INSTITUTE OF SINGAPORE CHARTERED ACCOUNTANTS

Think Ahead

ACCA

All Aboard the Transparency Express!

The Enhanced Auditor's Report

– including views from board directors

Produced by: Association of Chartered Certified Accountants and Institute of Singapore Chartered Accountants

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May 2016

When investors turn to the auditor's reports on financial statements for the financial year ending on or after 15 December 2016, they will open the page on the biggest change to the auditor's report in over half a century.

This report provides an overview of the changes and a discussion of the directors' reflection of the changes and the factors they consider to be critical to their successful implementation.

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When investors turn to the auditor's reports on financial statements for the financial year ending on or after 15 December 2016, they will open the page on the biggest change to the auditor's report in over half a century.

Instead of what is often perceived as a binary opinion in 'boiler-plate' language, auditors of Singapore listed entities will report on the most significant matters they had to deal with during the audit, and explain how they addressed them. For all entities, the auditor's report will look different – the opinion will be up front and will include other information such as the name of the engagement partner for audits of listed entities, and a statement about the auditor's independence and ethical responsibilities.

These new features will be mandated by Singapore's adoption of the International Standards on Auditing (ISAs) pertaining to auditor's reports – the 700 series.

This report provides an overview of the changes and a discussion of the directors' reflection of the changes and the factors they consider to be critical to their successful implementation.

From the point of view of the directors, the train has left the station, the destination is increased transparency, and the only choice is to get on board and ensure everyone pulls together and makes it work.

THE CHANGES IN A NUTSHELL

- The Audit Opinion will start the auditor's report instead of concluding it.
- Auditors of listed companies must report the 'Key Audit Matters' – the matters that were the **most significant** in the audit of the financial statements and how the audit addressed these issues.
- Auditors must explicitly mention material uncertainties about an entity's ability to continue as a going concern. Additionally, auditors must evaluate the adequacy of the company's disclosure of 'close call' situations.
- Other changes such as inclusion of the engagement partner's name in the audit of listed companies, and an affirmative statement about the auditor's independence.

> Auditors and directors in Singapore and Malaysia should be well prepared for the transition because communication between auditors and audit committees has been strengthening and audit quality is generally high.

WHY ARE AUDITORS LIFTING THE LID ON THE AUDIT PROCESS?

- The enhanced auditor's report is the audit profession's response to calls from investors, regulators and other stakeholders for more relevant and useful information from the audit. It forms part of the improvements made throughout the financial reporting supply chain to restore investor confidence, particularly following the financial turbulence that came to a head in 2008.

WHAT IS THE VALUE OF GIVING MORE INFORMATION TO INVESTORS?

- The enhanced auditor's report will give a sharper focus to communication between auditors, management and those charged with governance. It will also provide focal points for discussion between directors and investors, thereby improving communication. And it is intended to increase the transparency and potentially the quality of audits.

WHAT DO DIRECTORS NEED TO UNDERSTAND ABOUT THE ENHANCED AUDITOR'S REPORT?

- The contents of the enhanced auditor's report are the auditor's responsibility, based on the auditor's professional judgement, and are guided by a robust framework set out in the auditor reporting standards.

- Directors, audit committees and management will need to be more pro-active in engaging with the auditors, and improve their discussions with the auditors, to ensure that investors receive relevant and well-described information that is consistent across all communications in the annual report.

- While the enhanced auditor's report requires no additional audit work, it is not 'business as usual' when it comes to reporting. The language must be entity-specific rather than based on a template. The issues must be described relevantly and usefully. Successfully transitioning to such transparency will require early coordination between directors, audit committee members and management.

- There will remain one audit opinion from the auditor, on the financial statements as a whole, instead of opinions on each individual risk area included in the report. Discussion of Key Audit Matters (KAM) and, where necessary, going concern issues, will describe the risk and how it was addressed by the auditor. The risks will not necessarily be 'problematic' areas – they might, for example, arise from the complexity of a transaction or market conditions.

- Directors in Singapore and Malaysia should feel well prepared for the transition because communication between auditors and audit committees has been strengthening and audit quality is generally high.

- Yet sharing with the public what used to be closed door discussions will require an even sharper focus. Early action is required to ensure that the first enhanced auditor's reports go well in 2016.

- Directors and auditors are strongly encouraged to conduct practices or 'dry runs' so that they can understand what might be in the KAM and how they would be described, so that there will be minimal surprises or delays when the first enhanced auditor's reports are due to be published.

Introduction

This report helps directors think about how the new enhanced auditor's report will affect their governance and financial reporting responsibilities and change their involvement in the audit reporting process.

This report helps directors think about how the new enhanced auditor's report will affect their governance and financial reporting responsibilities and change their involvement in the audit reporting process.

The report draws on a roundtable held in Singapore in November 2015, involving directors from Singapore and Malaysia who chair and sit on various audit committees, regulator and the international and local auditing standard setters.

WHAT IS IN THIS REPORT?

PART ONE of this report sets out the background and reasons for the change and the important aspects for directors to understand.

PART TWO canvasses the issues raised by the directors at the roundtable, which are likely to be (or should be) in the minds of many other directors in Singapore and Malaysia. The section also describes the directors' views on what it will take to achieve the promised value of the new report.

PART THREE examines how prepared directors are for the transition to transparency, what actions they should take now to prepare for the first reports, and the aid and resources available to help them on the journey.

Directors should prepare themselves for the changes ahead. They will need to pro-actively involve themselves in the implementation of the enhanced auditor's report, especially the Key Audit Matters.

Early preparation and practice will help ensure that the significant issues to be included in the auditor's report are relevant, valuable and appropriately received by investors.

The new and revised standards are the result of eight years of robust process and consultations by the International Auditing and Assurance Standards Board (IAASB), but the journey will continue after implementation. The roundtable formed part of the IAASB's work plan of progressive engagement. This engagement will continue to ensure that the market understands the information they receive from the enhanced auditor's report.

1. The background and changes

The enhanced auditor's report monumentally changes the way auditors report their work publicly. The significance is underlined by the fact that the wording of the auditor's report has only changed twice in the last fifty years. Eight years of work lie behind the new and revised standards and the implementation work will continue after the effective date.

The IAASB representatives gave the roundtable participants insights into why the auditor's report is changing, what the key changes are and how they should be implemented.

WHY THE AUDIT PROFESSION PLUNGED INTO TRANSPARENCY

The enhanced auditor's report monumentally changes the way auditors report their work publicly. The significance is underlined by the fact that the wording of the auditor's report has only changed twice in the last fifty years. Eight years of work lie behind the new and revised standards and the implementation work will continue after the effective date. This timescale and the considerable effort indicate the force of the momentum required for such a big shift.

The genesis of this momentum came from dissatisfaction with the report expressed by investors, regulators and other stakeholders.

Auditors spend a great amount of time on each audit and gather significant information about their clients, and the expectation is that at least part of that information should be shared. The financial turbulence of recent years intensified this view.

Increased transparency in auditor reporting helps strengthen trust in the audit process and contributes to the important need to re-establish confidence in corporate governance and reporting. The financial crisis led investors, regulators and other stakeholders to ask whether auditors, directors and audit committees were having the right conversations and addressing risks appropriately when necessary, and to request insight into this.

> "Outsiders wanted ways to focus the attention of management and directors and the audit committee members on the big problems… If a company has big risks, or problems, regulators want to know that auditors have focused their professional scepticism on these issues. Reporting on these issues tells us that the auditor focused on these issues during the audit."
> Jim Sylph, Co-Chair of IAASB's Auditor Reporting Implementation Task Force

THE MAIN CHANGES

The auditor's report will look different – conclusion first

The format of the auditor's report will change for the first time in 25 years, so that it starts with the most important item – the audit opinion.

> "Everyone said: 'Tell us what the conclusion is and then explain how you got there.'"
> Jim Sylph

The Key Audit Matters

The challenge and intent behind KAM was to require the auditor to provide greater transparency about the matters that were most significant to the audit from the auditor's perspective.

The KAM are matters that auditors already discuss with audit committees and management – they do not stem from new audit work. Yet they should not simply repeat the discussion with the audit committee – they need to be focused so that the report is relevant and cogent to investors. It is also clear that the KAM does not replace management's disclosures made elsewhere in the annual report.

> "The KAM should not in any way, shape or form replace the management's perspective on the issues mentioned in the KAM that management would appropriately disclose in the financial statements."
> Jim Sylph

The international standard does not expect auditors to score management's actions or give an opinion on the individual matters, for example by describing a particular accounting treatment as relatively conservative or aggressive.

However, auditors in the UK have experimented with indicating their view on particular items. See 'Experience with the Enhanced Auditor's Report in the United Kingdom' section on pages 11 and 12 for description of the UK experience.

> The IAASB is providing more implementation support than it usually gives for professional standards, because of the auditor's report's prominent public position and importance to investors and the public.

More specific reporting about going concern issues
Auditor's reports will, when the circumstances call for it, more specifically describe going concern issues. Auditors will clearly discuss any material uncertainty about the entity's ability to continue as a going concern. In instances where there have been 'close calls' (situations where events or conditions were identified that may cast significant doubt on the entity's ability to continue as a going concern, but after considering management's plans to deal with these events or conditions, management and the auditor conclude that no material uncertainty exists), the auditor will focus more attention on the adequacy of disclosures and may decide to communicate a Key Audit Matter (about one or more underlying events or conditions). This is in response to investors' and others' requests for earlier warning of any potential issues that may exist with respect to an entity's ability to continue as a going concern.

HITTING THE GROUND RUNNING – THE STANDARD IN REALITY

Singapore and Malaysia should be relatively more prepared for the change than some other jurisdictions because the two markets already have good audit committees with active engagement between audit committees, auditors and regulators on issues such as audit quality. Other countries without these developed relationships and communications will face a more challenging journey.

However, directors will notice some immediate changes in the lead up to implementation of the report.

> "It's the same audit scope, the same audit procedures, today, as it will be tomorrow. But it requires increased communication with those charged with governance, and it will certainly require this communication to start earlier."
> Jim Sylph

What will remain the same
Audit committees will not receive any more information than they should already be getting from the auditor under the current auditing standards. The potential KAM will come from what the auditor has already discussed with those charged with governance, and the issues that were the most difficult and required the most attention and time and thinking.

Because people involved in the financial reporting process will very soon feel the effects of the changes, audit committee members should ask their auditors what needs to change in their interactions, at the earliest opportunity. The processes need to start way before the effective date – i.e. before the financial year ending on or after 15 December 2016.

Suggested actions that will need to be taken by management and those charged with governance are set out in "Prescription for a Headache-free Implementation" section on page 21.

CONTINUING THE JOURNEY – HELP WITH IMPLEMENTATION

The IAASB is providing more implementation support than it usually gives for professional standards, because of the auditor's report's prominent public position and importance to investors and the public.

The standard setter also wants to keep an open dialogue to learn about the experiences of those responsible for adoption and implementation, and to prepare for post-implementation review efforts.

> "The auditor's opinion is valued, and users want to hear more from the auditor – more pertinent, and more tailored, information about the specific audit performed on an entity's financial statements. There is symbolic value in the current report, but little communicative value – and users see the potential for the auditor to provide more value and more transparency. So, now is the time to lay the foundation for the auditor's report of the future."
> Prof Arnold Schilder, Chairman, IAASB

EXPERIENCE WITH THE ENHANCED AUDITOR'S REPORT IN THE UNITED KINGDOM

> "United Kingdom investors told us that the enhanced auditor's report 'provides us a better platform for dialogue with the company. We understand better the complexities, the sensitivities and these arrangements of evaluations'."
> Jim Sylph

The UK enhanced auditor's report is similar, though not identical, to the new ISA report and was implemented with effect for periods commencing on or after 1 October 2012.

The United Kingdom's Financial Reporting Council (FRC) reviewed the early experience with enhanced auditor's reports and reported its findings in a public report.[1] Some of the findings are summarised here.

THE UK ENHANCED AUDITOR'S REPORT

To restore confidence after the recent financial crises, the FRC gave new reporting responsibilities to directors, audit committees and auditors. The main changes included:

- Directors must "present a fair, balanced and understandable assessment of the company's position and prospects", and to state that the annual report and accounts are "fair, balanced and understandable."

- The Audit Committee must describe its work in a separate section of the annual report, including the significant issues considered in relation to the financial statements and how these issues were addressed.

- Auditors must:
  - o Report by exception on the "fair, balanced and understandable" statement and on the work of the Audit Committee,
  - o To provide greater transparency about the audit:
    a. Describe the risks of material misstatement that the auditor identified which had the greatest effect on the overall strategy;
    b. How this risk influenced the allocation of resources and efforts in the audit;
    c. An explanation of how the auditor applied the concept of materiality; and
    d. A summary of the audit scope, including an explanation of how the scope was responsive to the assessed risks of material misstatement described in (a) and the concept of materiality as described in (c).

THE LESSONS OF THE UK EXPERIENCE

The FRC reviewed whether a sample of auditor's reports published in the first year of implementation complied with the new requirements and how auditors innovated in their reports. The interesting lessons were in the innovations, rather than the level of compliance, which the FRC found to be largely satisfactory.

Main areas of improvement called for:
- Increasing the granularity of risk reporting (i.e. be as entity specific as possible)
- Making clearer how risk and materiality influenced the scope of the audit.

Average number of risks reported by each firm:
- Ranged between 3.6 and 4.9.
- When 'presumed risks' (risks that that the standards require auditors to treat as a risk in all audits) were excluded from the calculation, the average ranged between 3.5 to 4.2.

Top three reported risks:
- Impairment of assets
- Goodwill
- Tax (mostly related to overseas jurisdictions or deferred taxation balances).

1 The press release and related report can be found at https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2015/March/FRC-finds-good-take-up-of-new-auditor-reporting-re.aspx

INNOVATIONS OF INTEREST TO DIRECTORS

The UK standard encourages auditors to be 'entity specific' and leaves auditors with considerable room to use professional judgement. This resulted in varied and innovative reports, enabling the FRC's review to answer some 'what if' questions that directors might have.

From a director's perspective, the most significant 'experiment' was perhaps the reporting of detailed audit findings about the identified risks, which are similar to the KAM in the ISA.[2]

The UK standard does not require nor encourage auditors to make individual findings on the risks of material misstatement that the auditor identified as having the greatest effect on the overall strategy.

However, one UK firm, KPMG decided to 'experiment' with this approach on a small number of audits, with the consent of its clients, including in Rolls Royce Holdings PLC. Explaining why, KPMG UK's head of audit Tony Cates said that, while the new auditor's report tells the reader what rocks the auditor checked under and how,

> "it is not telling shareholders what the auditor found when he looked under those rocks. It does not say, for example, how acceptable the policies, estimates or disclosures were."

One such finding was in relation to Rolls Royce's measurement of revenue and profit in the civil aerospace business. After describing control weaknesses and how the audit team responded to these, the auditor's report concluded on the risk:

> "Overall, our assessment is that the assumptions and resulting estimates (including appropriate contingencies) resulted in mildly cautious profit recognition."

KPMG felt that a graduated finding saying whereabouts in a range matters sit (e.g. "mildly cautious profit recognition") would add more value than a binary finding.

While the FRC encouraged experimentation and was interested to see how investors would react, it cautioned against such findings "inappropriately including discrete opinions on separate elements of the financial statements."

On an overall basis, FRC considered the extent of innovation and the diversity of approaches adopted to be very encouraging. The review confirmed that auditors appeared not only to have met the new requirements but in many cases had made, sometimes quite radical, further changes to auditor's reports going beyond the changes required by the FRC. A particular conclusion of the review was that each of the audit firms had adopted different approaches to the extended auditor's report and had, therefore, been innovative in different ways.

Audit committee reporting of significant issues – The inter-relationship between the UK Corporate Governance Code and the requirements of UK Auditing Standards
The UK experience illustrates how auditors and audit committees might interact and align their work upon introduction of the enhanced auditor's report.

The FRC assessed whether the 'significant issues' reported by the audit committees were aligned with the auditor's reported 'risks of material misstatement', noting they need not be identical.

The FRC's quantitative analysis found:

- Audit committees and auditors reported a similar average number of issues, at 4.3 for audit committees and 4.2 for auditors.
- Auditors reported 74 percent of the risks that were reported by the audit committee, which the FRC thought was in a reasonably expected range.

The FRC's subjective analysis found:

- The audit committee descriptions of significant issues were mostly more concise than the descriptions of the equivalent risk in the auditor's report, largely because many audit engagement partners described in detail the audit response to the risk.
- 90 percent of the sampled auditor's reports complemented the audit committee's reports well.
- Auditor's reports were generally more informative about the risks of material misstatement than the audit committee's reports about significant issues. The FRC speculated several reasons for this:
    - o Auditors embracing the disclosures of risks more wholeheartedly than the audit committee.
    - o Auditors being able to devote considerably more man hours to the identification and articulation of risks.
    - o Audit committees report in a derivative way rather than reporting their own findings.
    - o Audit committees seeking to be more clear and concise. The FRC had previously reported a need for some audit committees to better explain the work done in relation to areas of judgement and estimates in the accounts.

The FRC noted that some investors considered that, where an auditor reports a risk that the audit committee does not address at all, there should be a requirement for a discussion within either the auditor's report or the audit committee report as to why this is so.

2 The others were in the areas of disclosure of what materiality benchmark the auditor used, the magnitude of unadjusted differences being reported to the Audit Committee, and addressing going concern disclosures in auditor's reports.

2. The Directors speak

Together with some other organisations in Singapore, ISCA organised a forum in October 2015 to discuss how financial governance can be strengthened.

Together with some other organisations in Singapore, ISCA organised a forum in October 2015 to discuss how financial governance can be strengthened. One of the topics discussed was the enhanced auditor's report. A poll was conducted with the delegates, comprising directors, during the forum, and it was encouraging to see that most of them were either familiar with (54%) or had at least heard of (37%) the impending changes to the auditor's report.

Throughout the initial implementation period, directors will get to discuss the KAM with their auditors, and during the first reporting season, observe investors' reactions to peeking behind the audit's veil for the first time.

Hopefully, many of these experiences can be had beforehand through 'dry-runs' that some companies were running in 2015. The discussion at the roundtable gave some important pointers about the issues that directors should be thinking about.

THE DIRECTORS DISCUSS: KEY AUDIT MATTERS

Not surprisingly, the Key Audit Matters generated the most discussion amongst the directors. Gauging investors' potential reactions underlined much of the conversation. Will investors feel that the information is valuable and respond constructively? Or will the additional disclosures give investors, and perhaps regulators, another platform to criticise or even punish company stewards and auditors?

While it is natural that these concerns arise, the discussion suggested that the overall attitude and outlook is largely positive.

> "The community that made the enhanced auditor's report possible should be commended because it is going to increase the responsibility of those charged with governance as well as the auditor."
> Lee Chong Kwee

What is the value of the KAM?

The Key Audit Matters are those matters that, in the auditor's professional judgement, were of the most significance in the audit of the financial statements. But if the result is a clean opinion, what is the value of telling the world about those matters?

> "At first I was apprehensive about the KAM. Being an ex-auditor, I felt that a clean audit opinion is enough. But surprisingly, when I read two UK auditor's reports written under the new standard, for the first time in my life, I enjoyed reading a clean auditor's report."
> Lim Boon Cheng

The directors were clear about the intention of reassuring investors with relevant information about the company's risks and how they were addressed. Most of the discussion focused on whether this value could be achieved in reality, and what each party needed to do to make sure value is delivered.

> "The real value of the enhanced auditor's report to the company would be to elevate the standard of corporate governance, and so attract investment, but we will have to wait and see whether this proves to be a differentiating factor."
> Euleen Goh

The directors were hopeful that the enhanced report could bring value by improving corporate governance across the board. It would "keep everyone on their toes" they thought. It could create synergy, for example, between the auditor and audit committee as they discuss the issues that each must cover as part of their separate responsibilities.

But there was also recognition that achieving this value would require everyone, especially, audit committees to enhance their role in tandem with developments on the auditor's side. This is discussed further in the section "The Directors Look Ahead: Tri-partism!" on page 18.

It was also considered that the KAM could strengthen the auditor's role as a watchdog over appropriate disclosure by the company.

> "The KAM will add to the auditor's 'kit-bag of tools' and give them more leverage to encourage improvement by companies at the poorer end of disclosure spectrum."
> Merran Kelsall

It would be unreasonable to add liability to a good audit that now provides more information. However, if the audit work is not adequate in the first place, no amount of KAM reporting can make up for the poor quality.

In a hypothetical example of how this might work, the roundtable considered the example of a company that was reluctant to disclose that it had struggled to obtain financing and had experienced a "close-call" on its ability to continue as a going concern. The auditor could suggest this as something that required significant attention and was therefore a KAM. It was believed that this would help focus the discussion between auditors and the audit committee, with the ultimate effect of improving the company's disclosure.

> "Knowing that the auditor's report will draw users' attention to this matter, management and those charged with governance will likely give careful consideration to the quality of the financial statement disclosure."
> Prof Arnold Schilder

Liability matters

A question at the forefront of the directors' minds was who would be liable, to censure or claims, if matters that should have been part of KAM were not, and subsequently became an issue.

In practice, it would be inevitable that some matters that are significant to the audit will nonetheless be left out of KAM, as auditors are required to funnel down to the most significant, i.e. the "key" matters for the investors' attention.

> "There is a risk that audit committees will be challenged by shareholders, asking why wasn't this disclosed in the notes, why were there 102 notes and not 103? But what a good audit committee should do is ask, given the facts available, have we thought about all the issues that we thought relevant at the time and has the auditor done so?"
> Jim Sylph

Three principles underlie the response to the concerns about liability.

The first was that while the auditor will discuss this selection with management and the audit committee, the decision is ultimately the auditor's and needs to be based on their professional judgement. And there is a dedicated auditing standard to guide auditors in exercising that judgement appropriately.

Secondly, an auditor can guard against liability concerns by ensuring that they had adequately performed the underlying audit work to address the material risks associated with the financial statements. It would be unreasonable to add liability to a good audit that now provides more information. However, if the audit work is not adequate in the first place, no amount of KAM reporting can make up for the poor quality.

And thirdly, it should always be borne in mind that the audit is based on a set of historical financial information and should not be expected to act as a "crystal ball".

The onus remains on those charged with governance and the auditor to thoroughly discharge their responsibilities.

> "Ultimately, KAM reporting is about enhancing transparency in the audit process to benefit investors. This objective should be a shared goal between auditors and those charged with governance. Hence, audit committees should also weigh in and provide their perspective of how the company has dealt with financial reporting or internal control issues reported under the KAM."
> Julia Tay

Selecting and crafting the KAM

In the directors' experience, auditors in Singapore and Malaysia were already raising pertinent issues and having robust discussions with audit committees, so they were confident that those involved would meet the challenge of selecting the KAM.

> "We [Audit committees] have already been asking the auditors, 'what were the most difficult discussions you had with management.' In this sense we have been discussing KAM for a while."
> Datuk Zaiton Hassan

> The FRC also cautioned that 'care needs to be taken with the inclusion of such findings in an auditor's report so as not to inappropriately include discrete opinions on separate elements of the financial statements'.

Yet it is another matter reporting these discussions to the public knowing that the public does not have the benefit of the depth of conversation that is possible between auditors and audit committees.

The challenge will be to determine what should be disclosed about the KAM and what wording to use. As one director pointed out, if a company is well governed, the issue itself would be in the public domain, but the auditing of such issues had not been exposed to the public before – this will bring a new dynamic into the conversation.

Another challenge the directors raised was the interaction with the previous year's KAM. If the same KAM are repeated year after year, will the value to the investor be lost? The experience of the UK was again instructive here. It was observed that in the UK, the reports have generally improved in the second year of implementation due to the learning from the first. The challenge to the auditors is to ensure their reports are relevant every year even if the key issues may not deviate significantly from the previous reporting period.

Should auditors provide a view on the KAM?

The experiment by a UK auditor, to give a 'degree' of opinion (for example that management's assumption and resulting estimates are 'mildly optimistic' or 'balanced', profit recognition is 'mildly cautious') provoked some discussion amongst the directors. Although by virtue of the audit opinion on the overall financial statements, the auditors would have implicitly concluded on the KAM, the question was should auditors share their views on the degree to which management's estimates, policies or judgements are acceptable?

Some of the directors felt that for a KAM to be truly valuable, it needs some form of closure to it. They thought an issue included in the KAM should not be 'left hanging' with no indication of whether the issue had been resolved.

> "The whole purpose of this exercise is to improve communication between the auditor and the shareholders and other stakeholders. If you are not giving an opinion on the KAM, then what you are doing is raising issues and heightening concerns without really addressing them."
> Kevin Kwok

The IAASB standard does not require nor encourage auditors to opine on single items in the financial statements – the position being that there is only one auditor's opinion, and that is the opinion on the financial statements as a whole.

> "I think the idea of putting a specific auditor opinion on… one individual judgement or one individual estimate of management is risky."
> Jim Sylph

In its reflection on the reporting experience of UK companies in the first year, the FRC (see box on pages 11 and 12) encouraged such experimentation and innovation by auditors and was 'particularly interested in the reaction of investors and users to auditor's reports of this ilk'. The FRC also cautioned that 'care needs to be taken with the inclusion of such findings in an auditor's report so as not to inappropriately include discrete opinions on separate elements of the financial statements'.

Impact on investors

The potential investor reaction to the KAM, as alluded to in the discussion around whether there should be some form of conclusion to each KAM, was a key concern for the directors. This is perhaps a larger concern because they have less direct influence over the investors (compared to procedures in their own companies, for example).

Adding to the importance of engagement would be the dominance of retail investors in Asia. The unfamiliar sight of a longer auditor's report might cause uninformed investors to think that the report is showing a modified opinion.

It was observed that while KAM are the auditor's responsibility, they would not be developed in a vacuum and the audit committee would be involved closely throughout the process.

To address this challenge two key actions were identified: conduct practice reports or 'dry runs' so that directors could get a real sense of how the KAM might read, and engage with investors about the auditor's report whenever directors have the opportunity.

> "A dry run is important so that the audit committee can, together with the auditors, make sure that the outcome is enhancement in corporate governance and information for the investors, and not an unintended disruption to the market."
> Datuk Zaiton Hassan

The importance of conducting a dry run was demonstrated by the experience of 'early adopters' in the UK. The directors noted that the first enhanced auditor's report of one 'early-adopter' stated the critical judgement areas relating to revenue recognition, without describing the procedures used to gain satisfaction that the risk had been addressed. This left the reader with no idea of whether the auditor had addressed the risk. The following year's report was an improvement, suggesting they had learnt from the experience.

Other examples from the UK generated more optimism about how the enhanced auditor's report could generate more confidence amongst investors without giving directors additional stress.

> "It [an auditor's report on a UK listed company] gave better insight, it gave me more information, and there was nothing there that I would have worried about as an audit committee member."
> Lim Boon Cheng

Looking to the future, directors were also concerned that investor expectation might grow.

> "From the point of investors, obviously one of the expectations which we can imagine is that they are trying to look to the auditor to tell them where the demons lie in the company or where the gem is so they can invest their money in."
> Cheng Heng Tan

This emphasised the importance of continuing to educate investors about how the financial reporting chain works.

Implications of the KAM for audit committees

The directors felt it was very important to understand where the audit committee fits in the process and what its role and responsibilities should be, whether they have a big part in shaping the KAM included in the auditor's report or 'just a bystander'.

This question was perhaps due to a feeling that the KAM cover issues that are the audit committee's responsibility and reason for being, specifically its responsibility to review the financial statements prior to submission to the full board.

> "I think we can't introduce the enhanced auditor's report without the audit committees responding in like manner and carrying out a very similar discussion in the Audit Committee's report. Otherwise audit committees are going to look like they have significant gaps in their oversight function."
> Kevin Kwok

It was observed that while KAM are the auditor's responsibility, they would not be developed in a vacuum and the audit committee would be involved closely throughout the process.

Audit committees are involved in the audit process as supervisors and so should be proactive in the development of the KAM. For example, the proposed list of KAM would likely be part of the discussions with directors that auditors are required to have under ISA 260 Communication with Those Charged with Governance.

It was felt however that this could also be an opportunity for the smaller practices to show innovation and demonstrate relevance.

Some directors thought that giving audit committees specific reporting commitments, for example corresponding with the auditor, would add an additional link to strengthen the chain. This idea is further discussed in the section "The Directors Look Ahead: Tri-partism!" on page 18.

The directors' own experiences on the boards of UK listed companies provided some inspiration for this. The audit committees of UK listed companies must report on the significant and important matters under its supervision. One director suggested that this could provide good symmetry with the development of KAM. It was also suggested that as the audit committee's and auditor's report were likely to include similar items, at an early stage the two would discuss and compare the list of items to be included in the early draft.

The uncertainty around how the audit committees should best interact with auditors was considered to be another reason why it was important to have dry runs of deciding on KAM, involving auditors, audit committees and preparers.

THE DIRECTORS DISCUSS: GOING CONCERN

As with the KAM, the directors discussed whether auditors should conclude about going concern issues, on the occasions when they need to mention going concern issues in their auditor's report.

It was also asked whether, in a similar spirit to the KAM, the auditor should always include a statement about the going concern risk, for example by concurring with the directors' assessment that the financial statements were prepared on a going concern basis.

In an earlier proposal, it was indeed suggested that there should be explicit statement of agreement with management's basis of preparation on a going concern basis. The feedback that the IAASB had received made it clear, however, that such standard wordings will not add to the report's relevance and value. This was why the standard now requires the auditor to include a separate section, with a specific heading, in the auditor's report on occasions when there is a material going concern issue. Auditors are now also required to evaluate the adequacy of disclosures under the applicable financial reporting framework in 'close call' situations, and may communicate underlying conditions as Key Audit Matters in certain situations.

THE DIRECTORS DISCUSS: PRACTICALITIES

The directors at the roundtable delved into the potential problems and costs that might prevent smooth implementation of the enhanced auditor reporting.

The cost of the audit was mentioned briefly, with some directors enquiring about the associated cost and potential fees discussion that might ensue.

The IAASB's feedback about costs from early adopters was that the additional resources required by the auditor had not been significant, because the enhanced auditor's report stems from existing processes, such as discussions with the audit committee. The need for the lead partner and the core supporting team to draft the KAM was cited as the main cost contributor specific to the new requirements.

Smaller companies

Smaller companies were seen as facing the most challenging journey. They were often not as advanced along the corporate governance journey as the larger listed companies and, sometimes, neither were their auditors in particular the smaller practices. The concern was whether smaller audit firms would be comfortable with the judgement required about what should be included in the KAM.

One director noted that the enhanced auditor's report might add to existing challenges faced by the audit profession, especially those that can disrupt the process, such as staff turnover, the auditor rotation requirements, and sometimes a need to improve communication skills. This could put further pressure on the process and the time needed. It was felt however that this could also be an opportunity for the smaller practices to show innovation and demonstrate relevance.

A tri-partite approach was viewed as consistent with the regulatory and development focus in Singapore, which had moved from initially focusing on auditors, to treating the financial reporting process as an eco-system.

THE DIRECTORS LOOK AHEAD: TRI-PARTISM!

> "The integrity of financial statements and corporate governance should be a tripartite effort. Auditors should not be alone in ensuring financial reporting is correct – that is only one-third of the effort."
> Cheng Heng Tan

Permeating the directors' discussions was the view that directors and audit committees, management, and auditors, would all need to work together to ensure that the enhanced auditor's report achieved its potential value (and not bring about unnecessary problems).

The directors observed that the synergy achieved in the UK was in part due to the audit committee itself also needing to make its own report.

> "I sit on the audit committee of a UK listed entity… the corporate governance guidelines require the audit committee report to state all the critical issues that we have covered. So… it's a multi-party approach and that's important."
> Euleen Goh

The idea of an audit committee report was seen as a potential way to address investors' concerns in the absence of a final opinion on each KAM from the auditor. One director suggested that for this reason, audit committees should follow the UK example and issue their own report, 'as part and parcel' of the enhanced auditor's report.

It was also highlighted that the directors themselves should ensure that their reports and disclosures cover the issues in the KAM so that the two reports can be read in conjunction with each other. If they do not cover these subjects, they should ask themselves why not.

Even in the absence of a standalone report by the audit committee, the directors should review the financial statements to ensure that the issues covered by the KAM are given adequate attention by the company and, where relevant, in other parts of the annual report (e.g. the Chairman and CEO statement, as well as management commentary). This is to ensure that on an overall basis, the investors and other users of the financial statements will get a good insight into the important issues.

A tri-partite approach was viewed as consistent with the regulatory and development focus in Singapore, which had moved from initially focusing on auditors, to treating the financial reporting process as an eco-system. Julia Tay shared that since adopting this approach, ACRA had observed a greater level of ownership and responsibility with each group working together – directors, CFOs and auditors work together.

> "This is not just an auditor's report but an important change that should be embraced by all stakeholders in the financial reporting value chain. The big picture is about raising governance standards and making Singapore more attractive to investors."
> Julia Tay

PERSPECTIVES FROM INTERNATIONAL DIRECTORS: ROUNDTABLES IN EUROPE AND CANADA

The IAASB held roundtables with directors and other stakeholders in Brussels and Toronto similar to the roundtable held in Singapore. Some of the key issues relating to auditor reporting that surfaced from those discussions are:

THE BRUSSELS ROUNDTABLE

In Brussels on April 23, 2015, the IAASB held a roundtable discussion in collaboration with the Federation of European Accountants. The participants were from across EU Member States, and included audit committee members and other corporate governance stakeholders.

Understandability of the Auditor's Report

Participants discussed the possibility of simplifying the language of the auditor's report and thought that the changes were an excellent opportunity for auditors to improve the language and so improve transparency and the report's usefulness.

Participants were concerned about the risk of KAM being too technical for the average reader, or that they may degenerate into boilerplate language.

The Audit Committee's Role

Communication between the auditor and the audit committee was seen as vital and needing to start as early as possible in the audit process.

The IAASB clarified that it is not intended that the changes to the auditor's report should change the nature of discussion that already exists between the audit committee and the auditor.

Potential risks to this relationship that the participants noted included the risk of KAM monopolising the discussions between the auditor and the audit committee, and discussions having a disproportionate focus on the form rather than on the substance of the matter to be disclosed.

The participants thought it was important that the enhanced auditor's report should not overshadow the role of the audit committee. It was agreed that the entity would of course remain responsible for addressing the risks faced by the entity, not the auditor.

THE TORONTO ROUNDTABLE

In Toronto on June 10, 2015, the IAASB held a roundtable of two sessions – one with audit committee members, and another with CFOs and auditors. The roundtable was held in conjunction with CPA Canada and Canada's independent audit regulator, the Canadian Public Accountability Board.

In Canada, discussions are ongoing on how to best adopt the new auditor reporting standards. The two key discussion points potentially of interest to the Singapore discussion were firstly, whether investors would value the enhanced auditor's report, and secondly, how it would affect the audit committee's role.

Whether Canadian Investors Would Value the Changes

To date, there is little evidence that Canadian investors are calling for the change. If the changes are not valued by investors, some are questioning whether the benefits would exceed the costs.

A participant reported an analyst's view, based on the example of the UK early adopter Rolls Royce, that the additional information may not go far enough to satisfy and provide real value for investors. However, the analyst believed it might cause analysts to push companies for more information in their Management Discussion and Analysis (MD&A).

It was thought investors might value more auditor involvement with MD&A, especially about non-GAAP measures. However, it was recognized that this would need to be balanced against a need to avoid 'disclosure overload'.

The Impact on the Audit Committee's Role

The Canadian directors thought that the enhanced auditor's report might not reach its full value unless Canada's audit committees support the objectives of the new report and their responsibilities are enhanced similar to UK audit committees. Some had the view that audit committee reporting might be needed to support an effective implementation of the standards.

A CFO identified the challenge of having three different public discussions on the same topic – from auditors, audit committees and management. Auditors in the discussion suggested that audit committees would need to give a strong steer to the process to help resolve potential instances of tension between auditors and management around what should be included in the auditor's report.

One key concluding emphasis from the Toronto discussion was that all key parties need to work together to make the changes valuable and not regulation-driven.

3. Getting started!

Singapore's and Malaysia's development of a unified approach to corporate governance and financial reporting was viewed as a good foundation for implementing the enhanced auditor's report.

ARE WE PREPARED?

Singapore's and Malaysia's development of a unified approach to corporate governance and financial reporting was viewed as a good foundation for implementing the enhanced auditor's report.

As noted during the directors' discussion, most well performing audit committees were already having the kind of discussions with auditors that are necessary in order to identify and report the KAM.

Directors are gearing up for change with the assistance of their auditors. As mentioned, according to the poll conducted in October 2015 at a forum attended by mainly directors, more than half who responded indicated that they were familiar with the changes, with some having already discussed the changes in detail with their auditors (28 percent). Even more encouragingly, while only 17 percent were open to early adoption, 60 percent will plan for a dry run, with another 21 percent studying the implication before making a decision.

Figure 1: Before today, were you aware of the impending changes to the auditor's report?

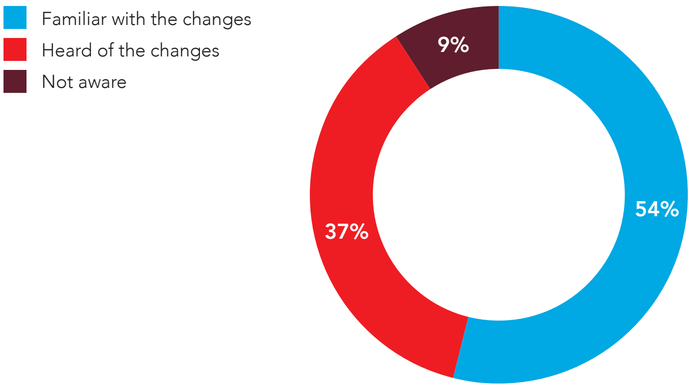


Figure 2: Has your auditor discussed the changes and implications of the revised auditor's report with the board or audit committee?

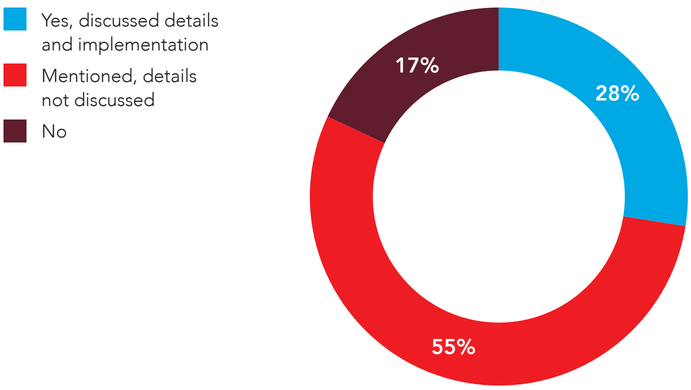
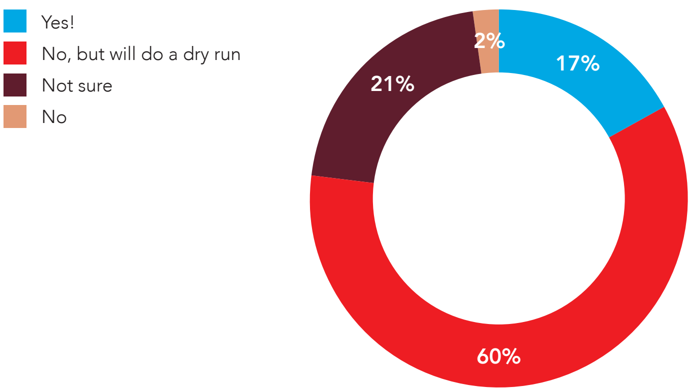


Figure 3: Will you encourage early adoption?



DO COMPANIES HAVE THE RIGHT AUDITORS WITH THE RIGHT AUDIT PLAN FOR A NEW ERA?

Having the right auditor for the company and good supervision over the process will be important as the audit process becomes more transparent.

Julia Tay spoke about ACRA's Audit Quality Indicators (AQI) initiative, launched in October 2015, which gives audit committees a framework to monitor and evaluate their auditors against certain factors.

Some of the AQI are relevant to the enhanced auditor's report. For example one of the indicators is the time spent on the engagement by the audit partner – the person that the audit committee should discuss the KAM in the enhanced auditor's report with.

ACRA launched the AQI before the enhanced auditor's report because companies will need their auditors to be more involved and will also need to make sure they have the right auditors for their company.

PRESCRIPTION FOR A HEADACHE-FREE IMPLEMENTATION

> "The journey is not going to be simple, because it takes years to get everybody to the same quality level. But I believe if there is engagement, earlier rather than later, it will be welcomed by auditors and audit committees."
> Dato Lukman Bin Ibrahim

Several important action areas became clear during the discussion, all of which were in the hands of directors to kick start.

- ***Start early – discuss implementation with auditors at the soonest opportunity***

A director compared adoption of the KAM to her experience as director of a company that had adopted integrated reporting.

> "The reality of integrated reporting is that we have to start early. By the third quarter, we have got to be settling the judgement issues and clearing as many of the surprises so that they don't catch us in the last quarter."
> Euleen Goh

- ***Encourage the audit committee and auditors to undertake a dry run***

Advance trialling in private, without adding it to the annual report before the effective date, will be really important for audit committees, preparers and auditors. Some directors at the roundtable had already asked the auditors for samples of what might be in their companies' auditor's reports.

> "I think the whole trialling in private is going to be really important for the audit committee, the preparers and for the auditors, to actually have a chance to discuss within the confines of the audit committee… What's the response of the committee? How is that going to play out in practice?... Clearly it's the auditors' decision at the end of the day, but (it is important that) this is not done in a vacuum."
> Merran Kelsall

- ***Look out for consistency***

Consider the implications of the potential KAM on the reports from directors and the MD&A in the annual report.

- ***Pro-actively engage in the process***

One director noted that a practice in Singapore is to have a 'lead' independent director who is more pro-active in driving the process. By attending meetings between management and the auditors at the start and closing of the audit, it will help the directors get their concerns into the audit process and also prevent important issues getting glossed over.

> "Take part in the discussion, understand what auditors are looking at, and from their own perspectives, maybe they can even point out matters that auditors have left out 'I have concern about this, can you check?'"
> Cheng Heng Tan

- ***Educate investors***

Directors and auditors should take every opportunity to engage with investors about the enhanced auditor's report. This should include coverage of audit quality and the audit process, including helping investors understand the interaction between auditors and the audit committee.

- ***Make use of the available help***

Resources such as quick guides and illustrations are available in abundance, including the following:

- **IAASB Webpage on "The New Auditor's Report"**
  - o Auditor Reporting Fact Sheet and "At a Glance"
  - o Basis for Conclusions
  - o Publications on Going Concern and Key Audit Matters
  - o Illustrative Key Audit Matters examples
- **ISCA Webpage on Auditor Reporting**
  - o The Auditor Reporting Standards in Singapore
  - o Key localisation amendments
  - o ISCA comment letters, publications and articles.
- **UK Financial Reporting Council's Publications on Review of Experience**

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