

ACRA-SGX-SID AC Seminar 2022

Audit Adjustments Matter:

What They Reveal about Companies' Financial Reporting

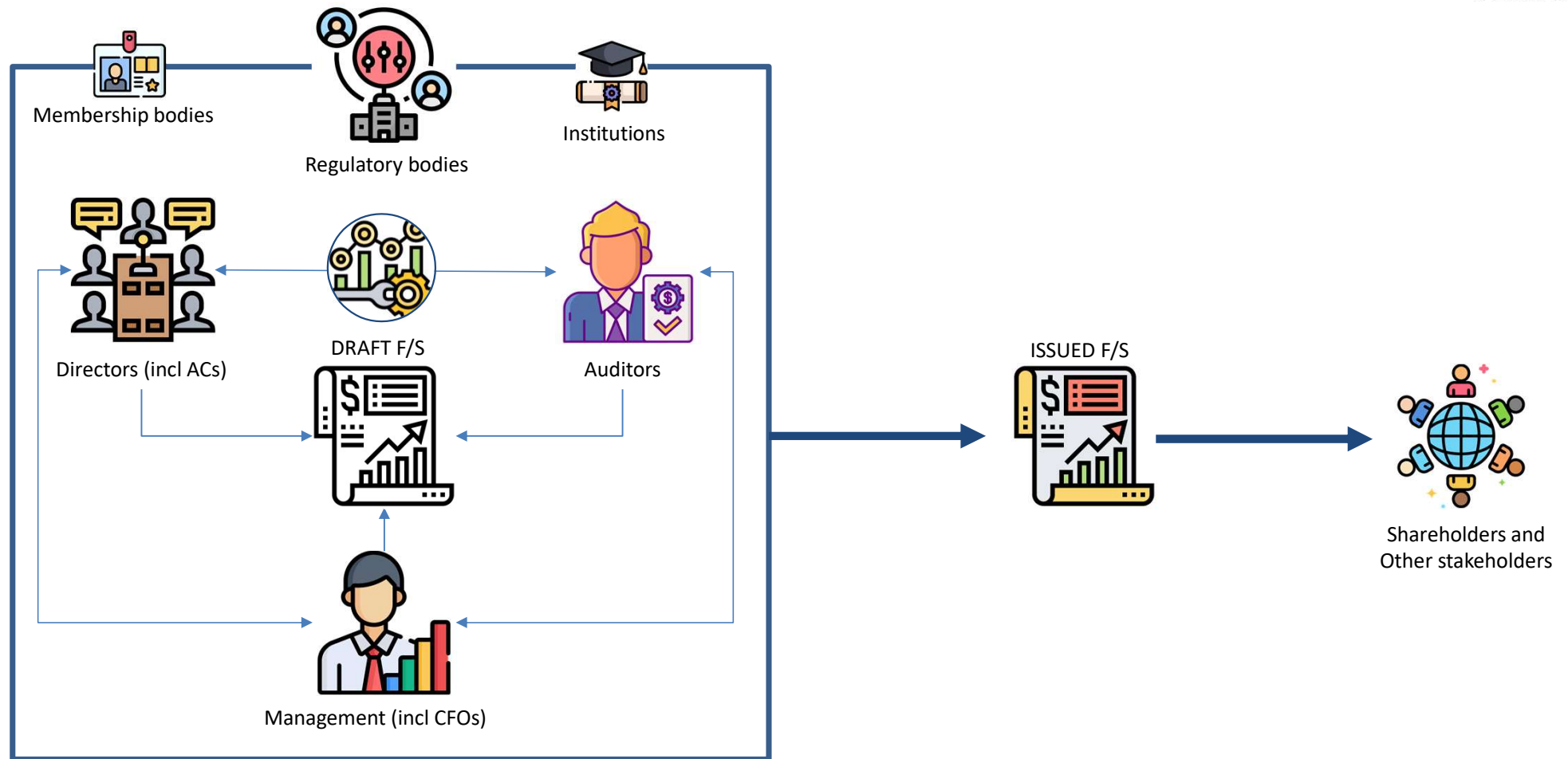
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Singapore Management University

Dr Lim Chu Yeong

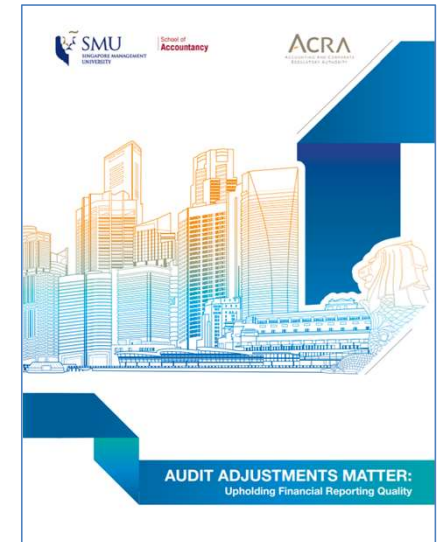
Nanyang Technological University

Financial Reporting Quality as an Ecosystem



Audit Adjustment studies

- Conducted first study in 2014
 - 7 audit firms, 257 SGX-listed companies on 31/12/2013 year end,
 - 3,222 entries, 7,842 lines with a total of \$34B adjustments, 89% are reflected in issued F/S



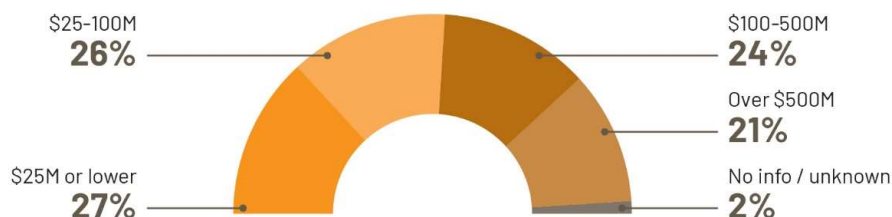
This second iteration

- Additional data points across 3 years, plus survey of ACs & CFO/HF perception of finance effectiveness
 - 12 firms: Deloitte, EY, KPMG, PwC, BDO, Baker Tilly, Crowe, Foo Kon Tan, Mazars, Moore Stephens, Nexia TS, and RSM CL
 - Audit adjustments data of 412 companies x 3 years (1,236 obs)
 - Survey of finance functions: 120 ACs, 159HFs, total 279 responses with 62 pairs on same company
- And inputs from many others in focus groups, meetings, etc...

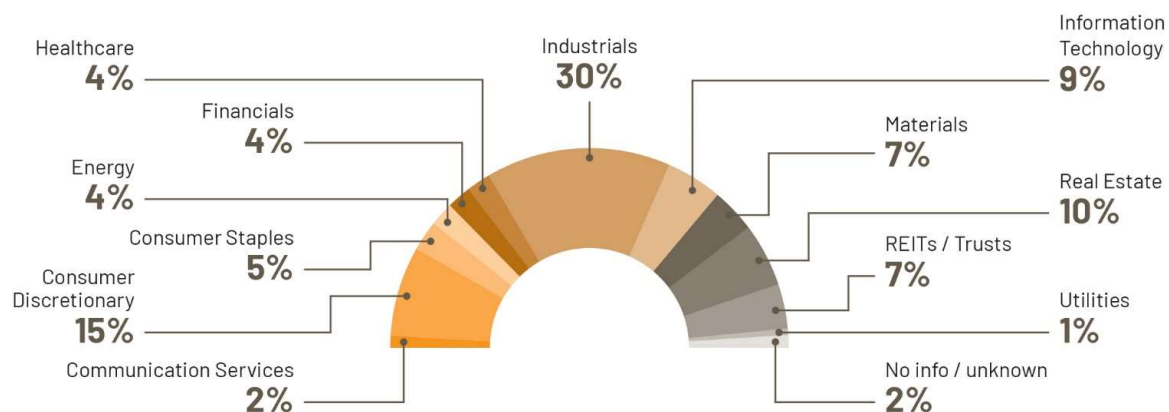
Company Background Demographics

Market Capitalisation

As at end of 2020

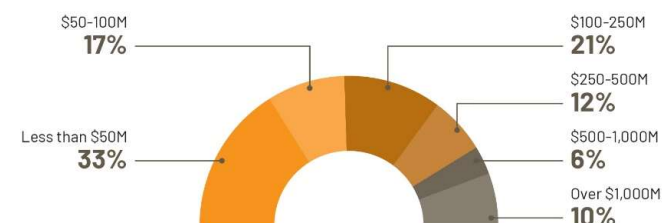


Industry Classification



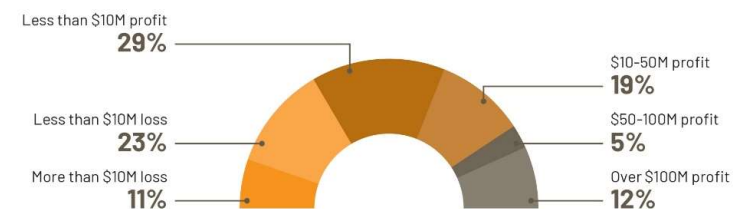
Revenue

Average 2018-2020



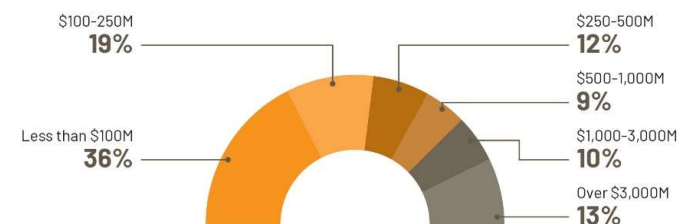
Net Profit

Average 2018-2020



Total Assets

Average 2018-2020





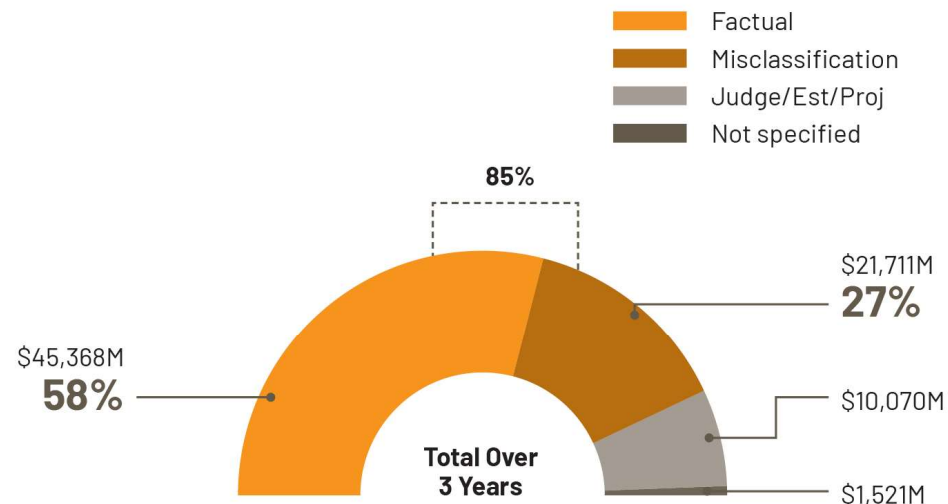
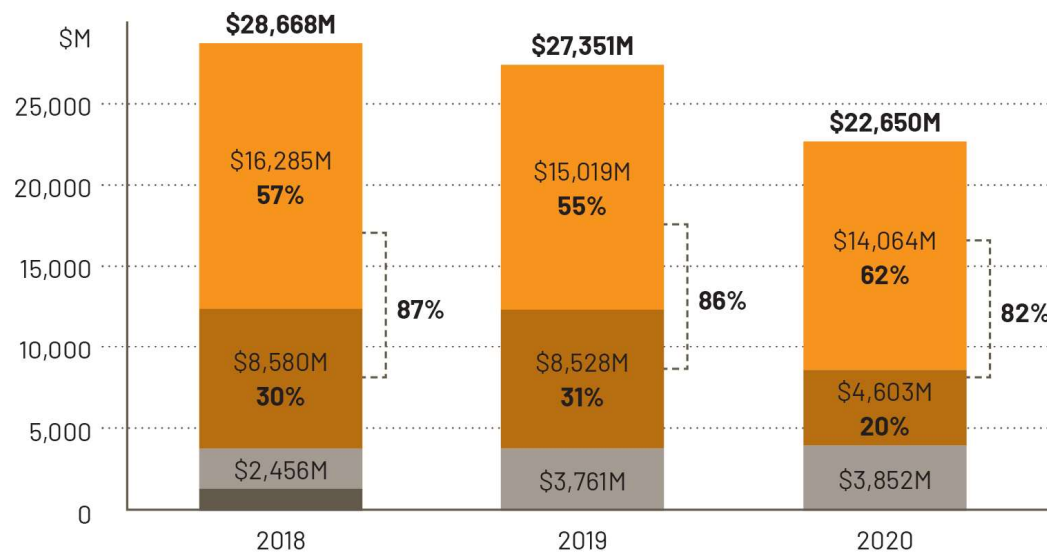
#1: Auditors continue to play a key role in upholding financial reporting quality

Audit adjustments	2018	2019	2020	Total
Entries (Count)	7,441	6,961	7,649	22,051
Lines	17,550	19,040	18,825	55,415
Amount (\$ million)	\$28,668	\$27,351	\$22,650	\$78,670

Table 1 – Proposed Audit Adjustments by Count, Lines and Amount

Audit Adjustments

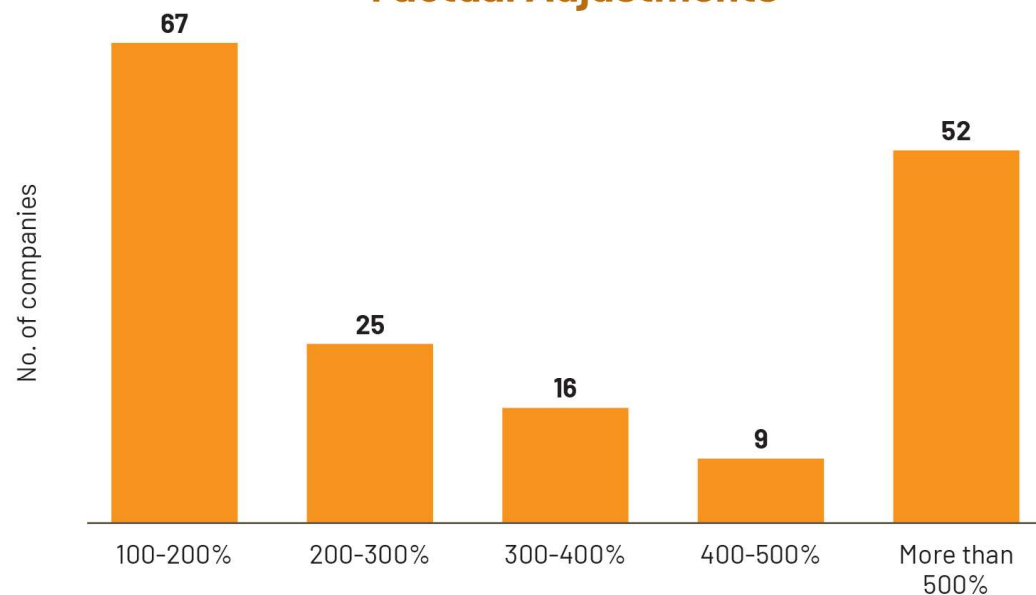
By year and type of misstatements



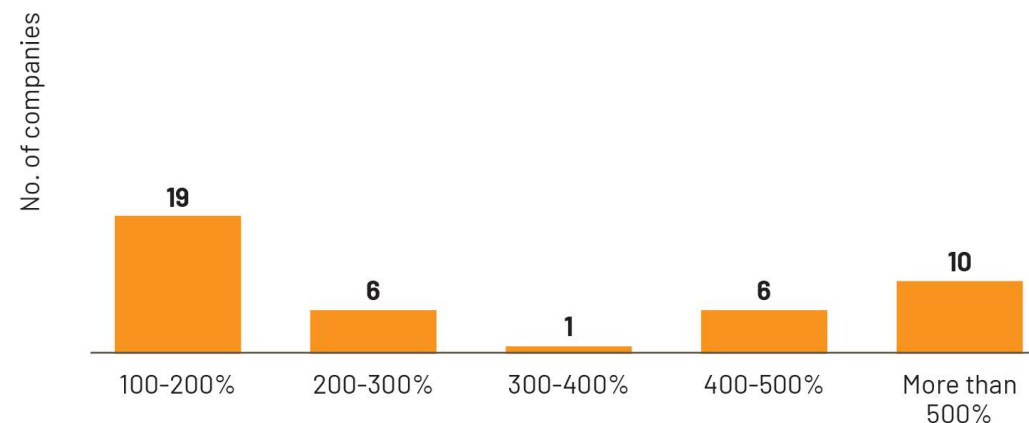


#1: Auditors continue to play a key role in upholding financial reporting quality

**2020 vs 2018
Factual Adjustments**



**2020 vs 2018
Misclassification
Adjustments**

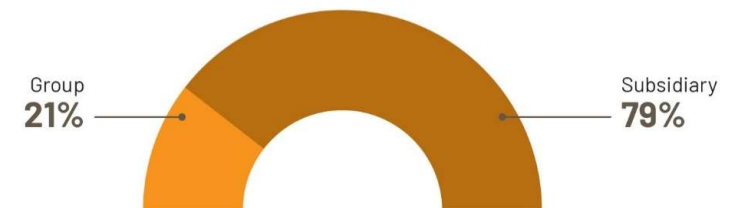
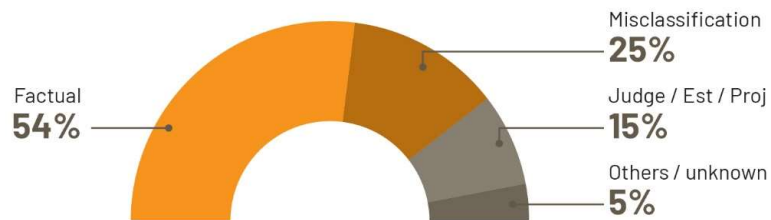




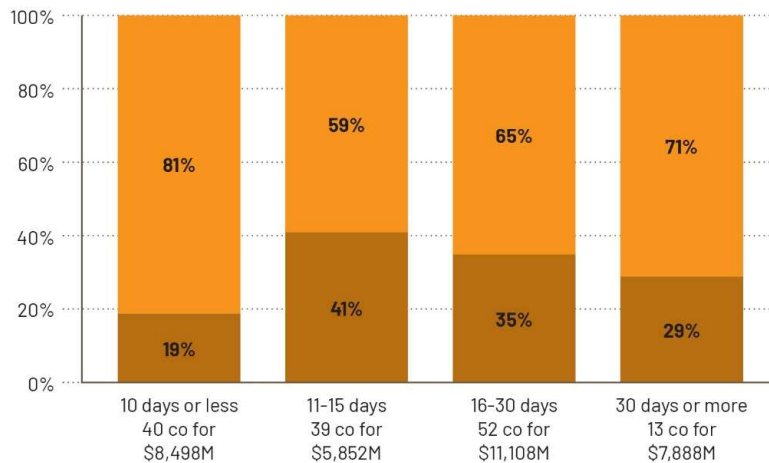
#2: Some companies have issues in finalising their accounts for audit – more than 1/3 of the proposed audit adjustments were identified by companies themselves

Late Client Adjustments

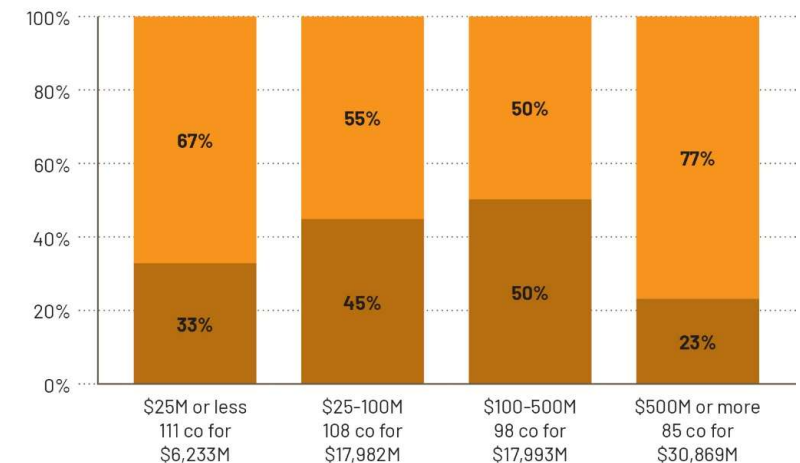
\$27.929M
(36% of total audit adjustments)



Auditor vs Late Client Adjustments by Days to Close



Auditor vs Late Client Adjustments by Market Cap





#3: Companies to pay more attention to common underlying accounting issues in their industries

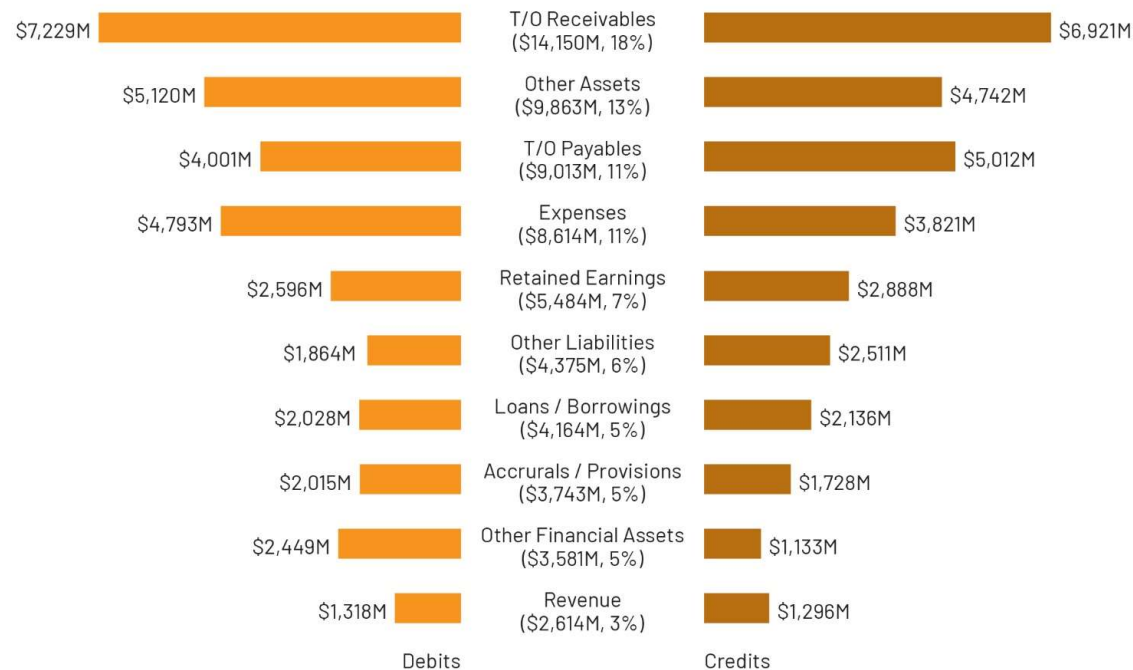
- Top 3 industries by amount: Industrials (27%), Real Estate (19%) and Consumer Discretionary (12%)
- Top 3 industries by proportional comparisons: Consumer Staples (5% of companies for 10% adjustments), Real Estate (10% for 19%), Utilities (1% for 2%)
- Impairment is more prevalent in the Energy (30%), Financials (24%) and IT (20%)
- Fair value measurements highest in Financials (33%) and Revenue recognition in Consumer Discretionary (26%)

Industry classification (no of companies, % of population) Primary accounting issues	Communications Services (7 co, 2%)	Consumer Discretionary (60 co, 15%)	Consumer Staples (20 co, 5%)	Energy (18 co, 4%)	Financial (17 co, 4%)	Health Care (16 co, 4%)	Industrials (122 co, 30%)	Information Technology (39 co, 9%)	Materials (27 co, 7%)	Real Estate (43 co, 10%)	REITs/Trusts (27 co, 7%)	Utilities (6 co, 1%)
Impairment	49M (2%)	686M (7%)	341M (4%)	870M (30%)	252M (24%)	172M (14%)	1,794M (8%)	620M (20%)	494M (13%)	1,163M (8%)	7M (0%)	91M (8%)
Revenue recognition	171M (8%)	2,410M (26%)	184M (2%)	37M (1%)	37M (4%)	41M (3%)	1,751M (8%)	114M (4%)	17M (0%)	438M (3%)	259M (5%)	172M (14%)
Recognition of assets/expenses	71M (3%)	873M (9%)	463M (6%)	26M (1%)	54M (5%)	47M (4%)	1,089M (5%)	307M (10%)	596M (15%)	890M (6%)	213M (4%)	72M (6%)
Over/under accrual/provision/deferral	321M (15%)	937M (10%)	335M (4%)	219M (8%)	52M (5%)	51M (4%)	1,514M (7%)	346M (11%)	147M (4%)	1,179M (8%)	103M (2%)	342M (28%)
Fair value measurements	39M (2%)	458M (5%)	578M (7%)	36M (1%)	346M (33%)	23M (2%)	504M (2%)	97M (3%)	15M (0%)	1,267M (8%)	159M (3%)	28M (2%)
Business combination, equity accounting and consolidation	20M (1%)	746M (8%)	339M (4%)	45M (2%)	0M (0%)	145M (12%)	479M (2%)	142M (5%)	148M (4%)	1,329M (9%)	11M (0%)	22M (2%)
Tax-related	51M (2%)	572M (6%)	208M (3%)	46M (2%)	51M (5%)	32M (3%)	441M (2%)	156M (5%)	66M (2%)	1,049M (7%)	97M (2%)	33M (3%)
Others	1,431M (66%)	2,595M (28%)	5,794M (70%)	1,590M (55%)	246M (24%)	746M (59%)	13,789M (65%)	1,271M (42%)	2,458M (62%)	7,931M (52%)	4,773M (85%)	449M (37%)
\$ and % of total adjustments by industry classification	2,153M (3%)	9,276M (12%)	8,240M (10%)	2,869M (4%)	1,038M (1%)	1,256M (2%)	21,361M (27%)	3,053M (4%)	3,940M (5%)	15,246M (19%)	5,622M (7%)	1,209M (2%)



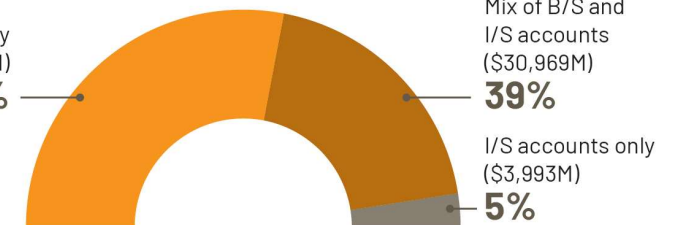
#4: Receivables, other assets and payables were line items with the highest amount of proposed adjustments

Top 10 Accounts (\$65,601M, 83%)

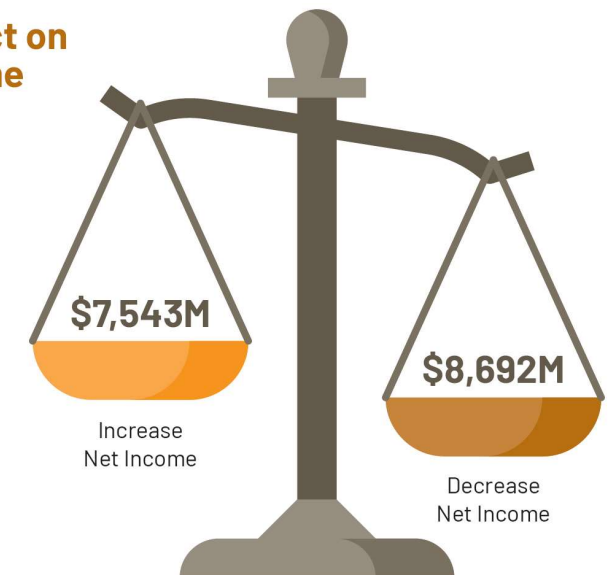


Impact on Account Pairings

B/S accounts only
(\$43,707M)
56%

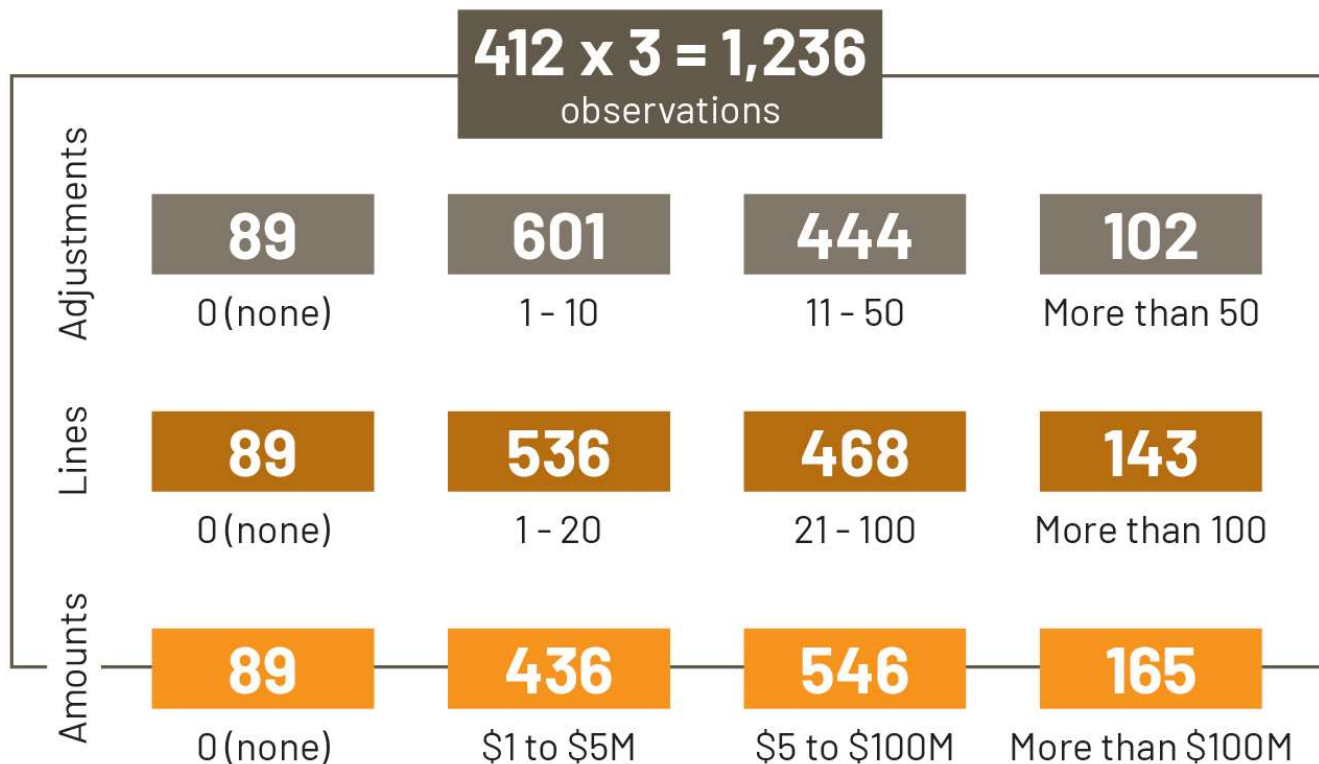


Net Impact on Net Income





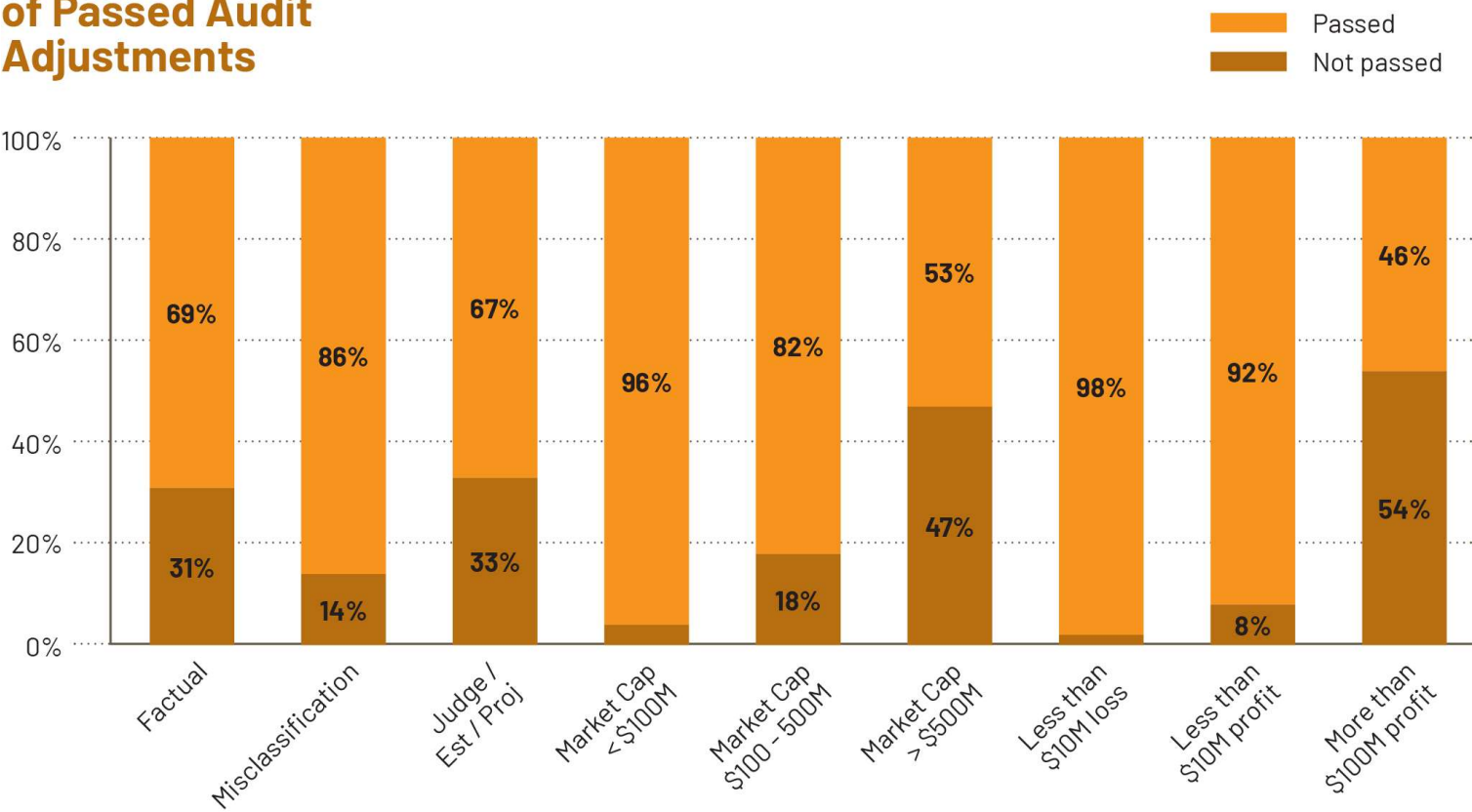
#5: A minority of companies accounted for most of the proposed audit adjustments, some with persistently high level of adjustments each year



- Twenty-eight companies had over \$100 million adjustments year after year after year, accounting for s\$39,929 million (just below 50%) of the total adjustments of \$78,670 million. No discernible profiles were noted, with different market caps and from diverse industries.

#6: Majority of the proposed audit adjustments were accepted and reflected in the published financial statements

Characteristics
of Passed Audit
Adjustments



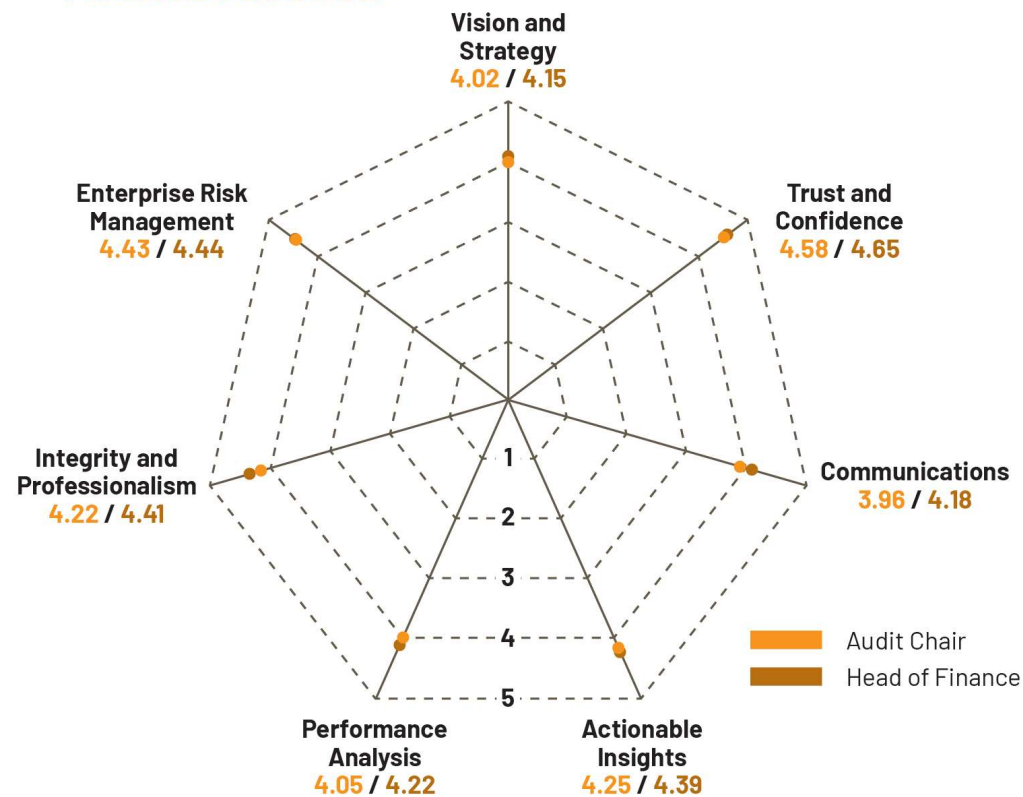
- Overall, 74% passed (vs 89% 2013)
- But when modified opinions are issued, 98% passed (71% if unqualified)





#7: The finance function was highly regarded in Trust & Confidence; perceived to have contributed less in Communications and Vision & Strategy

Effectiveness of Finance Function





#7: The finance function was highly regarded in Trust & Confidence; perceived to have contributed less in Communications and Vision & Strategy

- Tried to identify link between characteristics of ACs and CFO/HFs to audit adjustments but there was no clear link (except for below), suggesting that the level of audit adjustment is not materially related to a specific characteristic
 - On average, respondent companies with CFO/HFs holding professional accountancy memberships were associated with lower number of proposed audit adjustments (\$219 million compared to \$276 million)

Implications



Shareholders and
Other stakeholders

- Demand accountability by companies over the preparation of financial statements



Directors (incl ACs)

- Support investments in finance functions
- A questioning mind to identify and address root cause of audit adjustments

Implications



Management
(incl CFOs)

- Ensure appropriate and adequate resources, knowledge and skills-sets
- Be transparent to auditors and Boards on issues



Auditors

- Educate and communicate expectations
- Engage the preparers early



Regulatory
bodies



Membership
bodies



Institutions

- Educate and drive collective responsibility to improve financial reporting

Thank You!