the outcomes or results of procedures addressing each KAM. Some respondents were especially concerned that otherwise there would be no “closures” to the KAMs. Hence, by including the outcomes or results, auditors will be meeting the expectations and needs of ACs and investors, which could also reflect positively on the quality of audit work performed. There is strong impetus to do so and auditors who are not disclosing the outcomes or results should consider relooking at this in a different light.

Interestingly, the same can be said of HK where the proportion of KAMs reported with outcomes or results remained low at 26% in Year 2, vis-à-vis 27% in Year 1. There was no substantial change noted. It would seem that auditors are, in general, cautious when it comes to providing information that is more than necessary.

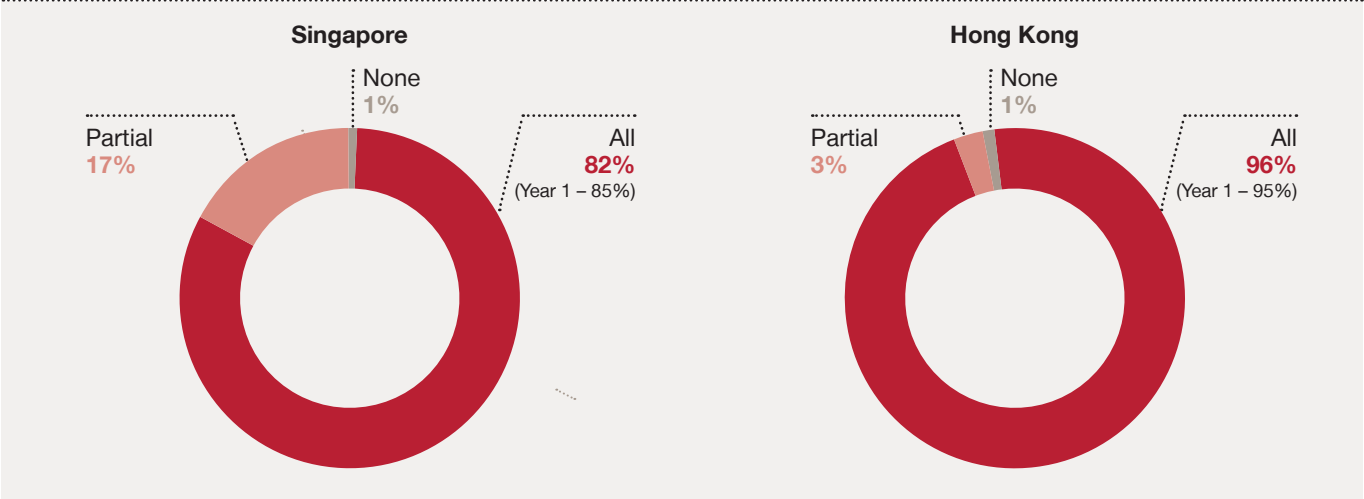
If there is growing demand from stakeholders for the outcomes or results of the procedures addressing KAMs to be disclosed, there may be some merit for the IAASB to consider revising the standards to make this a requirement so as to promote consistency.

Other Information

Entities should provide all OI to auditor prior to date of auditor’s report

Diagram 7 sets out the extent of OI that had been provided to the auditor as of the date of the auditor’s report in both Singapore and HK.

Diagram 7: OI – All, Partial and None – categories and % of reports in each category



In Year 2, 82% of the auditor’s reports in Singapore indicated that all of the OI had already been obtained prior to the date of the auditor’s report. This is a slight drop from the 85% in Year 1. This may be somewhat odd – one would expect that at least the same, if not more, entities would have provided all of the OI to the auditor in Year 2.

Based on the ACRA-ISCA-ACCA-NTU survey, a majority of the ACs and investors surveyed had greater confidence over the OI as a result of the auditor’s work in reading and considering the OI even though auditors are currently not required to provide an opinion on the OI¹. Hence, both ACs and investors valued the work performed by auditors in respect of the OI.

Also, entities providing only partial OI may be seen less favourably than those that provide all of the OI by the date of the auditor’s report as it may be perceived that their internal systems and processes are not adequately set up to provide information quickly. If this was indeed the case, the relevant entities may need to consider relooking at and improving their existing systems and processes.

While Singapore’s 82% is creditable, HK has excelled in this aspect. In Year 2, 96% of entities provided all of the OI to the auditors prior to the date of the auditor’s report. This was even better than the 95% noted in Year 1. Entities in Singapore should follow HK’s example and strive to provide all of the OI to their auditors prior to the date of the auditor’s report for them to complete their work on

the OI before the date of auditor’s report and report accordingly in the auditor’s report. Early planning and discussion with the auditors on what constitutes OI will go a long way towards helping entities achieve this.

Although it may seem excessive to suggest that entities provide all of the OI to their auditors prior to the date of auditor’s report, it is noteworthy that in the United Kingdom (“UK”), it is already an audit requirement for the auditor to receive all of the OI in the annual report and consider all necessary available evidence before the auditor can sign and date the auditor’s report. This basically means that the relevant entities in the UK will have to provide all of the OI to the auditor prior to the date of auditor’s report.

1 According to SSA 720, The Auditor’s Responsibilities Relating to Other Information, the objective of the auditor, having read the OI, is to consider whether the OI is materially inconsistent with the financial statements or the auditor’s knowledge obtained in the audit.

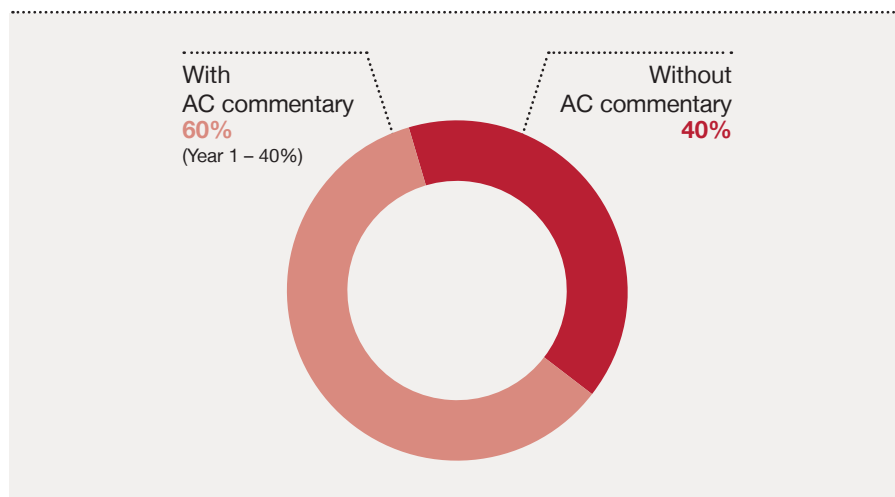
Commentary by Audit Committees

More ACs are recognising the significance of AC commentaries

Encouragingly, in Year 2, we saw AC commentaries included in more annual reports. Diagram 8 presents the proportion of annual reports with AC commentaries.



Diagram 8: % of annual reports with AC commentary

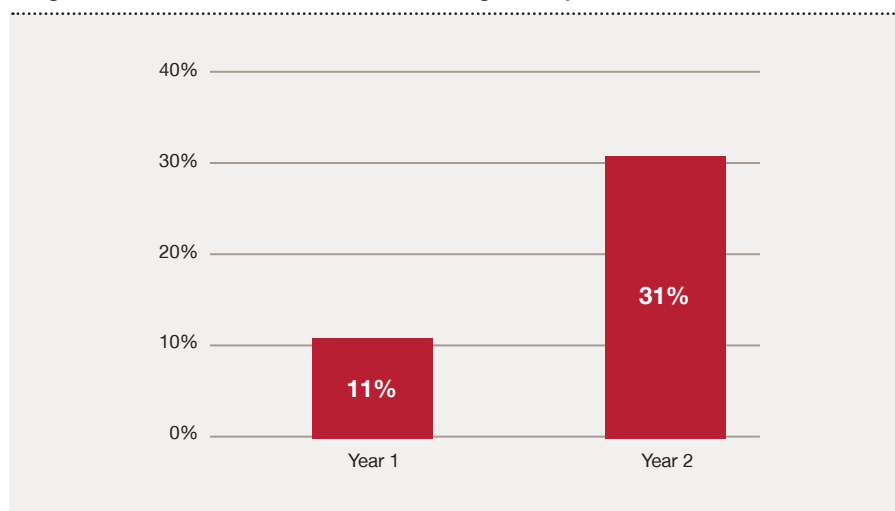


Given that it is not mandatory in Singapore to have AC commentary², it is pleasantly surprising to see a 20% increase in annual reports with AC commentaries in Year 2. This vindicates the numerous outreach efforts by stakeholders such as ACRA, SGX, the Monetary Authority of Singapore (“MAS”) and the Singapore Institute of Directors, over the past couple of years to raise awareness amongst ACs of the importance of the AC commentary and to encourage them to include it in the annual report.

This is further corroborated by the near three-fold increase in the proportion of AC commentaries that met the three-part expectation from ACRA, MAS and SGX³ as depicted in Diagram 9.

That said, 31% remains a relatively low achievement. There is still plenty of room for improvement. Additional guidance from the regulators will go a long way towards raising the percentage.

Diagram 9: % of AC commentaries meeting the expectations of ACRA/MAS/SGX



² In the UK, the annual report of a company is required to include a separate report describing the work of the AC which, among other matters, describes the significant issues that the AC considered in relation to the financial statements and how these issues were addressed.

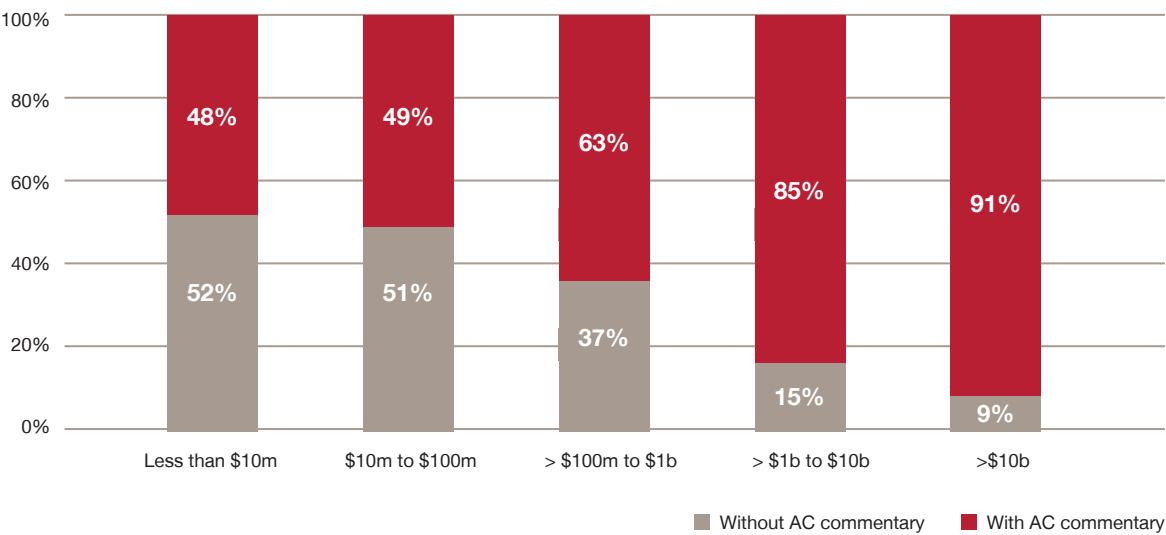
³ In January 2017, ACRA, MAS and SGX sent a joint letter to ACs of all Singapore-listed entities asking them to consider disclosing the following in the AC commentary: (a) Significant financial reporting matters specific to their listed entities, including their perspectives on the key audit matters reported by the external auditors; (b) How they have assessed and concluded on each significant matter; and (c) Significant judgement calls made.

Do ACs of smaller entities see the benefits of making commentaries?

From our survey, we noted a possible relationship between the size of entities, based on market capitalisation, and the willingness of ACs to provide their commentary in the annual report.

Diagram 10 sets out the proportion of annual reports with AC commentary, analysed by market capitalisation.

Diagram 10: % of annual reports with AC commentary – By market capitalisation



As the market capitalisation increases, so does the proportion of annual reports with AC commentary. Hence, it would seem that ACs of larger entities are more likely to include AC commentary.

This begs the question why then are the ACs of smaller entities less inclined to include AC commentary in the annual reports? One possible explanation is that the ACs of these entities may not have fully appreciated the benefits of putting out their commentary and hence have not prioritised it to be included in the annual report. Coupled with the fact that these entities may have lesser resources to devote to developing AC commentary compared with the larger entities, the inclusion of the voluntary AC commentary would expectedly take a backseat.



Are ACs too cautious in providing commentaries?

A well-written AC commentary can demonstrate that the AC members have discharged their roles and responsibilities independently and competently.

To be useful and meaningful to the readers, good AC commentary should ideally provide entity-specific information and share the AC's impartial views on the significant matters raised by the auditor. It should also include matters which may not have been highlighted by the auditor, to show the AC's independent thought process.

While we have seen an improvement in the number of AC commentaries included in the annual reports, the quality of the AC commentaries can be further enhanced.

Based on our survey, the descriptions in the AC commentaries are generally short and fairly generic. More often than not, the commentary on a significant matter comprises a single short paragraph or a few short lines. The commentaries are not entity-specific and the same descriptions can be applied to any other entity. Such commentaries are unlikely to enrich a reader's understanding and could instead undermine the value of the AC commentary.

In addition, the following are some of our other observations regarding AC commentaries in the 2017 annual reports:

a) Some AC commentaries purely referred to the section on KAMs in the auditor's reports without stating what the significant matters are and/or how the AC has assessed and concluded on the matters.

- b) Some AC commentaries merely repeated the work performed by management as stated in the KAMs without any description of any independent process undertaken by the AC.
- c) In some AC commentaries, the description of the process undertaken by the AC are similar to the audit responses in the KAMs.
- d) Some AC commentaries simply indicated the conclusions of the AC without explaining how the AC arrived at those conclusions.

These commentaries neither provide any additional information to readers different from the KAMs nor do they give insights into the AC's assessment and decision-making processes.

Essentially, while it is reasonable to expect some consistency between the AC commentaries and the KAMs, they should preferably not be identical. The perspectives of the auditor and AC are not the same which should rightfully give rise to some differences in the significant matters identified for additional attention. For example, we may see AC commentary discussing the adequacy of the entity's risk management systems, but not in KAMs.

Based on the observations above, it appears that ACs are sensitive about providing too much information in the AC commentary. This mindset only serves to hinder the effectiveness of the AC commentary as a communicative tool and deny the ACs of the opportunity to take advantage of a good platform to showcase the robustness of the work that they have done.



In December 2017, the UK Financial Reporting Council published a project report titled Audit Committee Reporting. Amongst others, the report shared the following improvement points on UK's audit committee reports:

- a. Have an introductory paragraph from the Audit Committee Chair to draw readers' attention to key messages.
- b. Avoid the use of excessive jargons to enhance understanding of issues.
- c. Have someone who has attended the AC meetings prepare the first draft.
- d. Involve the ACs early in the process to get their views on the

contents to be included.

- e. Explain how any auditor independence issue has been addressed.
- f. Explain how the auditor has demonstrated professional scepticism in the audit.
- g. Describe the factors used to assess the auditor's effectiveness.
- h. Include the following when reporting significant issues:
 - i. Quantify the effects;
 - ii. Explain what the AC has done;
 - iii. Indicate the AC's conclusion;
 - iv. Provide the rationale for the AC's conclusion; and
 - v. Cross-reference to where other

relevant information is found.

- i. Highlight any significant deficiencies in internal control system and/or risk management system.

These improvement points should also be considered by ACs in Singapore as they are equally relevant.





Call to Action

From the survey of Year 2 reports, we see room for improvement in the enhanced auditor reporting project achieving its objective of improving the communicative value of the auditor's report. The AC commentary could also gradually lose its appeal if it is not implemented in the proper manner to provide relevant information to readers. Clearly, there is still much work to be done.

To generate the greatest impact and achieve the most desirable results, a concerted effort amongst the relevant parties in the auditor reporting ecosystem – from auditors, audit committees, standard-setters to regulators – may be the best way forward to tackle the issues ahead, leveraging on one another's strengths.

We, at PwC, are committed to producing high-quality audits and will continue to go the extra mile to raise our standards to deliver greater value to investors and other stakeholders.



Contacts

Marcus Lam

Assurance Leader

+65 9661 6308

marcus.hc.lam@sg.pwc.com

Hans Koopmans

Partner, Assurance

+65 9640 7940

hans.koopmans@sg.pwc.com

Tan Bee Nah

Partner, Assurance

+65 9632 8568

bee.nah.tan@sg.pwc.com

Alima Banu

Associate Director, Assurance Risk & Quality

+65 8809 1473

alima.banu@sg.pwc.com

