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Audit Adjustments Matter: Upholding Financial Reporting Quality

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AUDIT ADJUSTMENTS MATTER:
Upholding Financial Reporting Quality

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Foreword

ACRA and SMU are pleased to publish this insight into audit adjustments made to the financial statements prepared by management of Singapore's listed companies.

Trusted financial information is essential in promoting investment and economic growth and in this respect investor expectations are rising. Businesses are increasingly more complex and the application of financial reporting standards requires more expertise and judgment. Hence, the task of uplifting our financial reporting capabilities has perhaps never been more urgent.

The findings in this study show that audit adjustments are made across a wide spectrum of companies regardless of size and industry. This suggests that improvements must be driven at the macro level, beginning with the collaboration of all stakeholders in the financial reporting eco-system. While investors can be assured that their appointed auditors have performed their role in ensuring the final audited financial statements are reliable, the findings from this study suggest that the investors should nevertheless push the agenda of high quality financial reporting as a key priority for companies.

Companies, for their part, must take ownership of their financial reporting and set the tone by expecting and resourcing their companies to produce high quality financial reports. Audit committees and those charged with governance should work constructively with management to identify and address areas for improvement. Auditors should also add value by recommending improvements to financial reporting and internal controls, sharing best practices of finance functions in companies and providing timely alerts on financial reporting developments.

When each stakeholder takes ownership and plays his respective roles effectively, the result is a strengthened financial reporting eco-system that continually ensures Singapore remains a leading and trusted financial hub.

ACRA and SMU would like to express deep appreciation to the seven participating audit firms for undertaking the strenuous task of extracting and compiling the audit adjustment data. We would also like to thank the individuals who participated in the focus group discussions for their invaluable contributions.

We hope this report will aid all directors, audit committees, management, auditors and investors in fulfilling their respective roles and responsibilities in the financial reporting value chain.

Professor Pang Yang Hoong
Dean, School of Accountancy
Singapore Management University

Kenneth Yap
Chief Executive
Accounting and Corporate Regulatory Authority

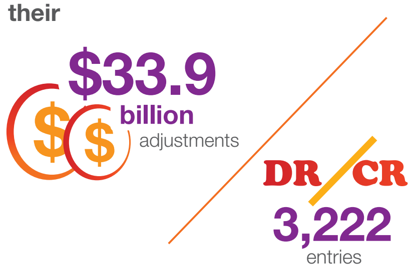
Executive Summary

This study investigates the characteristics, nature and extent of proposed audit adjustments to the financial statements of companies listed in Singapore. Data were gathered from the 2013 audits of 257 listed companies in Singapore, with aggregate market capitalisation of $288.3 billion

Executive Summary

Key Findings and Implications

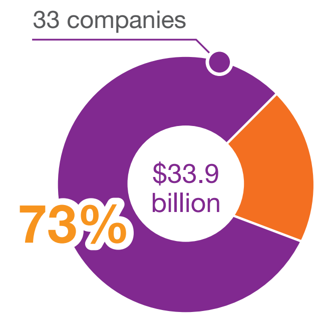
1. **Companies must take more responsibility for their financial statements**
   Auditors proposed 3,222 adjusting entries totalling $33.9 billion worth of adjustments for 257 companies. The quality of financial statements, as prepared by management, varies, and for some, there is significant room for improvements.



Implications
The financial statements prepared by management form the basis of a financial statement audit. If not prepared well, the auditors will find it difficult to deliver efficient and effective audits. It may also prevent auditors from devoting more attention on other aspects of an audit that will better demonstrate the value of an audit.

2. **Companies should pay more attention on expense accounts, receivables and payables**
   Over a quarter (2,059 lines) of 7,842 line adjustments affected expense accounts. This signified a considerable amount of effort to get the expense accounts right. Expense-related adjustments totalled $3.4 billion, comprising of $1.9 billion upwards adjustments and $1.5 billion downwards adjustments. In terms of dollar value, receivables and payables collectively accounted for $15.9 billion or 47% of the $33.9 billion adjustments.

3. **Manufacturing companies should identify and rectify causes of factual differences and misclassifications**
   Manufacturing companies (32% of population) accounted for $20.1 billion (59%) of total proposed adjustments. Of this, $13.3 billion was due to misclassifications and $6.1 billion was due to factual differences. These were significantly much higher than other industries.



4. **Companies with many audit adjustments should improve their internal control systems and processes**
   About half (49%) of the companies had fewer than five proposed adjustments each while 33 companies (13% of population) had more than 20 proposed adjustments each. These 33 companies accounted for about 73% of all proposed amounts totalling $24.7 billion.

5. **Growing companies should expand their internal accounting capacity and capabilities**
   Companies with market capitalisation between $100 million and $500 million (32% of population) accounted for $22.0 billion (65%) of total proposed adjustments. This could have arisen as a result of increased complexity when companies scale up and expand operations, including overseas ventures.

Implications
Companies, including directors, audit committees, management and finance teams, must have a higher sense of "ownership" when preparing financial statements. They should strive to minimise proposed audit adjustments, particularly relating to factual differences and misclassifications. This means giving due attention and priority to upgrading the capacity and capability of their accounting functions, be it human resources, technology and/or accounting systems. Such investment is even more crucial in times of expansion.

6. **Auditors should continue to uphold their stance on material adjustments**
   Approximately two-thirds (65%) of the proposed accounting entries, representing a total of $30.0 billion (89%) of the total proposed adjustments, were accepted and adjusted in arriving at the audited financial statements.

Implications
Audit committees need to consider making improvements on the underlying financial reporting process, especially if the proposed adjustments are recurring year to year. Investors, too, have a role to play in clearly articulating their expectations of high quality financial reports. When each stakeholder takes ownership and plays his role effectively, the result is a strengthened financial reporting eco-system that allows Singapore to remain a leading and trusted financial hub.

About this Study

A financial statement audit underpins the trust and obligation of stewardship between management and shareholders. Proposed adjustments give an indication of the gap between the financial statements as prepared by management and what is prescribed in the accounting standards.

About this Study

Introduction

ACRA commissioned the Singapore Management University's (SMU) School of Accountancy to conduct an independent research of proposed audit adjustments to the financial statements of listed companies for financial year ended 31 December 2013. This study investigates the characteristics, nature and extent of proposed audit adjustments to the financial statements of SGX-listed companies.

Financial Statement Audits

Many consider financial statement audits as the "final check" on the financial statements prepared by management which may (inadvertently or otherwise) contain errors, omissions or other forms of misstatements. It provides assurance that management has prepared accounts that present a true and fair view of a company's financial performance and position, and in compliance with applicable accounting standards.

The only visible **output** of a financial statement audit is the auditor's report, containing the audit opinion, that shareholders find in the company's annual report. However, the **outcomes** of an audit extend beyond the auditor's report but they are unfortunately confidential in nature and not publicly available. Shareholders and general readers of financial statements are thus often unaware of them.

For example, the management letter issued by auditors may contain the auditor's observations on significant deficiencies in the internal controls noted when conducting the audit, whilst the report to audit committees may include the auditor's views on the appropriateness of accounting policies, significant accounting estimates and judgements, and financial statement disclosures.

Audit Adjustments

Another outcome of a financial statement audit is the (list of) proposed audit adjustments for review and discussions with management and those charged with governance. At the end of the audit, audit adjustments may be proposed by auditors to correct factual, judgemental or projected misstatements on the financial statements before they sign off on the audit report.

Proposed adjustments give an indication of **the gap** between the financial statements as prepared by management and what is prescribed in the accounting standards. An analysis of these adjustments can yield insights into the more commonly occurring misstatements and their root causes, allowing directors, management, accountants and auditors to identify ways to rectify or minimise them and improve the overall quality of financial reporting by companies.

However, it is important to note that an auditor's effort should not be measured just by the number or dollar amounts of the proposed adjustments. The auditor would have performed his duties if the audit is executed in accordance with auditing standards, even if this did not result in any proposed adjustment. On the other hand, the presence of many audit adjustments suggests underlying issues with the quality of financial statements prepared by management.

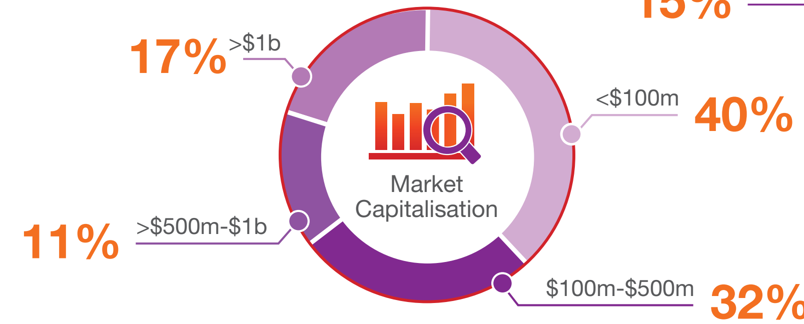
> *"A good financial reporting process supported by an experienced and adequately staffed finance function is probably one where an external auditor would not find any material misstatement."*

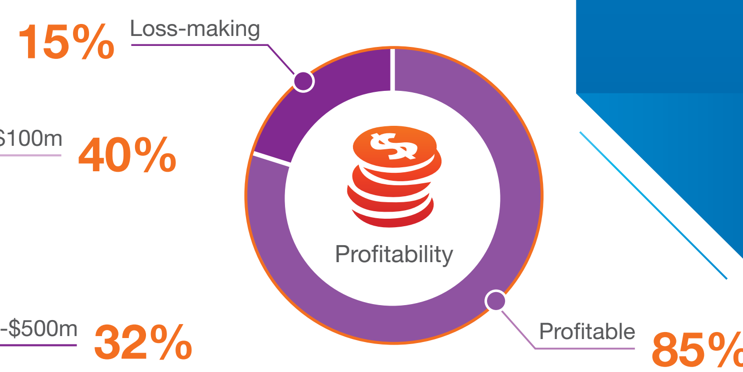
Mr. Ong Pang Thye,
Head of Audit,
KPMG

Following review and discussions with management and audit committees, the three parties will come to an agreement on which proposed adjustments must be passed in order for the financial statements to present a true and fair view of the company's financial performance and position, and to comply with applicable accounting standards.

Profile of 257 Companies

The participating audit firms provided directly to the SMU research team, on a non-attributable and confidential basis, all proposed adjustments **as communicated to those charged with governance** based on the audits of Singapore-listed companies for the financial year ended 31 December 2013. The consolidated dataset comprises information on audit adjustments for 257 companies with market capitalisation totalling $288.3 billion. All amounts in this report are presented in Singapore dollars.





The 257 companies constituted a reasonable selection of the companies listed on the Singapore Exchange.

Key Findings

(1) Auditors play a key role in ensuring higher financial reporting quality

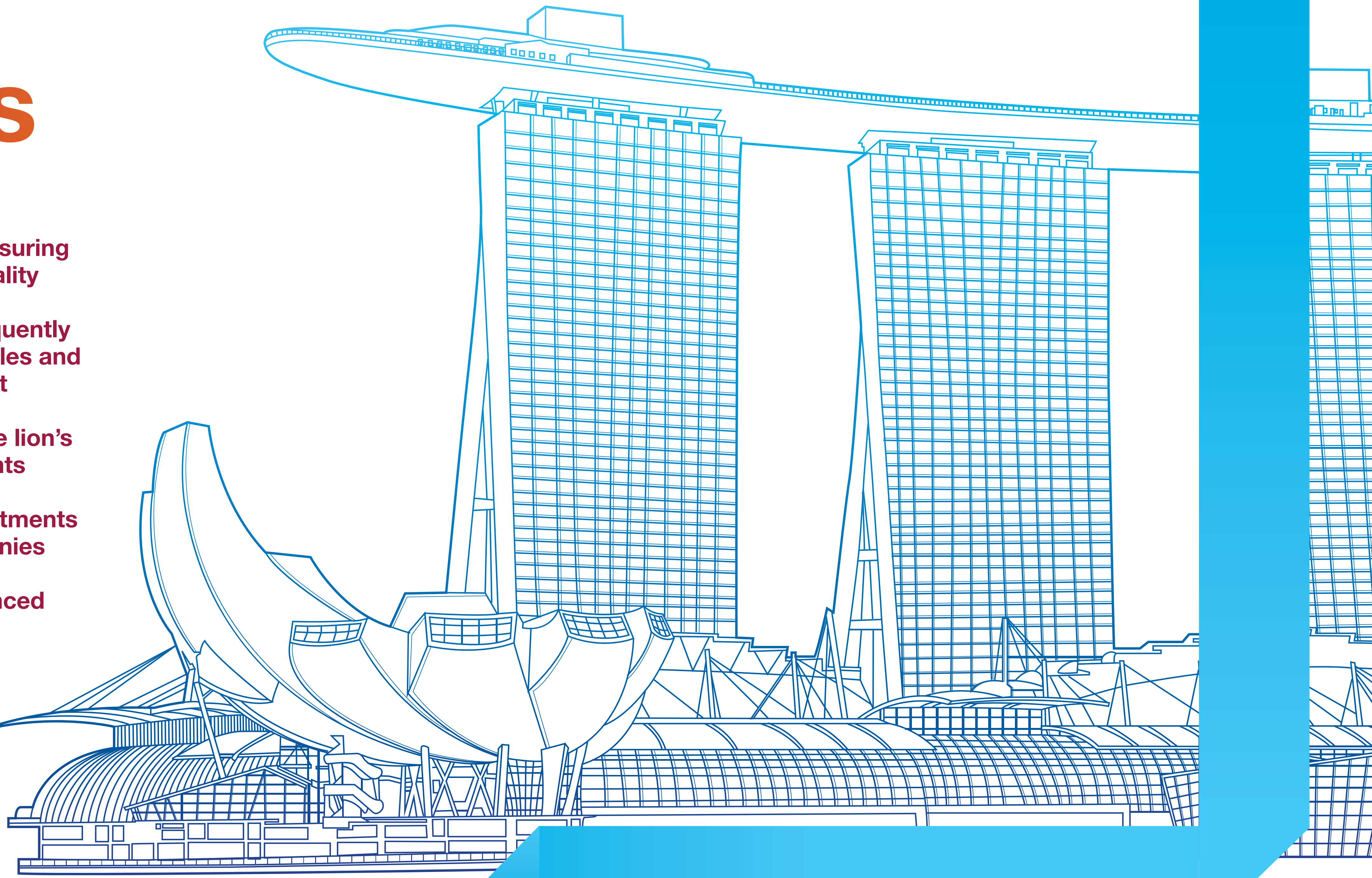
(2) Expenses were the most frequently adjusted accounts, Receivables and Payables the most by amount

(3) Manufacturing sector had the lion's share of proposed adjustments

(4) A majority of proposed adjustments were for a minority of companies

(5) Growing companies experienced difficulties with accounting complexities

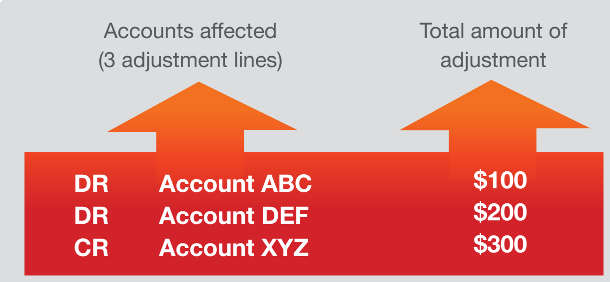
(6) A majority of proposed adjustments was accepted by companies



Key Findings

(1) Auditors play a key role in ensuring higher financial reporting quality

Auditors in this study proposed a total of $33.9 billion worth of audit adjustments. The sum was computed based on 3,222 accounting entries (consisting of 7,842 lines) proposed for the 257 companies in the study.



The number of **lines** in an audit adjustment is at least two. In this example, it has three adjustment lines.

The total impact of an adjustment is the **sum** of all the amounts in the entry. In this example, the sum is $600.

Anatomy of an Audit Adjustment

The quality of financial statements, as prepared by management, varies, and for some, there is significant room for improvements. Whilst we should not measure audit effort based solely on the extent of proposed adjustments, financial reporting quality would clearly be very different without the auditors' work.

"We are pleased to see that auditors play a significant role in correcting financial statements. Users of financial statements want to be sure that the numbers on the financial statements are reliable. This study provides assurance that auditors are doing their part in ensuring financial reporting quality remains high. We would like to see preparers up their game."

Mr. David Gerald,
President and Chief Executive Officer, Securities Investors Association (Singapore)

The four types of proposed adjustments as described by Singapore Standards of Auditing 450 are:

(1) Factual misstatements are misstatements about which there is no doubt;

(2) Misclassifications occur when transactions and events have not been recorded in the proper accounts;

(3) Judgemental misstatements are differences arising from the judgements of management concerning accounting estimates that the auditor considers unreasonable, or the selection or application of accounting policies that the auditor considers inappropriate; and

(4) Projected misstatements are the auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire populations from which the samples were drawn.

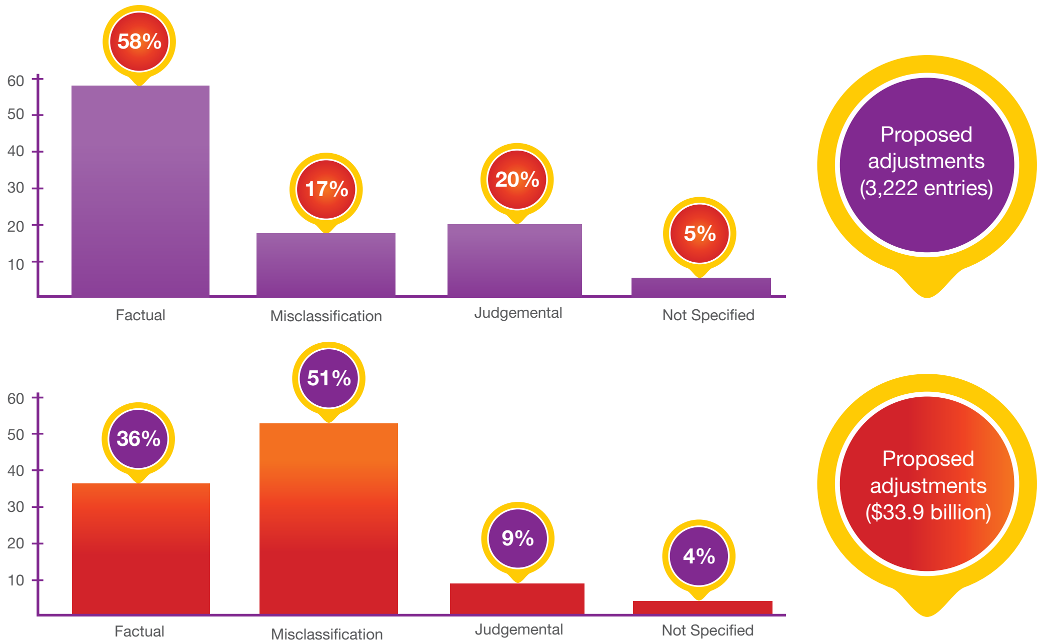
"The nature of the proposed audit adjustments provides an insight to the quality of the financial reporting process and competency of accounting function. In particular, the nature of the audit adjustments may suggest, in extreme cases, the presence of a systemic issue. Audit Committees should review these adjustments to understand their nature and seek rectification where necessary."

Mr. Soh Gim Teik,
Treasurer, Singapore Institute of Directors

For the purpose of this report, we have classified audit adjustments into:

- factual differences;
- misclassifications;
- judgemental differences (including those involving estimations and projections[1]); and
- not specified[2].

The most commonly proposed adjustments were for correcting factual differences. Together with misclassifications, they accounted for over 2,400 or about three quarters of total proposed adjustments. When analysed by dollar amounts, they accounted for $29.3 billion, or 87% of total proposed adjustments.



Proposed Adjustments Types

[1] Projected differences accounted for only 1.1% of total entries and 0.3% of proposed adjustment amounts. As suggested by focus group participants, for the purpose of this report, we have combined these adjustments with the judgemental differences category; and

[2] We were not provided with information on the adjustment type for 161 proposed adjustments; these have been labelled as "not specified".

Key Findings

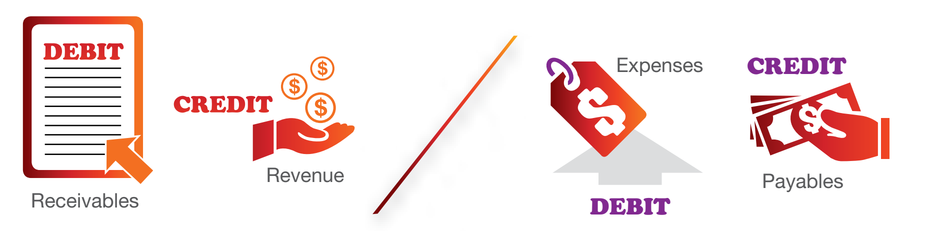
Mr. Reinhard Klemmer,
Partner, KPMG

"Whilst the overall amounts for judgemental differences may appear to be low, this should not give the impression that such misstatements are not prevalent. In practice, discussions over such judgemental differences between management and the external auditors are more frequent in view that they are the typical audit focus areas. Many of the corrections, if any, would have been corrected and recorded by management prior to the audit commencement date."

Ms. Angeline Tan,
Partner, Crowe Horwath First Trust

"High number of factual or misclassification adjustments could indicate the need for clients to improve their internal control procedures, especially those relating to the financial reporting process."

An example of a typical factual adjustment would be a debit entry ("DR") to Receivables and a credit entry ("CR") to Revenue, or a DR to Expenses and CR to Payables. These adjustments are probably due to financial reporting period "cut-off" issues. If left uncorrected, they would obviously result in misstatements in earnings. Other factual adjustments may be caused by incorrect amounts being posted in the financial records.



A misclassification, on the other hand, may not necessarily have any earnings impact. For example, an expense may have been incorrectly posted to a wrong expense account. The proposed adjustment would simply move the expense to the correct account.

Mr. Bill Bowman,
Senior Director, Risk Management and Internal Control, Infineon Technologies Asia Pacific

"Even if there is no impact on earnings, management should not leave it to the auditors to pick up any misclassification differences. It should be management's responsibility to ensure that accounts are prepared correctly in the first place."

There may be some expectations on auditors to correct the (known) misstatements, arising from "late client adjustments". Late client adjustments are errors that were identified by management, typically arising from post-closing procedures and preparation of financial statements. For this study, we have included late client adjustments as long as they were communicated to those charged with governance.

Mr. Yeo Boon Chye,
Head of Assurance, Foo Kon Tan Grant Thornton

"There is a lot of pressure on clients to close their accounts early for reporting purposes. This may result in factual or misclassification misstatements which are then subsequently corrected when the audit is done."

Ideally, once misstatements are detected and corrected, the underlying issues should be addressed to prevent the same misstatements from taking place year after year. For example, if late client adjustments are a regular source of audit adjustments, then management and the audit committee should take steps to improve the financial closing process. Similarly, if the misclassification is due to lack of training of accounting personnel, then corrective measures ought to be taken to ensure proper treatment in future periods.

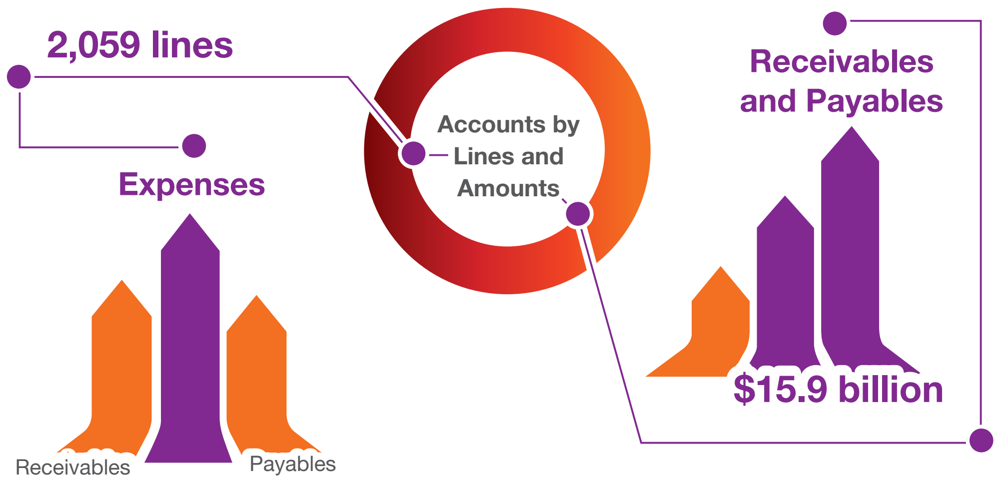
Mr. Reinhard Klemmer,
Partner, KPMG

"There should not be a compromise in the aim to prepare high quality financial reporting in the shortest time possible. Quality and timeliness should not be exclusive."

Key Findings

(2) Expenses were the most frequently adjusted accounts, Receivables and Payables the most by amount

In terms of accounts being affected, the following table lists the Top 10 accounts with the most proposed audit adjustments. Cumulatively, they represented 83% of the total adjustment lines and 89% of the total dollar amounts.



Major Accounts	Lines	% of lines	Total $m	% of amount
Trade and other receivables	982	13%	$8,888	26%
Trade and other payables	805	10%	$7,056	21%
Expenses	2,059	26%	$3,454	10%
All other assets	461	6%	$2,723	8%
Retained earnings	462	6%	$1,664	5%
Revenue	270	3%	$1,531	5%
Other income	277	3%	$1,424	4%
Accruals/provisions	690	9%	$1,304	4%
Other financial assets	116	2%	$1,243	3%
Property, plant & equipment	395	5%	$1,021	3%
Top 10	**6,517**	**83%**	**$30,308**	**89%**

Top 10 Accounts by Lines and Amounts

Expense accounts were by far the most affected account by occurrence. More than a quarter (2,059 lines) of proposed adjustment lines were to correct an expense account, either upwards (total $1.9 billion) or downwards (total $1.5 billion). The upward adjustments arose mainly from incomplete recording of expenses whilst the downward adjustments arose mainly from overprovision of expenses.

In contrast, revenue accounts which were typically audited with more care had relatively fewer proposed adjustments (270 lines or 3% of all lines). Auditing standards require auditors to conduct additional and specific procedures on revenue. Logically, when auditors perform additional work, more audit adjustments could arise especially if the company's internal controls are not effective. Thus, the results indicate better quality in the management's preparation of revenue numbers as compared to expense numbers.

When analysed by amounts, it was somewhat surprising that the top two most affected accounts were Trade and Other Receivables and Trade and Other Payables. Together, they accounted for $15.9 billion (47%) of total proposed adjustments. On closer examination, we found there were considerable reclassifications between these two accounts. It is possible the receivables and payables were not properly presented in accordance with applicable accounting standards.

> *"Misclassifications could arise because management classify certain balances and items based on their internal needs for management decision purposes. As they would not affect the bottom-line of the company, management would sometimes be tempted to leave these known differences as audit adjustments."*

Ms. Wong Sian Jing,
Chief Financial Officer,
Singapore Medical Group

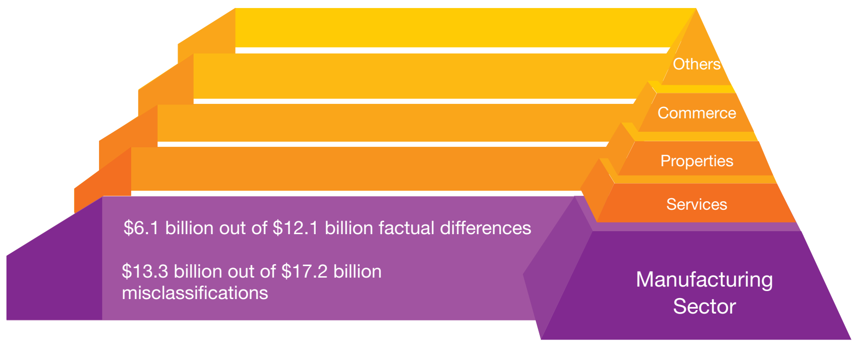
Key Findings

(3) Manufacturing sector had the lion's share of proposed adjustments

By far, proposed adjustments were most prevalent in the Manufacturing sector, followed by Services, Properties and lastly, Commerce. The "Others" sector includes companies that are classified as "multi-industry" under SGX's classification.

Industry Classification	Manufacturing (32%)	Services (23%)	Properties (15%)	Commerce (14%)	Others (16%)	Total 257 entities (100%)
Factual	$6,142	$2,117	$1,174	$1,970	$693	$12,096
Misclassification	$13,301	$1,631	$842	$1,382	$68	$17,224
Judgemental	$612	$855	$410	$410	$890	$3,177
Not specified	$53	$1,344	$15	$12	$13	$1,437
Total proposed adjustments (in $m)	**$20,108 (59%)**	**$5,947 (18%)**	**$2,441 (7%)**	**$3,774 (11%)**	**$1,664 (5%)**	**$33,934 (100%)**

Proposed Adjustments Types by Industry



The 81 companies in the manufacturing sector represented 32% of the population, but they accounted for almost 60% ($20.1 billion) of the total proposed adjustments. When examined by types of adjustment, manufacturing companies accounted for over half (51%) of all factual differences and more than three quarter (77%) of all misclassifications. This is surprising as manufacturing companies are usually more operationally structured and organised than other industries. It is also possible that these manufacturing companies do not have an adequately staffed finance function.

Mr. Soh Gim Teik,
Treasurer, Singapore Institute of Directors

"Talented finance personnel are essential to facilitate preparation of high quality financial statements. This also applies to manufacturing companies whose complexity in accounting may be better addressed by qualified accountants. Companies need to recognise their value and invest in them."

The top 5 accounts within each to sector (by dollar amounts), represented a large proportion of the total adjustments by industry. This may be helpful to auditors in their audit planning. Expense accounts appeared in all industry groupings. Trade and Other Receivables featured in all industries except for Properties. In contrast, adjustments to the Retained Earnings account only featured in the Commerce and Others industries. Typically adjustments to Retained Earnings take place when there are prior period adjustments. This indicates that the proposed adjustments generally relate to current period only.

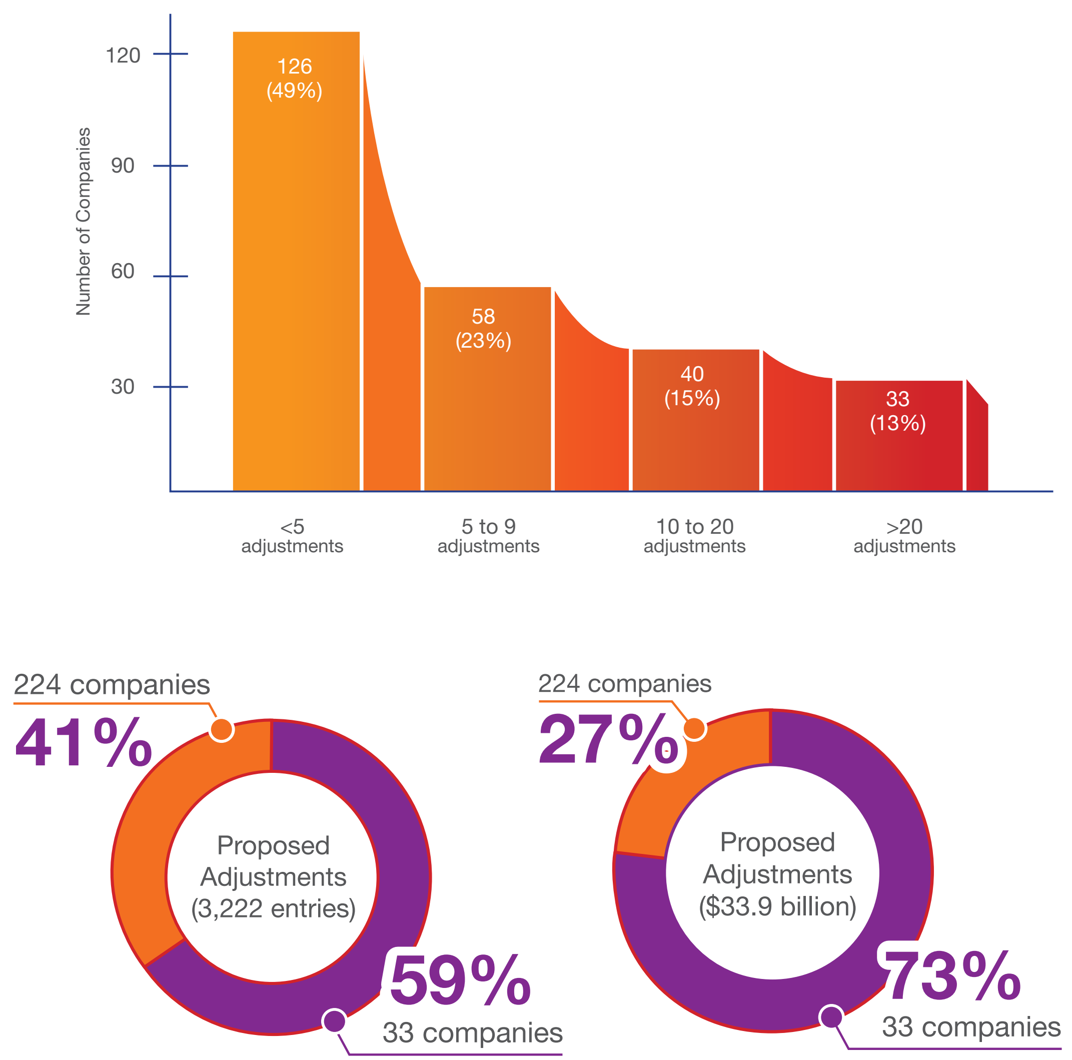
Manufacturing	Services	Properties	Commerce	Others
Receivables	Receivables	Losses	Other income	Receivables
Payables	Expenses	All other assets	Retained earnings	Expenses
All other assets	Accruals/Provisions	Other financial assets	Expenses	All other assets
Expenses	Payables	Gains	Accruals/Provisions	Revenue
PPE	Other financial assets	Expenses	Receivables	Retained earnings
85% of $20,108m	**68% of $5,947m**	**69% of $2,441m**	**65% of $3,774m**	**70% of $1,664m**

Top 5 Adjustments (by amounts)

Key Findings

(4) A majority of proposed adjustments were for a minority of companies

When we examined the distribution of the proposed adjustments by company, approximately half of them (49%) had less than five proposed adjustments each. This suggested that a majority of companies prepared their financial statements that required fewer subsequent corrections by their auditors.



Distribution of Proposed Adjustments for 257 Companies

On the other end of the distribution, 33 companies (13% of population) had more than 20 proposed adjustments each. These 33 companies received 1,905 (59%) of the proposed adjusting entries, totalling $24.7 billion (73%) of the total adjustment amounts. On closer examination, 16 of these 33 companies had market capitalisation below $100 million. Another 13 had market capitalisation between $100 million and $500 million.

These smaller listed companies can do more to improve their financial reporting. Otherwise, they potentially create threats to the proper functioning of the financial reporting value chain, resulting in unreliable financial information. Auditors may also be unable to deliver efficient and effective audits given the relatively low quality financial statements prepared by management.

> *"The tone from the top is important. Boards and management must recognise the importance of good financial reporting and invest the right resources and systems in the financial reporting process. The system does not have to be complicated, but just one suited to the scale and operations of the company."*

Mr. Peter Leong,
Head of Audit and Assurance, BDO

Key Findings

(5) Growing companies experienced difficulties with accounting complexities

We examined the distribution of proposed adjustments across companies by market capitalisation. When analysed by dollar amounts, companies with less than $100 million market capitalisation (40% of population) accounted for only 14% of audit adjustments, whereas the next band of companies, those with $100 million to $500 million market capitalisation (32% of population), accounted for almost two-thirds (65%) of the total proposed adjustments.

Market Capitalisation	< $100m (40%)	$100m-$500m (32%)	$500m-$1b (11%)	> $1b (17%)	Total 257 (100%)
Total proposed adjustments (in $m)	$4,657 (14%)	$22,005 (65%)	$1,899 (5%)	$5,373 (16%)	$33,934 (100%)

Proposed Adjustments by Market Capitalisation

The high proportion of proposed adjustments in the $100 million to $500 million market capitalisation band could be in part due to the increased volume and complexity in accounting when companies scale up and expand operations, including overseas ventures. Preparers may find themselves unable to cope without additional resources in their finance operations. Financial reporting quality may suffer, and more reliance will have to be placed on auditors to find and correct any potential misstatements.

In addition, the CFOs of today have many responsibilities that extend beyond the finance function, including strategic risk management, risk management, external relations and even business development. Whilst CFOs of larger listed companies are likely to be assisted by a group of experts in each of these fields, the CFOs in smaller listed companies may not have access to the same extent of resources or skill sets. This may create additional pressure on the CFOs, on top of the increased complexity for the finance functions.

"The role of CFOs has evolved significantly. As companies face greater challenges in their operating environment, CFOs need to play an increasingly greater and enhanced role to support the company's strategic activities. However, one of the core responsibilities of a CFO remains in financial reporting. To do it well is critical and essential."

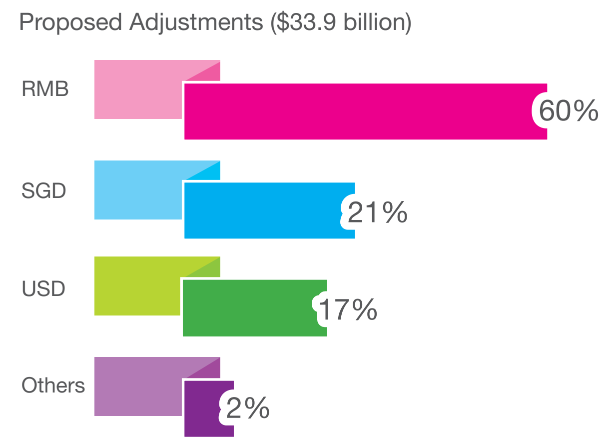
Mr. Gerard Ee,
President, Institute of Singapore Chartered Accountants

When examining the currencies in which the adjustments were proposed, it was clear that proposed adjustments denominated in Renminbi were predominant, representing 60% (over $20.0 billion) of total proposed adjustments. Almost all (98%) the Renminbi denominated adjustments were for factual differences or misclassifications.

This suggests that foreign companies and/or subsidiaries may need to improve their financial reporting quality and put in place adequate processes allowing compliance with the accounting standards both in Singapore and in the country of operation. This is especially so if the foreign country's accounting framework and disclosure requirements vary significantly from those of Singapore. There may also be need to rectify inherent infrastructural deficiencies, in areas such as human resources or information technology.

Some focus group participants believed that the proposed adjustments could arise from Generally Acceptable Accounting Practices (GAAP) differences between the overseas entities and the holding company in Singapore which prepares its consolidated financial statements under Singapore Financial Reporting Standards (SFRS). It was however puzzling as to why these adjustments were not made by the finance team during the consolidation process. It would likely be more efficient if these adjustments were done by the overseas entities' finance teams rather than by the auditors in the form of audit adjustments.

Proposed Adjustments by Currency



"Financial statements communicate a company's financial position and performance to its stakeholders. Given the ever increasing complexity of accounting standards and international operations, CFOs and their finance departments will need to have adequate expertise to deal with these challenges."

Mr. Uantchern Loh,
Chief Executive, Singapore Accountancy Commission

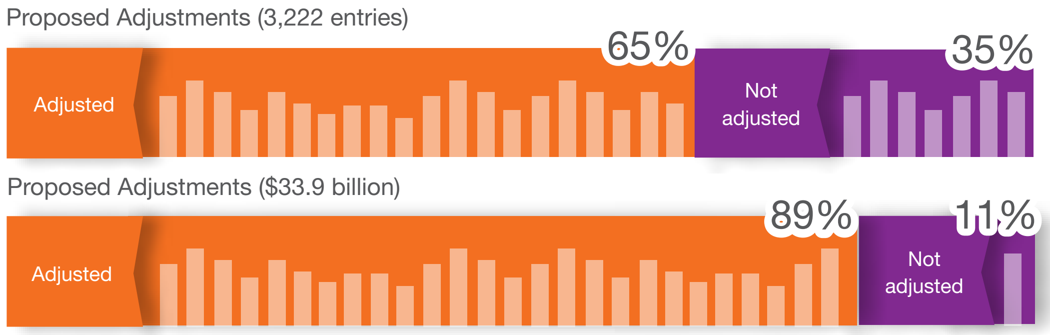
"Preparers of financial statements should pay more attention to this area, so that GAAP differences between jurisdictions, are identified timely by the finance team and incorporated into the group reporting process before the commencement of the statutory audits."

Mr. Yeow Chee Keong,
Partner, PricewaterhouseCoopers

Key Findings

(6) A majority of proposed adjustments was accepted by companies

A total of 3,222 accounting entries totalling $33.9 billion audit adjustments were proposed by the participating audit firms in this study. Of this, about two-thirds (65%) were accepted by management and audit committees and thus reflected in the audited financial statements. These entries represented a total of $30.0 billion (89%) of the total proposed adjustments.

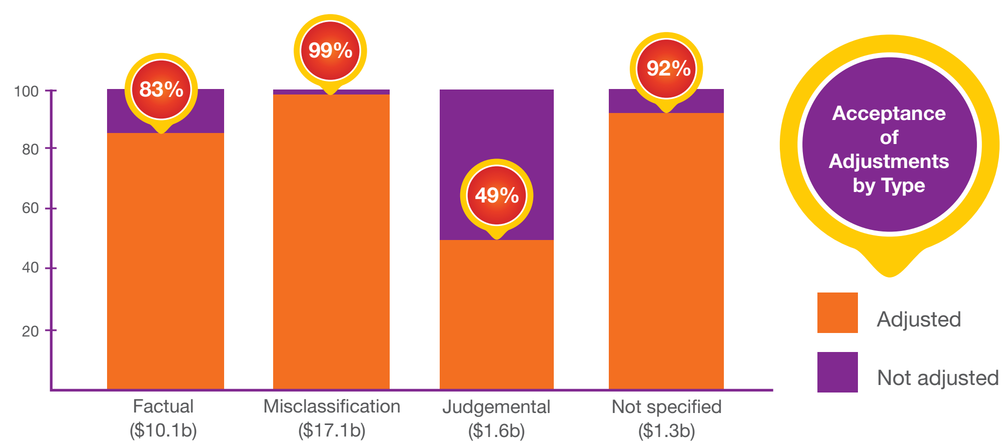


Proposed Adjustments Reflected in Audited Financial Statements

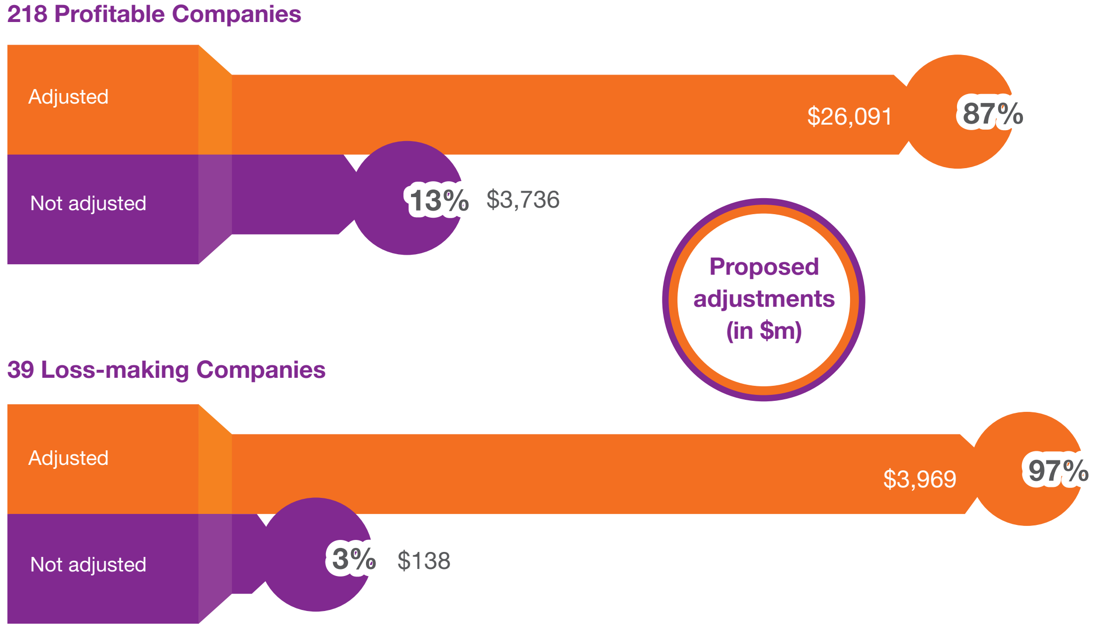
"When discussing proposed adjustments with management or audit committee, one key consideration is whether or not the adjustments are material to the financial statements. We would insist on all material adjustments to be reflected on the financial statements before we issue our audit opinion."

Ms. Lee Bee Leng,
Director, Deloitte & Touche

Practically all misclassification adjustments were accepted by management and those charged with governance, followed by factual differences. On the other end, less than half of the judgemental adjustments were accepted. The lower acceptance rate for judgemental adjustments may be a result of further information or explanation by management and/or audit committees.



Profitable companies accounted for a total of $29.8 billion of proposed adjustments, of which 87% were accepted. In contrast, 97% of the proposed $4.1 billion adjustments for loss-making companies were accepted. This may be because auditors are more risk averse when dealing with loss-making companies.



Adjustments by Profitability

"It is comforting to note that the auditors were able to push through most of the proposed adjustments. If the preparers' level could be improved to have fewer or none audit adjustment(s), then it will be even better."

Mr. David Gerald,
President and Chief Executive Officer, Securities Investors Association (Singapore)

Based on the auditing standards, an auditor must communicate all proposed adjustments, whether adjusted or not, to those charged with governance, typically the audit committees. Prior to the communication, the auditors must judge whether the proposed audit adjustments alone and/or in aggregate, are material to the financial statements as a whole. If they are judged as material, the auditors are obliged to ensure the audit adjustments be passed, failing which they would issue a qualified audit opinion. The auditors must also obtain the Audit Committees' confirmation that the unadjusted differences are not material individually and cumulatively.

Implications

This study has implications for all participants in the financial reporting eco-system, from investors, board of directors and audit committees, management and finance teams, auditors to professional bodies and regulators.

Implications

Implications

INVESTORS

1. Reliable financial information

The investors should be comforted to learn that most proposed adjustments are reflected in the audited financial statements. This provides them with a set of reliable and trustworthy financial statements to make informed decisions.

BOARD OF DIRECTORS AND AUDIT COMMITTEES

2. Tone from the top

Boards should ensure that management has developed and maintained an effective finance function and internal control systems allowing high quality financial reporting to be produced with minimal audit adjustments. Support should also be given to the CFOs and finance teams, who would need the cooperation from all parts of the organisations to achieve it.

3. Setting realistic target

Boards should have the commitment and practice to ensure that management reduce the number of proposed audit adjustments over time, especially those related to factual differences or misclassifications. This could be done by investigating the root causes of the proposed audit adjustments and adjusting the internal control systems and processes to prevent recurrence. Setting a zero audit adjustment target as a key performance indicator may not work unless the company has a very strong finance function and internal control system in place.

"Audit adjustments should be minimal and any audit differences should be confined to those of judgmental nature. This is the ideal upon which all companies should strive towards. Management can achieve this by making informed decisions through timely consultation with auditors in areas of complex accounting."

Mr. Mak Keat Meng,
Head of Assurance, Ernst & Young

4. Take more ownership of accounting

Boards should be committed to keep themselves abreast of financial reporting development to the degree that allows them to discuss audit issues and proposed adjustments meaningfully. Relying fully on the finance team's or the auditor's representation or both does not relieve the board from its fiduciary duties.

Directors are also encouraged to attend the *Director Financial Reporting Essentials Course*, organised by the Singapore Institute of Directors in collaboration with Institute of Singapore Chartered Accountants. The first 3,000 company directors who voluntarily attend this course before 31 March 2016 are entitled to subsidies of $300 per individual (about 50% of the course fee) funded by ACRA.

MANAGEMENT AND FINANCE TEAMS

5. Initiatives on audit adjustments

Management should embed into its workplan to require follow up on audit adjustments and to ensure timely rectification of their root causes. By doing so, management will gain comfort that their internal control systems and processes are continually improved upon, and that earnings announcements and financial statements are reliable and properly presented.

"As preparers, we don't want to see the same audit adjustments year after year. Our audit committee would make sure any underlying cause of the factual or misclassification adjustments are actioned-upon and remedied."

Mr. Tony Tang,
Chief Financial Officer, KSH Holdings

6. Accounting resources during expansion

In times of expansion, companies may focus more on immediate business concerns and relegate financial reporting issues to the margin. But high quality financial reporting is even more critical at such times. If systems, processes and the finance function are not enhanced, the accuracy and reliability of financial statements prepared by management may be an issue, potentially affecting the management's ability to use it to make informed business decisions.

AUDITORS

7. No status quo

Auditors should advise and work together with their clients to strengthen the financial reporting processes and to rectify the root causes of audit adjustments, including late client adjustments. Even if the audit risk is judged to be low for such items, audit efforts would have been channelled to pass these entries, thus reducing efficiency and taking the focus away from more important aspects of the audit. Auditors should continue to raise recommendations to improve their clients' internal control systems and processes.

8. Prepare the preparers

Preparers of financial statements need to anticipate the upcoming changes to the accounting standards and plan ahead to identify information needs so as to put in place the necessary process and systems changes on a timely basis. This will then reduce the frequency and extent of such audit adjustments and allow auditors to concentrate on more value-adding aspects of their audits, such as helping their audit clients with issues related to judgment and accounting estimates, and in broader areas such as risk assessments.

PROFESSIONAL BODIES AND REGULATORS

9. Re-balance the responsibilities

Professional bodies and regulators have to continue educating all accounting professionals and other stakeholders that high quality financial reporting is a collective responsibility, grounded by legal requirements and professional expectations. Auditors should continue to deliver efficient and effective audits, but this is only possible when they are supported by high quality financial statements prepared by management.

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