Audit Adjustments Matter

2ND EDITION

What They Reveal about Companies' Financial Reporting

ACCOUNTING AND CORPORATE REGULATORY AUTHORITY

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Foreword

Company directors have the primary responsibility of presenting a set of reliable and meaningful financial statements to help investors and other users in their decision making. Thus, it is important for companies' financial reporting functions to be well governed by sound leadership and supported by a strong finance team, robust controls and effective processes.

Audit adjustments proposed by a company's auditor can indicate the company's quality of financial reporting as it identifies potential gaps between the financial statements prepared by the company and the requirements in the accounting standards. This explains why, following our inaugural study in 2014, ACRA commissioned a second study in 2021 on the proposed audit adjustments on the financial statements of listed companies in Singapore. Compared to our 2014 study, this second study gathered a broader data set from 412 Singapore listed companies over three years. The study was further complemented with a survey on the effectiveness of companies' finance functions involving close to 280 audit committee chairs and heads of finance. This allowed us to gather a more comprehensive and deeper insight into the state of financial reporting of the listed companies under the study.

The extent and impact of audit adjustments proposed by auditors to correct misstatements showed that auditors continue to perform a crucial role in upholding the quality of financial statements in Singapore. The high amount of proposed audit adjustments relating to factual or misclassification errors however also indicates room for improvement in the quality of financial statements prepared by companies. In this regard, I urge directors to analyse the underlying root causes of the audit adjustments with the company's management, pay greater attention to common underlying accounting issues more susceptible to adjustments and take actions to prevent these adjustments from occurring and recurring.

ACRA would like to express our utmost appreciation to the study researchers, Associate Professor Themin Suwardy (Singapore Management University) and Dr Lim Chu Yeong (Nanyang Technological University), for conducting the study. We would also like to thank all participating audit firms, organisations and individuals who had dedicated invaluable time and efforts to provide the data, attend focus group sessions and contribute their ideas to this study.

We hope this report will provide useful insights to all stakeholders of the financial reporting value chain, as we work together to raise the quality of financial reporting in Singapore.

Ong Khiaw Hong
Chief Executive
Accounting and Corporate
Regulatory Authority
January 2022

Executive Summary

This study investigates the characteristics, nature and extent of proposed audit adjustments to the financial statements of listed companies in Singapore. Data was gathered from the 2018 to 2020 financial statements of 412 companies, along with views of close to 280 audit committee chairs and heads of finance (or similar designations) on the effectiveness of their companies' finance function.

A financial statement audit underpins the trust and obligation of stewardship between a company and its shareholders. Proposed audit adjustments give an indication of the gap between the financial statements prepared by management and the requirements in the accounting standards. An analysis of these adjustments can provide insights into more common misstatements and their root causes, allowing directors, management, finance teams, and auditors to identify ways to rectify or minimise them and thereby improve the overall quality of financial reporting.

Key Findings

22,051
proposed audit adjustments

totalling
$78,670 million

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

Auditors proposed a total of 22,051 audit adjustments with 55,415 lines amounting to $78,670 million on 2018 to 2020 financial statements. The audit adjustments were primarily proposed to correct factual or misclassification errors totalling $67,079 million (85% of $78,670 million). A number of companies had increasing factual and/or misclassification adjustments between 2018 and 2020, suggesting underlying issues in the preparation of draft financial statements. Audit committees, management and auditors should have open and meaningful conversations about these factual and misclassification adjustments and work towards preventing similar misstatements from recurring.

36%
proposed adjustments were late client adjustments

80%
late client adjustments were factual or misclassification errors

2. Some companies have issues in finalising their accounts for audit - more than one-third of the proposed audit adjustments were adjustments identified by companies themselves after the audits had commenced

Over one-third of proposed audit adjustments (36%) were "late client adjustments", i.e. they were identified by companies themselves and conveyed to the auditors during the course of audit. About 80% of these adjustments were either factual or misclassification errors. A similar proportion of the adjustments were proposed to correct errors at the subsidiaries level. This could be due to the time pressure to close the books early for the subsidiaries' results to be consolidated at the group level. These late client adjustments occurred across companies of different market capitalisation, with the highest proportion (50%) noted for companies with market capitalisation ranging from $100 million to $500 million. Notably, a longer time taken to close the books did not appear to reduce the amount of late client adjustments. Audit committees and management should examine whether improvements can be made to the financial statements preparation processes such as investments in digital solutions or automation to minimise errors and improve the efficiency of financial year-end reporting processes. Such adjustments should be put through prior to the closing of books for audit purposes.

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

27%
audit adjustments from Industrials sector

10%
audit adjustments from Consumer Staples (5% of population)

19%
audit adjustments from Real Estate (10% of population)

The lion's share of proposed audit adjustments (27%) was from the Industrials sector, in line with its share of representation (30%) of the 412 companies. In contrast, Consumer Staples and Real Estate represented 5% and 10% of the population but accounted for 10% and 19% of the total audit adjustments. The accounting issues underpinning the audit adjustments were varied by industries. Impairment was one of the top accounting issues for the Energy, Financial and Information Technology sectors. Fair value measurements accounted for one-third of the audit adjustments in the Financial sector whilst revenue recognition was the primary accounting issue for Consumer Discretionary sector. With knowledge of the common accounting issues across different industry sectors, audit committees, management and auditors can better focus on the areas more susceptible to misstatements for the sector.

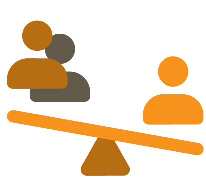
4. Receivables, other assets and payables were line items with the highest amount of proposed audit adjustments

Top 3
accounts were *Trade and Other Receivables*, *Other Assets* and *Trade and Other Payables*

The top three financial statements line items with the highest amount of proposed audit adjustments were *Trade and Other Receivables* ($14,150 million), *Other Assets* ($9,863 million) and *Trade and Other Payables* ($9,013 million), accounting for 42% of the total adjustments proposed. While most adjustments ($43,707 million, 56%) involved balance sheet only, the proposed audit adjustments led to an overall reduction in net income of $1,148 million for 412 companies over three years. Audit committees should work closely with management and finance teams to identify and remediate the root causes of audit adjustments.

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

165 out of 1,236 instances
where companies recorded over



$100 million
proposed audit adjustments in a particular year

There were 165 (13%) out of 1,236 (i.e. 412 companies over the three years) instances where the companies in the population had recorded over $100 million proposed audit adjustments in a particular year. They accounted for $62,262 million (or close to 80% of the proposed audit adjustments in this study). Out of 165 observations, 28 companies had over $100 million of proposed adjustments in each of the three-year period, with audit adjustments totalling $39,929 million (or close to 50% of the proposed audit adjustments in this study). The persistently high level of proposed audit adjustments each year is indicative of an over-reliance by these companies on the auditor to produce a proper set of financial statements. Audit committees and management in these companies should place greater scrutiny over these audit adjustments and take prompt actions to address their root causes.

6. The majority of the proposed audit adjustments were accepted and reflected in the published financial statements

74%
of proposed adjustments were accepted by companies

About three quarters (74%) of the proposed adjustments were accepted by the companies and reflected in the published financial statements. There was higher acceptance of misclassification adjustments (86%), as compared to factual (69%) or judgements/estimate/projected (67%) misstatements. Companies with smaller market capitalisation or close to break-even (i.e. low level of losses or profits) were more likely to accept the proposed adjustments and reflect them in the published financial statements. For financial statements that received modified audit reports, nearly all (98%) of the proposed audit adjustments were accepted by management. In contrast, only 71% of the proposed audit adjustments were accepted for financial statements that received unqualified audit opinions. In upholding their stance on material adjustments, auditors should explain how they have identified the adjustments and advise how these adjustments can be avoided in future.

7. The finance function was highly regarded in *Trust and Confidence* but was perceived to have contributed less in the areas of *Communications* and *Vision and Strategy*

Based on a survey on the effectiveness of companies' finance functions carried out on audit committee chairs and heads of finance, heads of finance consistently rated the effectiveness of finance functions more favourably than the audit committee chairs did across all eight areas, namely vision and strategy, trust and confidence, communications, actionable insights, performance analysis, integrity and professionalism and enterprise risk management. Both groups rated *Trust and Confidence in Internal Controls* as the strongest element of the finance function. On the other end, lowest ratings were noted for *Vision and Strategy* and *Communications*, suggesting that finance teams could do more to add value in these areas.

The findings from this study suggest that there is room for improvement in the preparation of financial statements. This calls for every stakeholder in the financial reporting ecosystem; investors, directors, management, finance teams, auditors, professional bodies, educational institutions and regulators to step up and do their part in raising the quality of financial reporting in Singapore.

About this Study

Introduction

ACRA commissioned Associate Professor Themin Suwardy (Singapore Management University) and Dr Lim Chu Yeong (Nanyang Technological University) to conduct a second study on audit adjustments. This independent study investigates the characteristics, nature and extent of proposed audit adjustments to the financial statements of Singapore Exchange (SGX)-listed companies. It builds on the inaugural study in 2014 by adding a multi-year longitudinal perspective, additional adjustment characteristics, complemented with an anonymous survey of audit committee chairs and heads of finance (or similar designations) on the effectiveness of companies' finance functions.

High-Quality Financial Information

In today's increasingly sophisticated business world, trust is the underlying key ingredient that makes enterprising activities possible. The trust creditors and investors place on a company's financial statements fosters the vibrancy of a capital market. The Conceptual Framework for Financial Reporting indicates that quality financial information will enable investments and other market participants to make informed economic decisions.

Quality, however, is seldom reflected by a single dimension or determined by one single person or department. Hence it is crucial to strengthen the financial reporting function of companies by having good people, processes, controls and tools. Each stakeholder, ranging from preparers of financial statement (i.e. company directors, in particular audit committees, management and finance teams) to auditors, investors, professional bodies, educational institutions and regulators, would need to take ownership and play their respective roles effectively to strengthen the financial reporting ecosystem.

Effectiveness of Companies' Finance Functions

Section 201 of the Companies Act makes it an obligation for directors to table financial statements that comply with the prescribed accounting standards in Singapore. The International Federation of Accountants (IFAC) suggests that a high performing finance operation, supported by four enablers: (1) data and models, (2) technology, (3) talent and skills, and (4) culture, would produce "actionable insights for better decision to create value". IFAC also advocates that an effective finance function is integral to an organisation's long-term success, thus a fit-for-purpose finance function that meets the needs of an organisation is crucially important.

If financial statements are prepared properly, CFO, management and directors are able to direct more of their attention to resolve judgemental account issues and strategic activities. If draft financial statements require significant corrections or adjustments, more efforts need to be redirected to take care of these matters prior to signing off the financial statements.

Max Loh
Chair of the Audit Committee Chapter,
Singapore Institute of Directors

> **"Having the right talent and skillsets, enabled by innovation, data, technology and continuous learning, is imperative to the success of the Finance function being a strategic partner of the business. With globalisation, constant change and evolving regulatory requirements, sustained improvement must be the norm."**

Financial Statement Audits

The draft financial statements prepared by management may (inadvertently or otherwise) contain errors, omissions, or other forms of misstatements. Many consider statutory audits as the "final line of defence" in ensuring that the public has access to high-quality financial statements that fairly represent the financial performance and financial position of an entity. An unqualified audit report provides assurance that management has prepared accounts that present a true and fair view of a company's financial performance and position, in compliance with applicable accounting standards.

The key 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 efforts that go into an audit typically extend beyond what is expressed in the auditor's report. Shareholders and general users of financial statements are often unaware of them.

One such effort or 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, misclassification, judgemental or projected misstatements on the financial statements.

Proposed audit adjustments give an indication of the gap between the financial statements prepared by management and the requirements in the accounting standards. An analysis of these adjustments can yield insights into common misstatements and their root causes, allowing directors, management, finance teams, and auditors to identify ways to rectify or minimise them and thereby improve the overall quality of financial reporting by companies.

It is important to note that an auditor's effort should not be measured solely by the number or dollar amounts of the proposed adjustments. The auditor would have performed his duties if the audit was executed in accordance with auditing standards, even if there were no proposed audit adjustments. That said, a high level of audit adjustments may suggest underlying issues with the quality of financial statements prepared by management.

> **Auditors offer an independent, critical look at a company's accounting. As auditing processes become more complex with global trends, a lot more judgement and estimates are involved. Auditors examine the submissions from the company board and management, taking an objective view and challenging significant issues. This could include querying management's judgements and checking on whether there are effective controls in place to drive trust and credibility.**

Lee Sze Yeng
Partner, Head of Audit,
KPMG in Singapore

Methodology

Twelve participating audit firms provided information on proposed audit adjustments of 412 Singapore-registered listed companies on a non-attributable and confidential basis. These companies were the firms' audit clients consecutively for the three-year period under the study (financial years 2018, 2019 and 2020). Collected data was maintained and processed in aggregates independently by the research team.

Audit adjustments may be analysed by (1) the number of journal entries, (2) the number of line items and (3) the total amounts of adjustments. To illustrate, the audit adjustment below would involve corrections to three line items totalling $600. Given that one audit adjustment can range from two line items (i.e. the minimum one debit entry and one credit entry) to many lines, it is often more meaningful to analyse them based on total adjustment amounts. Hence, the proposed adjustments in this report are assessed and compared in dollar amounts, unless otherwise stated.

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

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

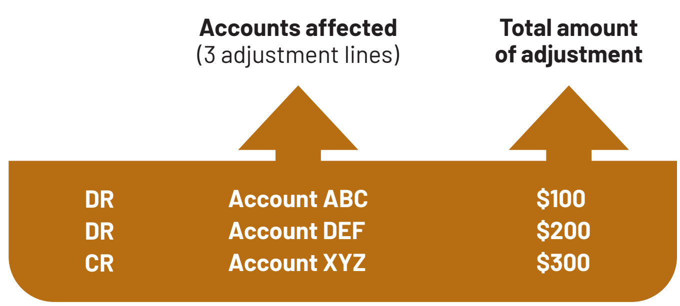


Figure 1 – Anatomy of an Audit Adjustment

In accordance with Singapore Standards on Auditing (SSA) 450 *Evaluation of Misstatements Identified during the Audit*, audit adjustments are categorised as follows:

1. Factual misstatements;
2. Misclassifications, i.e. recorded in wrong accounts;
3. Judgemental misstatements involving use of accounting estimates; and
4. Projected misstatements based on identified misstatements in an audit sample to the entire population.

For simplicity, judgemental and projected misstatements are categorised together in this report.

To assess the effectiveness of companies' finance function, the research team conducted a survey using IFAC's self-assessment tool as a base to evaluate the finance function[1]. This evaluation tool includes 16 questions on 1-5 rating scale, with supplementary questions added for this study. The participating audit firms assisted in reaching out to their clients' audit committee chairs and the heads of finance (e.g. chief financial officers, financial controllers) to complete the survey. A total of 279 responses were received from 120 audit committee chairs and 159 heads of finance.

Several briefing sessions and focus groups discussions were held with representatives of the participating audit firms, audit committee chairs and heads of the finance function.

In the inaugural audit adjustment study in 2014, data was gathered from the audits of 257 listed companies in Singapore and the total proposed audit adjustments for their financial statements for the year ended 31 December 2013 were $33,934 million. As the demographics and number of companies in the two studies are different, a direct comparison of the dollar amount of adjustments would not be appropriate. However, where relevant, percentage comparisons will be made.

Due to rounding, numbers presented in this report may not add up precisely to the totals provided and percentages may not precisely reflect the absolute figures. All amounts in this report are presented in Singapore dollars.

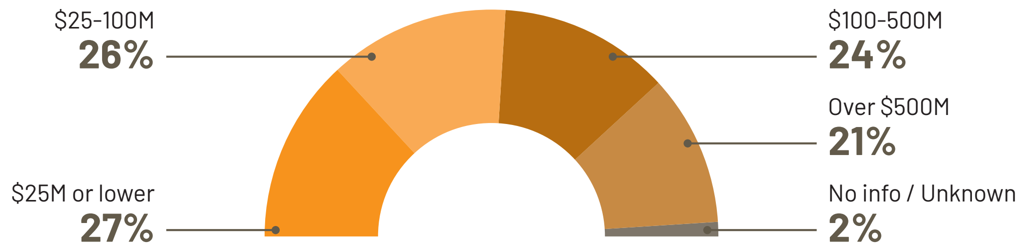
Company Profiles

Basic demographics and characteristics of the 412 companies are shown in Figure 2. Averages were used to present information involving multiple-year values (e.g. revenue, net profits and assets across 2018 -2020).

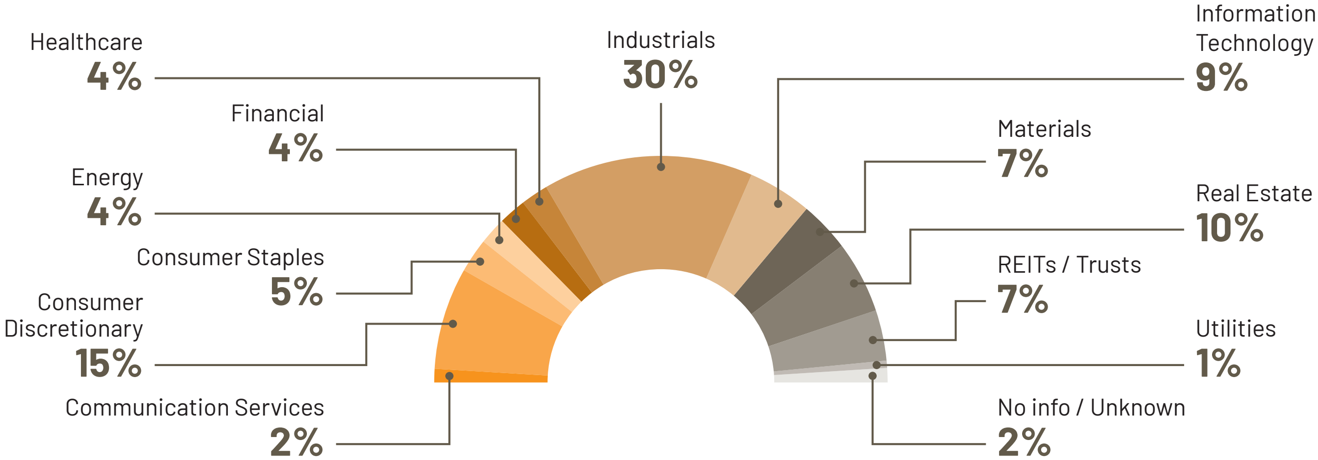
[1] The IFAC's self-assessment tool, "Evaluating the Finance Function" is available at https://www.ifac.org/knowledge-gateway/preparing-future-ready-professionals/publications/evaluating-finance-function

Market Capitalisation

As at end of 2020

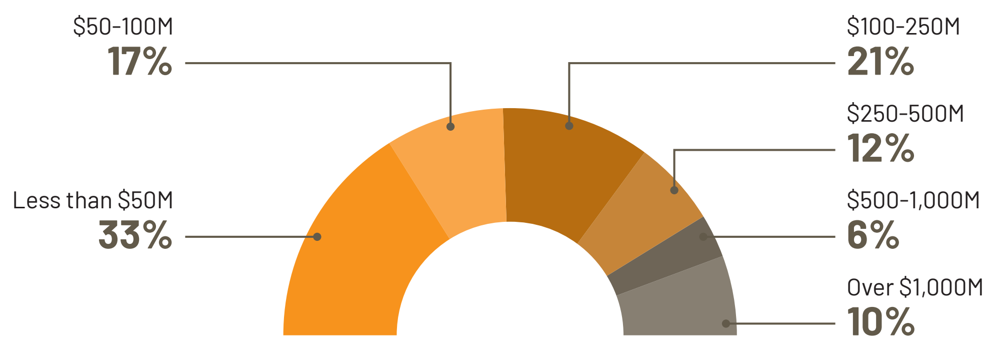


Industry Classification



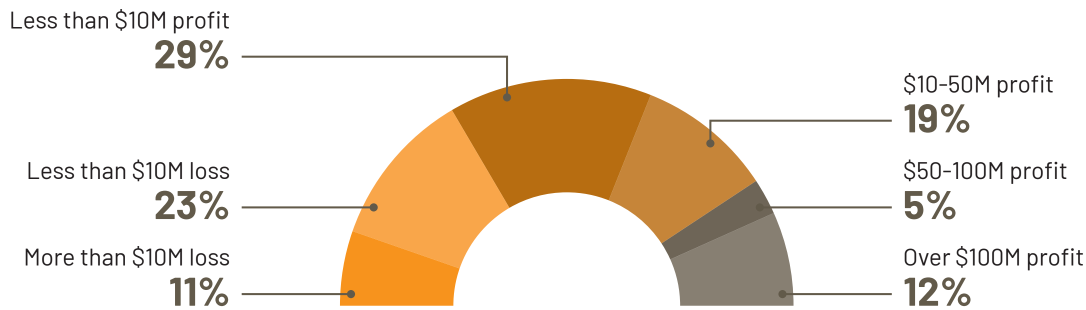
Revenue

Average 2018-2020



Net Profit

Average 2018-2020



Total Assets

Average 2018-2020

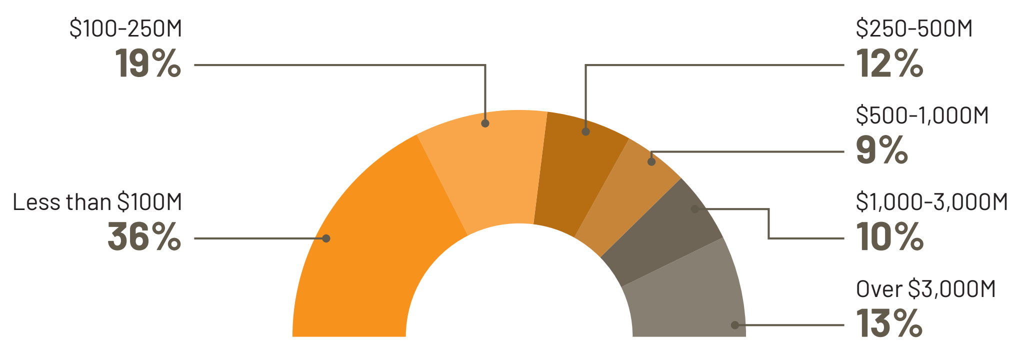


Figure 2 – Company Profiles

Key Findings

KEY FINDING 1

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

Across the three financial years (2018 to 2020), auditors proposed a total of 22,051 audit adjustments with 55,415 lines totalling $78,670 million for the 412 companies. This works out to an average of 18 audit adjustments, with 45 correcting line items, totalling $63.6 million per company per year.

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

If a statutory audit is considered as the "last line of defence" to high-quality financial reporting, one may argue any audit adjustment is a "near miss", having occurred despite the presence of internal control procedures and other forms of management oversight. The extent of proposed adjustments over the three-year period is an indicator that auditors continue to uphold their role in ensuring the quality of financial statements for the users. By the same measure, it also indicates room for improvement in the quality of financial statements prepared by management.

As described earlier, the adjustments have been grouped into three categories: (1) Factual, (2) Misclassification and (3) Judgemental, Estimates and Projections. Figure 3 shows the types of proposed audit adjustments across the study period.

Audit Adjustments

By year and type of misstatements

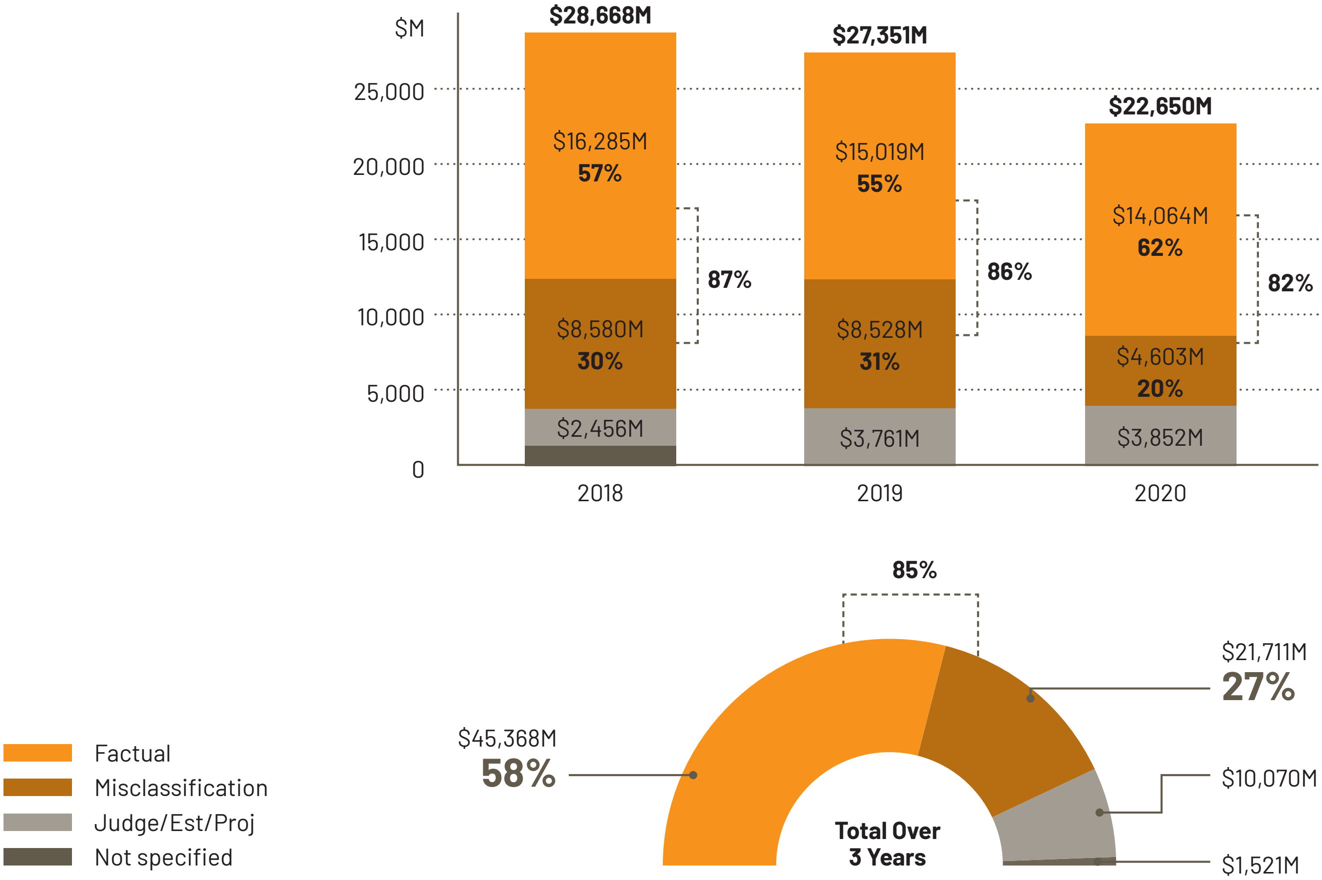


Figure 3 – Types of Audit Adjustments

The majority of proposed audit adjustments were either factual or misclassification misstatements. Together, they accounted for $67,079 million or 85% of total proposed audit adjustments over the three-year period. In the first study in 2014, they accounted for 87% of the total adjustments.

The high percentage of factual and misclassification adjustments suggests the need to address the underlying issues in the preparation of draft financial statements. The finance team should prevent or minimise these misstatements in the draft financial statements. This will allow both management and auditors to spend time and resources on more value-added activities or audit work, instead of having to address the same issues repeatedly.

Max Loh
Chair of the Audit Committee Chapter, Singapore Institute of Directors

> **“That the majority of audit adjustments were either factual or misclassification errors speaks to the need for financial reporters to take ownership and not overly rely on the auditors to pick these up. The financial reporting ecosystem needs to holistically step up in ensuring that financial reporting (including disclosures) is fit for purpose in enabling effective decision making by all stakeholders.”**

A direct comparison of the value of adjustments between 2020 and 2018 showed that many companies experienced significant increases in factual and misclassification adjustments during the period. 169 (41%) of companies saw the values of their proposed factual adjustments increasing more than two fold in 2020 as compared to 2018. In fact, the value of the factual misstatements for 52 companies were at least 5 times higher in 2020 as compared to 2018. For misclassification adjustments, 10 companies saw the value of such adjustments at least 5 times higher in 2020 as compared to 2018.

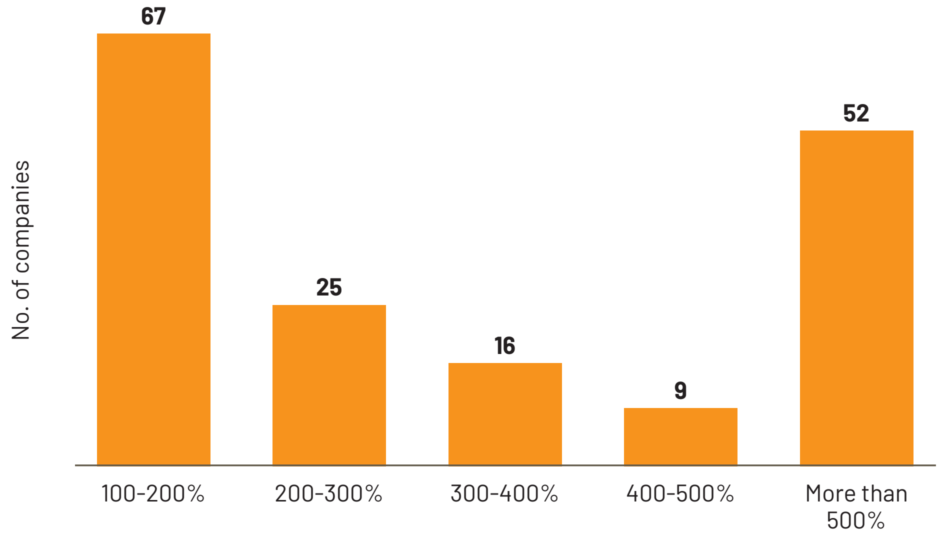
Choo Eng Beng
Partner, Assurance Leader, PwC Singapore

> **“Companies should stay on top of recurring adjustments.”**

David Gerald
Founder, President & CEO, Securities Investors Association (Singapore)

> **“The responsibility for such recurring issues lies with the AC chairman. There’s no excuse for such recurrence and it will certainly raise investors’ concerns. The AC chairman should take proactive steps to ensure that issues do not recur under his watch.”**

2020 vs 2018 Factual Adjustments



2020 vs 2018 Misclassification Adjustments

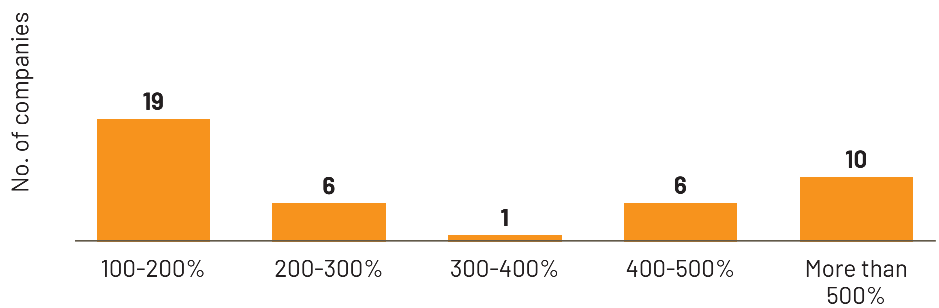


Figure 4 – Factual and Misclassification Adjustments (2020 vs 2018)

Audit committees, management and auditors need to have an open and meaningful conversation about recurring factual and misclassification adjustments. Ideally, once these misstatements are identified and corrected, the underlying root causes for these adjustments should be addressed to prevent similar misstatements year after year. For example, it may be useful to deduce if the misstatements resulted from an incorrect application of accounting standards, internal control lapses or circumstances or factors specific to a particular subsidiary or region. If root causes are uncovered and remediated promptly, the recurrence of factual and misclassification adjustments can be reduced or eliminated accordingly.

KEY FINDING 2

Some companies have issues in finalising their accounts for audit - more than one-third of the proposed audit adjustments were adjustments identified by companies themselves after the audits had commenced

One interesting observation is that not all of the audit adjustments were identified by auditors. Many clients convey known misstatements to be passed as "late client adjustments" during the audit work. This could be caused by reasons, such as the time pressure to close the books at year-end especially when dealing with business units spread across many geographical regions.

Each year, over $9,000 million of these late client adjustments (totalling $27,929 million for the three-year period) were given to the auditors to be adjusted. This represented more than one-third of the total proposed audit adjustments. The characteristics of these late client adjustments are shown in Figures 5 to Figure 7 below.

About 80% of late client adjustments were either factual (54%) or misclassification (25%) adjustments. This is fairly consistent with the extent of proposed factual and misclassification adjustments of the overall population.

A significant majority of the adjustments (79%) were proposed to correct errors at subsidiaries' level. This could be due to the time pressure to close the book early for the subsidiaries results to be consolidated at the group level. Another possible explanation would be adjustments to ensure the accounting treatment, assumptions and estimates of the subsidiaries or business units are consistent within the reporting entity.

> **"Common instances of late client adjustments include accounts closing having been finalised and hence it may not be practical to book adjustments, and this is often the case especially if the adjustments are below the materiality threshold. Also, if a set of financials have been announced publicly, there is often a reluctance to amend the numbers. The risk of not booking late adjustments is that it may result in the build-up of audit differences, which may or may not have reversing effect in the following year and hence makes tracking difficult and inefficient."**

Christopher Wong
Head of Assurance, EY Singapore

Late Client Adjustments

$27,929M
(36% of total audit adjustments)

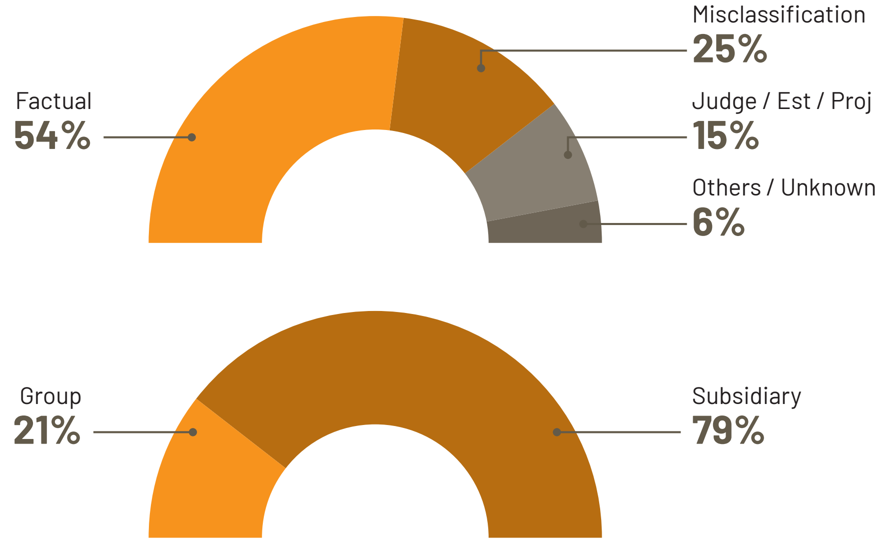


Figure 5 – Characteristics of Late Client Adjustments

The prevalence of late client adjustments was noted across companies with different market capitalisation, suggesting that the practice is not confined to companies of a certain size. However, the proportion of late client adjustments was highest (50%) for companies with market capitalisation ranging between $100 million to $500 million.

Auditors vs Late Client Adjustments by Market Capitalisation

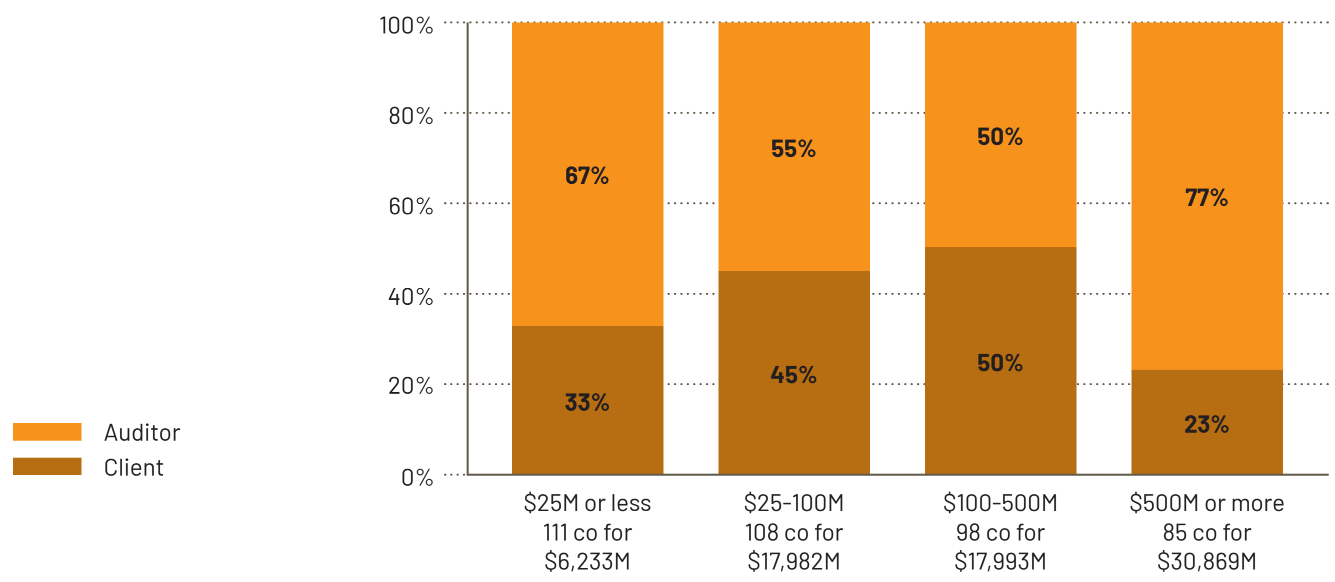


Figure 6 – Auditors vs Late Client Adjustments by Market Capitalisation

Notably, a longer time used to close the books[2] did not appear to reduce the amount of proposed audit adjustments, nor the amount of late client adjustments.

Auditors vs Late Client Adjustments by Days to Close

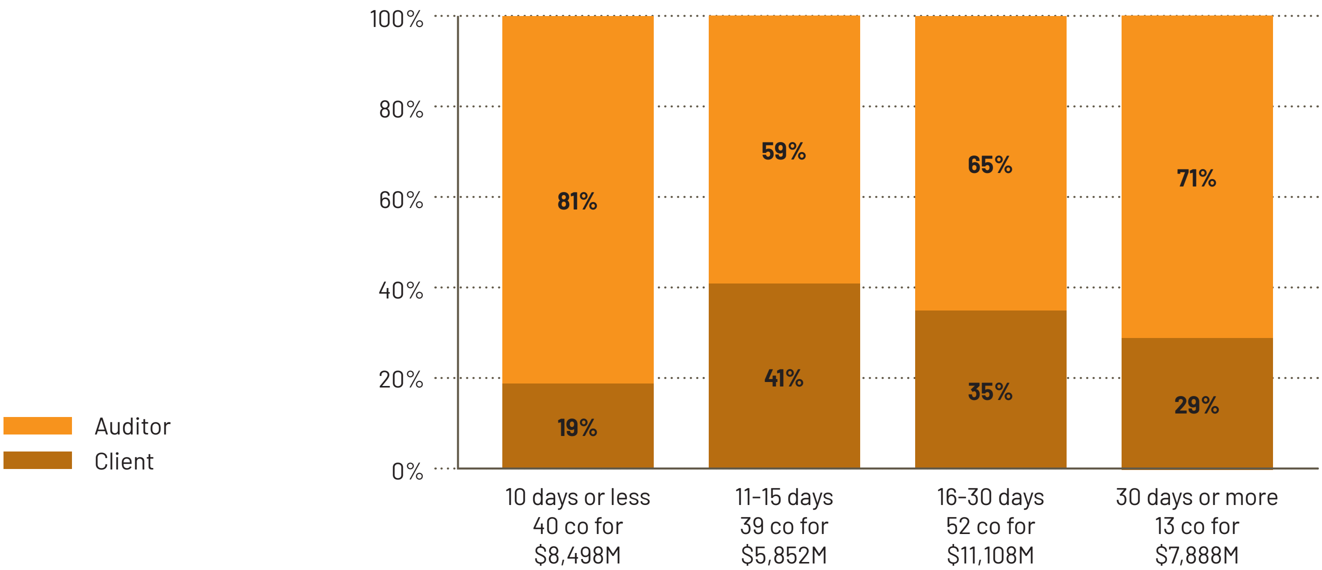


Figure 7 – Auditors vs Late Client Adjustments by Days to Close

The high proportion of late client adjustments warrants further examination by audit committees and management on whether improvements can be made to the financial statements preparation process; such adjustments should be put through prior to the closing of books for audit purposes. If the ability to close accounts early is crucial, more investments in digital transformation and automation may be necessary to improve the efficiency and effectiveness of the financial year-end processes.

> **"To ensure a good set of accounts is being prepared, a high standard of corporate governance, internal control environment and financial discipline would be key. The management could consider embarking on finance transformation initiatives to better leverage on technology tools, systems and integrated accounting software to enhance the financial reporting process and capabilities. The Audit Committee can play an important oversight role in ensuring that robust controls are in place and proper financial reporting happens."**

Shariq Barmaky
Regional Managing Partner,
Deloitte Southeast Asia

[2] This information was provided by 159 heads of finance (or similar titles) respondents who responded to the Effectiveness of Companies Finance Function survey.

KEY FINDING 3

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

Participating audit firms provided the primary accounting issue associated with each adjustment[3]. The distribution of accounting issues by the number and amounts of journal entries are shown in Table 2 below.

Primary accounting issues	Count	Count%	Amount	Amount%
Impairment	1,992	9%	$6,930M	9%
Revenue recognition	1,223	6%	$5,800M	7%
Recognition of assets/ expenses	2,845	13%	$5,712M	7%
Over/under accrual/ provision/deferral	3,788	17%	$5,700M	7%
Fair value measurements	715	3%	$3,559M	5%
Business combination, equity accounting and consolidation	354	2%	$3,424M	4%
Tax-related	2,604	12%	$2,837M	4%
Others	8,520	39%	$44,707M	57%
Total	**22,051**	**100%**	**$78,670M**	**100%**

Table 2 – Proposed Audit Adjustments by Primary Accounting Issues

A high proportion of the proposed audit adjustments were classified under "others" category, representing 39% and 57% of the adjustment count and amount, respectively. Based on focus group discussions with the participating audit firms, the proposed audit adjustments were categorised under the "others" category when it was not related to one specific accounting issue. For examples, postings to rectify incorrect line items, or calculation errors. When examined further, 95% ($42,324 million out of $44,707 million) were due to factual errors or misclassification adjustments.

The primary accounting issues associated with the proposed audit adjustments by industry sectors are listed in Table 3. Companies with unspecified industry classification are not shown. Two key observations were noted.

[3] The list of primary accounting issues was validated via focus group discussions with the participating audit firms prior to commencement of the study.

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%)**
Impairment	$49M (2%)	$686M (7%)	$341M (4%)	$870M (30%)
Revenue recognition	$171M (8%)	$2,410M (26%)	$184M (2%)	$37M (1%)
Recognition of assets/expenses	$71M (3%)	$873M (9%)	$463M (6%)	$26M (1%)
Over/under accrual/provision/deferral	$321M (15%)	$937M (10%)	$335M (4%)	$219M (8%)
Fair value measurements	$39M (2%)	$458M (5%)	$578M (7%)	$36M (1%)
Business combination, equity accounting and consolidation	$20M (1%)	$746M (8%)	$339M (4%)	$45M (2%)
Tax-related	$51M (2%)	$572M (6%)	$208M (3%)	$46M (2%)
Others	$1,431M (66%)	$2,595M (28%)	$5,794M (70%)	$1,590M (55%)
$ and % of total adjustments by industry classification	**$2,153M (3%)**	**$9,276M (12%)**	**$8,240M (10%)**	**$2,869M (4%)**

Industry classification (no of companies, % of population) Primary accounting issues	**Financial (17 co, 4%)**	**Health Care (16 co, 4%)**	**Industrials (122 co, 30%)**	**Information Technology (39 co, 9%)**
Impairment	$252M (24%)	$172M (14%)	$1,794M (8%)	$620M (20%)
Revenue recognition	$37M (4%)	$41M (3%)	$1,751M (8%)	$114M (4%)
Recognition of assets/expenses	$54M (5%)	$47M (4%)	$1,089M (5%)	$307M (10%)
Over/under accrual/provision/deferral	$52M (5%)	$51M (4%)	$1,514M (7%)	$346M (11%)
Fair value measurements	$346M (33%)	$23M (2%)	$504M (2%)	$97M (3%)
Business combination, equity accounting and consolidation	$0M (0%)	$145M (12%)	$479M (2%)	$142M (5%)
Tax-related	$51M (5%)	$32M (3%)	$441M (2%)	$156M (5%)
Others	$246M (24%)	$746M (59%)	$13,789M (65%)	$1,271M (42%)
$ and % of total adjustments by industry classification	**$1,038M (1%)**	**$1,256M (2%)**	**$21,361M (27%)**	**$3,053M (4%)**

Industry classification (no of companies, % of population) Primary accounting issues	**Materials (27 co, 7%)**	**Real Estate (43 co, 10%)**	**REITs/Trusts (27 co, 7%)**	**Utilities (6 co, 1%)**
Impairment	$494M (13%)	$1,163M (8%)	$7M (0%)	$91M (8%)
Revenue recognition	$17M (0%)	$438M (3%)	$259M (5%)	$172M (14%)
Recognition of assets/expenses	$596M (15%)	$890M (6%)	$213M (4%)	$72M (6%)
Over/under accrual/provision/deferral	$147M (4%)	$1,179M (8%)	$103M (2%)	$342M (28%)
Fair value measurements	$15M (0%)	$1,267M (8%)	$159M (3%)	$28M (2%)
Business combination, equity accounting and consolidation	$148M (4%)	$1,329M (9%)	$11M (0%)	$22M (2%)
Tax-related	$66M (2%)	$1,049M (7%)	$97M (2%)	$33M (3%)
Others	$2,458M (62%)	$7,931M (52%)	$4,773M (85%)	$449M (37%)
$ and % of total adjustments by industry classification	**$3,940M (5%)**	**$15,246M (19%)**	**$5,622M (7%)**	**$1,209M (2%)**

Table 3 – Proposed Audit Adjustments by Accounting Issues and Industry Classification

First, the proposed audit adjustments were more prevalent in certain industry sectors, namely the Industrials, Consumer Staples and Real Estate sector.

By far, companies in the Industrials sector accounted for the lion's share (27%) of the audit adjustments, with revenue recognition and impairment being their primary accounting issues. This is in line with their share of representation (30%) of the 412 companies.

In contrast, 20 companies in the Consumer Staples sector represented 5% of the study population but accounted for 10% of the total proposed audit adjustments. Similarly, 43 companies in the Real Estate sector represented 10% of the company population but accounted for 19% of the total proposed audit adjustments.

Whilst not shown in the table, REITs/Trust (97%) and Consumer Discretionary (91%) sectors exhibited the highest number of factual and misclassification adjustments. In contrast, the Financial sector exhibited more judgement, estimates or projection adjustments than factual and misclassification adjustments.

Second, the primary accounting issues varied depending on the industry. Proposed audit adjustments relating to impairment were more prevalent in the Energy (30%), Financial (24%) and Information Technology (20%) sectors, although it only accounted for 9% of the overall proposed audit adjustments. Meanwhile, adjustments relating to accruals, provisions and deferrals were more common in the Utilities (28%) and Communication Services (15%) sectors. Fair value measurements accounted for one-third of proposed audit adjustments in the Financial sector. Proposed audit adjustments relating to revenue recognition accounted for 7% of proposed audit adjustments across the board but represented 26% of the proposed audit adjustments in the Consumer Discretionary sector.

“Fair value measurement of unquoted equity investments held by companies in the Financial Industry would usually require significant judgement and estimate... For the Information Technology industry, the dynamic and fast evolving nature of technology pose challenges for companies to justify their cash flow projections to support the carrying amounts of intangible assets (e.g. patents and software code).”

Ng Kian Hui
Head of Audit, BDO LLP

Audit committees and management can use these insights to place more attention on specific accounting issues for the applicable sectors and in getting their finance team to be well-equipped in these areas, for example, through targeted training. Knowing the common accounting issues across different industry sectors would also enable auditors to better tailor their audit plans in the upcoming financial year audits to pay more attention to areas that are susceptible to misstatements.

“The findings from interim or pre-final audits, coupled with data analytics on journal entries run by auditors will be useful when shared on timely basis with clients. Regular updates to clients on changes on accounting standards, sharing of areas with high risk of adjustments and regular engagement with clients on new developments or issues could help improve quality of financial reports.”

Koh Kah Sek
Audit Committee Chair,
NetLink NBN Trust

KEY FINDING 4

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

Figure 8 shows the Top 10 line items with the highest amount of proposed audit adjustments. Cumulatively, they represented $65,601 million or 83% of the total adjustment lines and dollar amounts.

Top 10 Accounts

($65,601M, 83%)

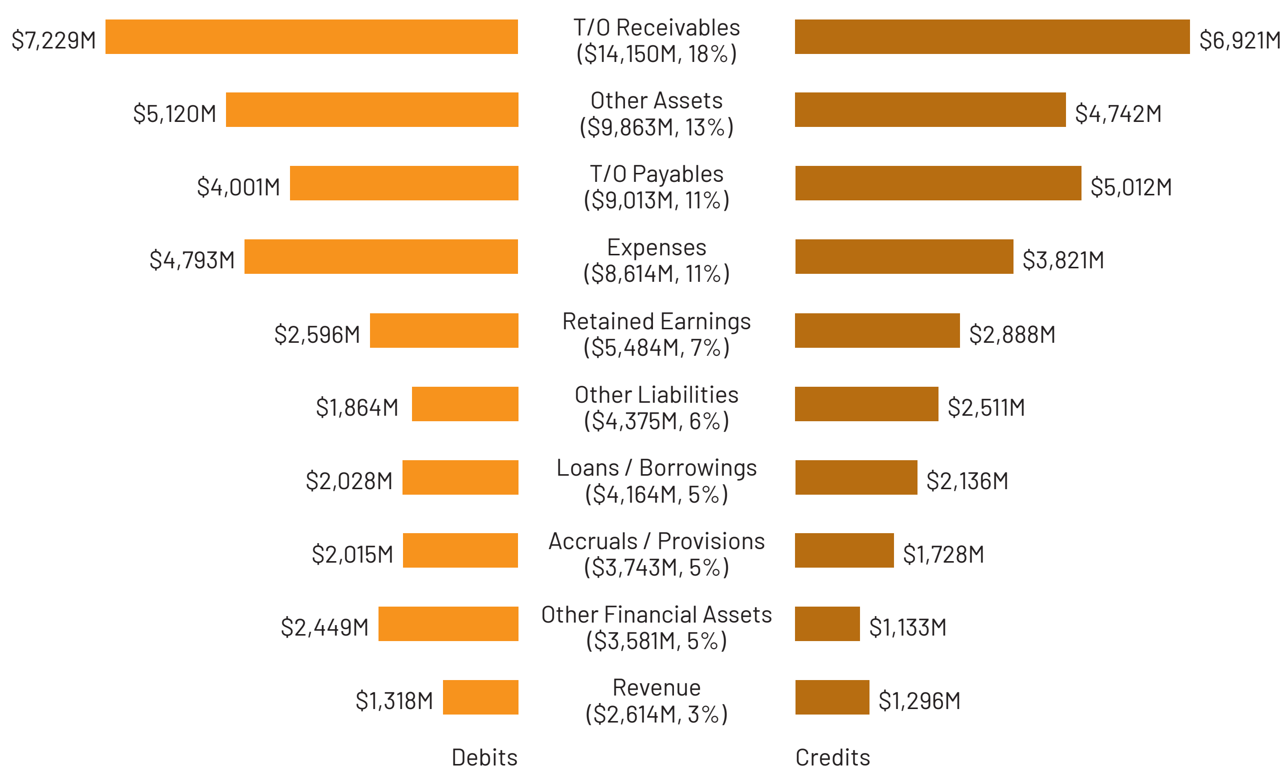


Figure 8 – Top 10 Accounts with Most Proposed Audit Adjustments

Balance sheet line items made up the top three accounts having the highest amount of proposed audit adjustments, with *Trade and Other Receivables* accounting for $14,150 million adjustments or 18% of the total adjustments, followed by *Other Assets* at $9,863 million (13%) and *Trade and Other Payables* at $9,013 million (11%). The high amounts of adjustments for Trade and Other Receivables in tandem with Trade and

Other Payables suggest that these might result from inter-company adjustments. This is further supported by the observation that about 90% of the audit adjustments were proposed to correct errors at the subsidiaries' level.

Only two income statement line items made the Top 10 list, *Expenses* at $8,614 million and *Revenue* at $2,614 million. Adjustments to other income statement accounts outside the Top 10 list include *Other Income*, *Losses*, and *Gains* totalled $5,007 million.

Additional insights can also be drawn from the direction of the adjustments. For example, the total upwards adjustments to expenses (i.e. DR *Expenses*) is at $4,793 million versus downward adjustments (i.e. CR *Expenses*) of $3,821 million, suggesting higher occurrences of under-provisioning of expense items by companies in the draft financial accounts, rather than over-provisioning.

When the pairings of audit adjustment entries were examined, 44% of proposed adjustments had an impact on net income, with $30,969 million (39%) affecting both Balance Sheet (B/S) and Income Statement (I/S) accounts and $3,993 million (5%) affecting the income statement accounts only. The majority of proposed adjustments ($43,707 million, 56%) involved balance sheet accounts only.

Impact on Account Pairings

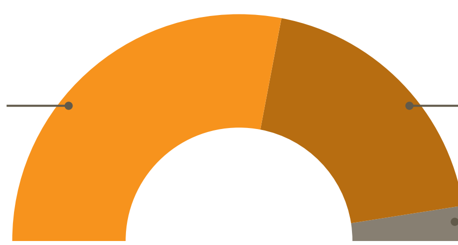


Figure 9 – Impact on Balance Sheets and Income Statements

> **"Typical examples leading to downward revisions to revenue could be due to application of SFRS(I) 15 Revenue which resulted in presentation of revenue at net basis (instead of gross) due to principal versus agent assessment; netting of variable considerations; change in estimates in revenue recognised overtime; and revenue cut-off errors, etc. These are generally more prevalent for industries that have more complex revenue streams and requires significant management's judgment and estimates."**

Shariq Barmaky
Regional Managing Partner,
Deloitte Southeast Asia

If the effects to financial statements were aggregated across each line item, one set of proposed adjustments increased net income by $7,543 million (via reduction of expenses/losses or addition to income/gains) whilst the other decreased net income by $8,692 million (via addition to expenses/losses or reduction to income/gains). On a net basis, the proposed audit adjustments led to an overall reduction in net income of $1,148 million for 412 companies over three years (2018-2020).

Net Impact on Net Income

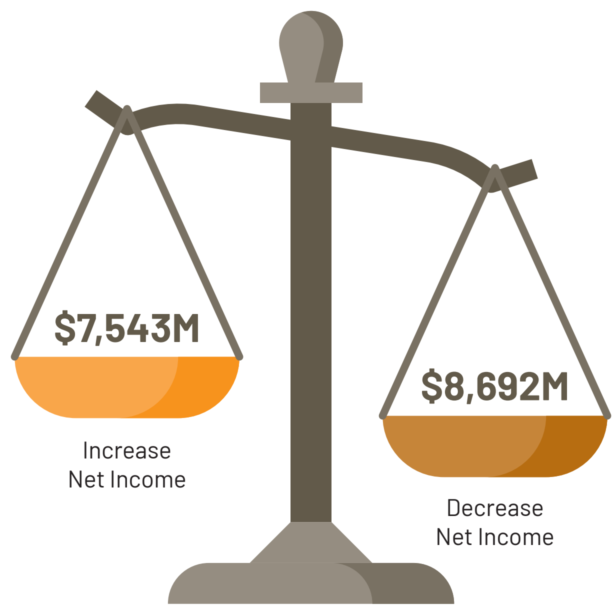


Figure 10 – Overall Impact of Adjustments to Net Income

> **"To prevent these adjustments from recurring, companies should perform a root cause analysis at the conclusion of each audit to understand the reasons for these adjustments and implement the necessary measures. These measures should be incorporated as part of the company's year-end closing procedures."**

Choo Eng Beng
Partner, Assurance Leader,
PwC Singapore

The impact of proposed adjustments across all account types reinforces calls for audit committees to work closely with management and finance teams to identify potential weaknesses in the financial reporting process and to remediate the root causes of these adjustments.

KEY FINDING 5

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

The discussion and analysis thus far have focused on characteristics of audit adjustments as a collective set of data points. An alternative perspective is to analyse the audit adjustments on an individual company basis. Given 412 companies, each with a three-year data point, the total available company-year observations were 1,236. If the adjustment data (adjustments count, number of lines and dollar amounts) were presented on a per company-year observation basis, the distribution would be as shown in Figure 11 below. This distribution should be of great interest to audit committee chairs and heads of finance to benchmark where they are (and where they want to be) when it comes to producing high-quality financial statements.

Audit Adjustments by Company-Year Observations

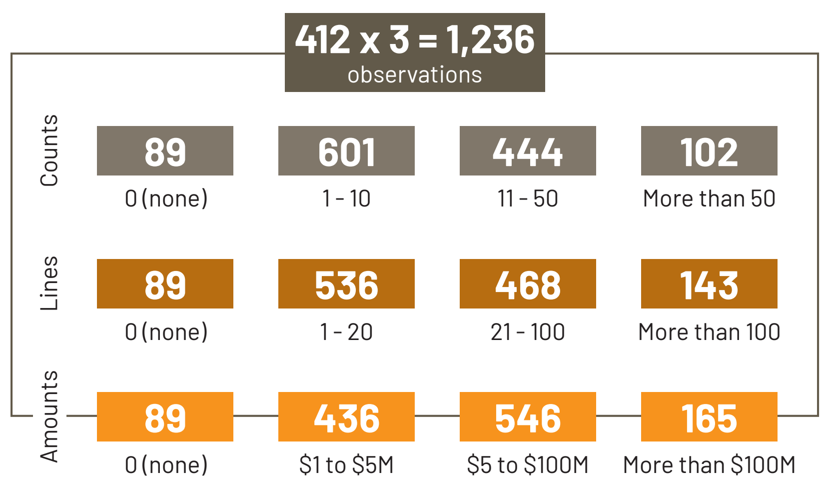


Figure 11 – Adjustment Counts, Lines and Amounts by Company-Year Observations

Of the 1,236 data points, 89 (7%) had no proposed audit adjustments at all, i.e. there was no late client or auditor adjustments. At the other end of the spectrum, 102 sets observations (8%) had 51 or more proposed audit adjustments, 143 (12%) had more than 100 line items to correct and 165 (13%) had proposed audit adjustments of $100 million or more proposed audit adjustments in the particular year. These 165 observations representing 87 companies accounted for a total of $62,262 million (or close to 80% of) proposed audit adjustments in this study. In other words, a minority (87, or 21%) of companies were responsible for the majority (80%) of the proposed audit adjustments.

> **“Companies having a high number of audit adjustments are potentially seeing a consequence of other lapses in the organisation, including the lack of emphasis to maintain a high level of financial reporting integrity. An analysis is advisable to determine the root cause and develop specific remediation. When financial reporting is accurate and timely, there is better use of resources and effort can be channelled to more productive work for the business.”**

Christopher Wong
Head of Assurance, EY Singapore

As it was possible for a company to have a higher adjustment in one year and a lower adjustment in the next year, further analysis was performed. It was observed that 28 unique companies had $100 million or more audit adjustments proposed each year over the three years. Collectively, they accounted for $39,929 million (close to 50%) of the total adjustments of $78,670 million. The 28 companies were of different sizes (market capitalisation) and came from diverse industries. The bulk of their adjustments were due to factual or misclassification errors. The persistently high level of proposed audit adjustments each year is indicative of an over-reliance by these companies on the auditor to produce a proper set of financial statements. Companies should treat audit adjustments as exceptions, rather than accepting them as norms. Audit committees and management in these companies should place greater scrutiny over these audit adjustments and take prompt actions to address their root causes.

> **“If recurrent adjustments are of a similar nature, management/finance team should look into the reason(s) for not putting through such adjustments before the commencement of audit. It is perhaps due to poor accounting discipline, for instance, the finance team is not taking pride or ownership in its work, or an over-reliance on the auditors to raise such recurrent adjustments.”**

CT Kuan
Audit Committee Chair, CNMC Goldmine Holdings Limited

KEY FINDING 6

The majority of the proposed audit adjustments were accepted and reflected in the published financial statements

Auditors are required to communicate all proposed adjustments, whether adjusted or not, to those charged with governance, typically the audit committees. Prior to the communication, the auditors must assess whether the proposed audit adjustments alone and/or in aggregate, are material to the financial statements as a whole. If they are assessed to be material, the auditors are obliged to ensure the audit adjustments be passed, i.e. reflected in the final financial statements, failing which they would issue a modified audit opinion.

> **"As an Audit Chair, I expect the company to take a serious view on audit adjustments proposed by auditors. The management is expected to examine the root causes for such adjustments and introduce fixes to the process gaps or issues as required to ensure as audit adjustments do not recur. Materiality is not a good reason for not passing the audit adjustment. Any error should be corrected. Audit adjustments which were not passed should be highlighted to audit committees."**

Koh Kah Sek
Audit Committee Chair,
NetLink NBN Trust

Based on the data collected in this study, about three quarters ($58,365 out of $78,760 million) of the proposed adjustments were accepted by the companies and reflected in the published financial statements. This was lower than the overall proposed adjustments accepted in the first study of 89%. There may be valid reasons as to why the proposed adjustments were eventually not accepted by the companies. In accepting the companies' reasons to not adjust the financial statements, auditors should also work with the company management and finance team to improve their financial processes and advise on how such adjustments can be avoided in future.

Characteristics of Passed Audit Adjustments

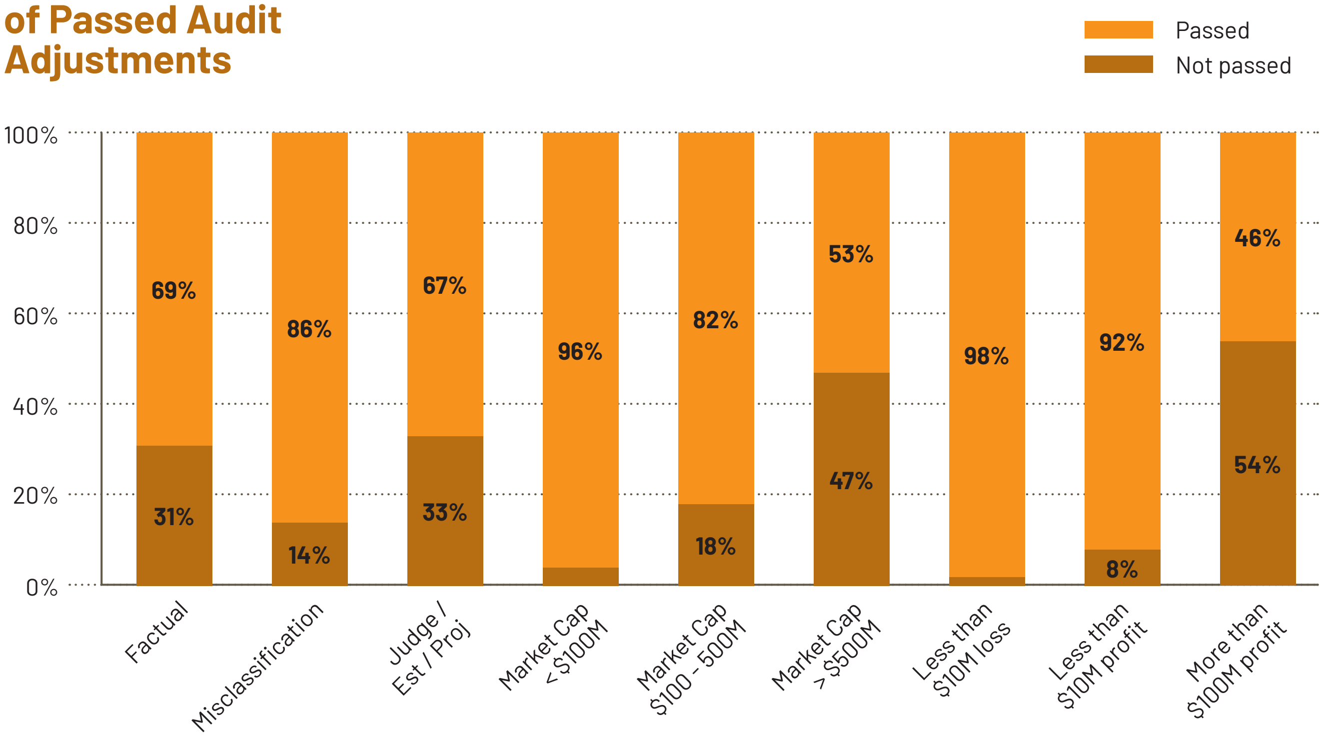


Figure 12 – Audit Adjustments "Pass" Rates

Additional examination of the characteristics of audit adjustments showed that 86% of misclassification adjustments were accepted and reflected in the published financial statements. This is compared to 69% for factual misstatements and 67% for judgement/estimate/projected misstatements.

Michael Koh
Deputy Chief Executive Officer,
P5 Capital Holdings Ltd

"In scrutinising audit adjustments, audit committees and heads of finance should generally ascertain the nature, occurrence, materiality and the consequence of not passing these adjustments."

Companies of smaller market capitalisation were found to be more likely to accept the proposed audit adjustments, as compared to larger ones. For example, 96% of proposed adjustments were accepted and reflected in the published financial statements by companies with market capitalisation below $100 million, as compared to 82% for those between $100 and $500 million, and 53% for those above $500 million.

Companies that were closer to "breakeven", i.e. less than $10 million loss and less than $10 million profit, had the highest rates of accepting the proposed audit adjustments at 98% and 92%, respectively. Meanwhile, companies with over $100 million profit has the lowest rate of accepting the proposed audi adjustments at 46%. The lower pass rates due to company size (market capitalisation or profit level) might be attributable to the higher level of audit materiality threshold.

In addition, for financial statements that received modified audit reports, nearly all (98%) of the proposed audit adjustments were accepted by management and reflected in the published financial statements. In contrast, only 71% of the proposed audit adjustments were accepted for financial statements that received unqualified auditor opinions. This is perhaps reflective of the circumstances giving rise to the modified opinions, resulting in the auditors being more cautious and persistent in making sure all adjustments were passed.

Audit Opinions and Adjustments Passed

Figure 13 – Audit Opinions and Adjustments Passed

"If the unadjusted audit adjustments have carried forward impact to the subsequent year's financial statements, companies need to ensure that these differences are taken into account early in the next financial year to avoid delay in the financial reporting process."

Ng Kian Hui
Head of Audit, BDO LLP

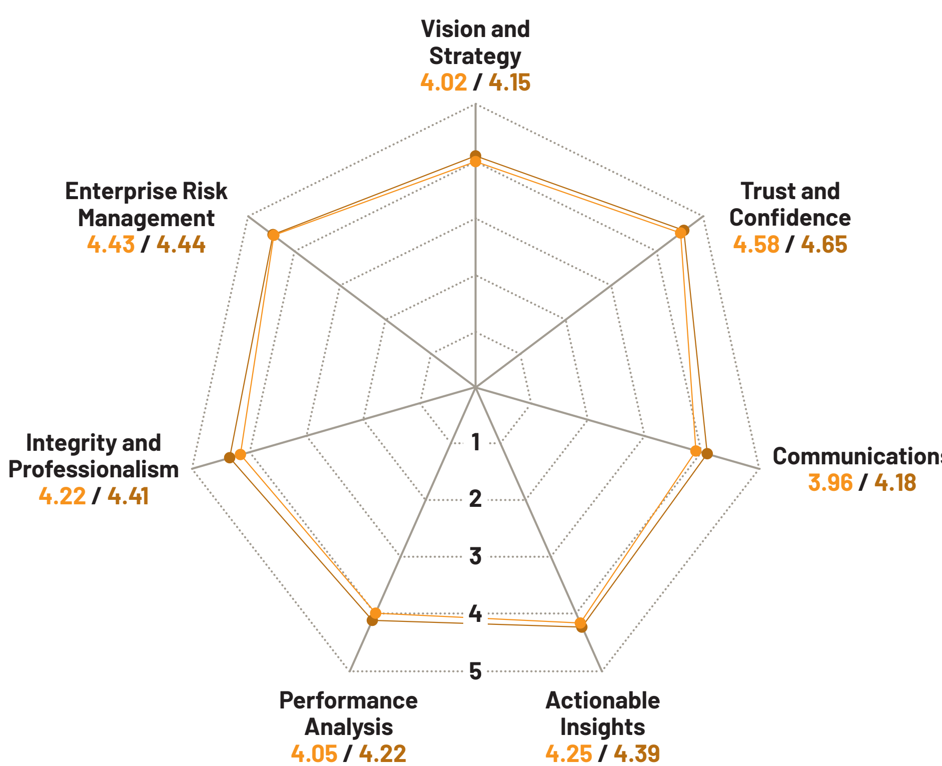
KEY FINDING 7

The finance function was highly regarded in *Trust and Confidence* but was perceived to have contributed less in the areas of *Communications* and *Vision and Strategy*

To complement the study, a survey on the effectiveness of companies' finance functions was also carried out with two groups of respondents: audit committee chairs and heads of finance (or similar designations). The survey which was based on an IFAC self-assessment tool, was meant as a starting point to examine expectations of audit committee chairs and heads of finance about how the finance functions were performing across a number of categories. A total of 279 respondents were received, 120 from audit committee chairs and 159 heads of finance.

The IFAC instrument consisted of a number of questions across seven dimensions and respondents rate their perception of the effectiveness finance function. Averages of these ratings were tabulated and when mapped together across these two groups, they showed a consistent pattern.

Effectiveness of Finance Function



Audit Chair
Head of Finance

Figure 14 – Rating of Effectiveness of Finance Function

The heads of finance consistently rated the effectiveness of finance functions more favourably than the audit committee chairs across all areas. There were similarities in the areas where both groups assess finance functions to be most and least effective. Both groups (4.65 rating by heads of finance and 4.58 rating by audit committee chairs) rated Trust and Confidence in Internal Controls as the strongest element of the finance function. On the other end, lowest ratings were noted for Vision and Strategy (4.15 by heads of finance and 4.02 by audit committee chairs), and Communications (4.18 by heads of finance and 3.96 by audit committee chairs). The area of Communications had the largest rating gap between heads of finance and audit committee chairs.

As shown in Figure 15 below, majority of the respondents completed their closing of year-end accounts within 15 days. The proportions of companies were roughly the same across different market capitalisation bands, suggesting that the size of companies did not impact the speed in which the year-end accounts closed.

> **"Quality reporting is an ongoing journey, and an evolving one in step with developments. To drive reporting excellence, companies have to develop capabilities inhouse, including talent and technologies. They will also need to cultivate a culture of candour to ensure values-driven oversight. All parties have to be committed towards achieving the highest standards of integrity and professionalism to build trust in the company and the potential it can bring."**

Lee Sze Yeng
Partner, Head of Audit,
KPMG in Singapore

Days to Close by Market Cap

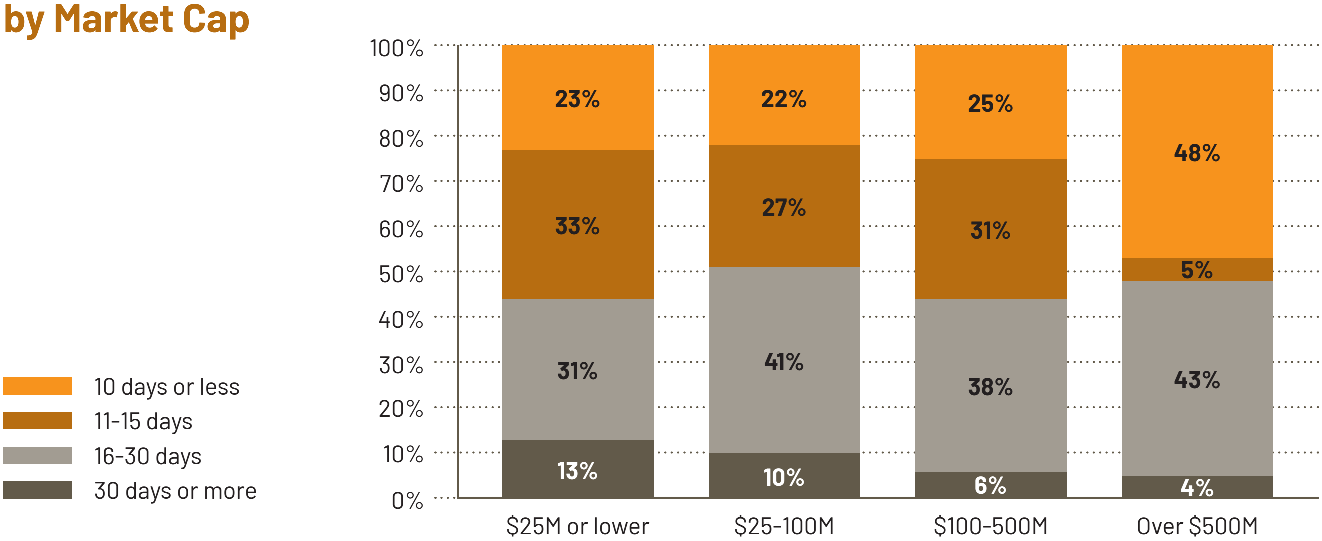


Figure 15 – Days to Close by Market Cap

Majority of the heads of finance who responded to the survey were members of professional accountancy bodies (87%), indicating that most would have accountancy qualifications and were accountancy-trained to take on this role. More than half (62%) had served for more than 5 years in their companies, suggesting familiarity to the companies' businesses and financials.

The study also considered the additional information provided by audit committee chairs and heads of finance to examine factors that may have any correlation with the proposed audit adjustments in their companies. On average, respondent companies with heads of finance holding professional accountancy memberships were associated with lower number of proposed audit adjustments ($219 million compared to $276 million).

> **“As part of good corporate governance, and to give impetus and priority to addressing the issues, the number of audit adjustments should be taken into consideration in the performance evaluation of relevant parties, from management to the finance team. Companies also need to ensure that those responsible for the preparation of the financial statements are suitably qualified.”**

Kon Yin Tong
President, Institute of Singapore Chartered Accountants

Whilst financial reporting quality cannot be achieved via just the effort of an individual alone, the importance of having proper accounting qualifications and expertise cannot be overstated. Being able to understand and appreciate the financial reporting intricacies, the head of the finance team would be able to provide leadership and drive the culture within the finance team to strive for improvements in financial reporting quality.

There was no other noticeable association between audit adjustments and size of audit committees, number of audit committee members with accounting and finance experience and the heads of finance's length of service.

Stakeholder Implications

The findings from this study suggest that there is room for improvement in the preparation of financial statements. This calls for every stakeholder in the financial reporting ecosystem; investors, directors, finance teams, auditors, professional bodies and regulators to step up and do our part in raising the quality of financial reporting in Singapore.

Investors

1. Demand accountability by companies over the preparation of financial statements

Investors require a set of reliable financial statements to make informed investment decisions. Whilst investors can rely on auditors to obtain confidence on the financial numbers, they need to hold companies responsible for preparing accurate and reliable financial statements right from the start. In this regard, investors should enquire about the volume and nature of audit adjustments passed by the auditors and have management explain the underlying accounting issues and the remediation actions taken to prevent recurrence.

Directors

2. Support investments in finance functions

An effective finance function is crucial to produce high-quality financial statements and support the oversight role of audit committees. Audit committees, in overseeing the financial reporting and audit process, should regularly assess the performance of the finance team, whether they are appropriately and adequately staffed, and how their competencies and capabilities can be improved. Boards should also be prepared to support investments in finance functions, be it through use of technology, training or strengthening of headcount and resources.

3. A questioning mind to identify and address root cause of audit adjustments

Audit committees should have open discussions with management and auditors to understand the reasons for audit adjustments, particularly the common factual and misclassification errors. They should seek to identify the root causes of the adjustments and ensure management take appropriate remediation action(s). For uncorrected adjustments, audit committees should also understand from management the reasons why they have not been passed in the financial statements. More importantly, audit committees should inculcate the culture and mindset that audit adjustments should be treated as exceptions, rather than accepting them as normal occurences.

Management and Finance Teams

4. Ensure appropriate and adequate resources, knowledge and skills-sets

The finance team should be equipped with the necessary skills-sets and adopt the mindset to "get the accounting treatment and disclosures right from the beginning". This ensures auditors are not overly-relied upon as the last line of defence for the quality of financial reporting. It is important to not only recruit adequate number of qualified individuals, but also to support their continued development and training, particularly in new technical areas susceptible to errors. Where necessary, management should also consider engaging a specialist to conduct impairment assessment or advise on the accounting treatments of complex transactions.

David Gerald
Founder, President & CEO, Securities Investors Association (Singapore)

> "Companies must up their game by ensuring that their finance functions are professionally qualified. This, together with a "getting it right from the beginning" attitude, will complement the role of the auditors."

5. Be transparent to auditors and Boards on issues

It is important for the finance team to have effective communication channels with the auditor and audit committees. In areas requiring significant judgement and estimation (e.g. expected credit losses), management and finance teams should be transparent and engage auditors and audit committees early so that the appropriate accounting treatments can be discussed and assessed promptly. This can help reduce unexpected or late client /auditor adjustments, especially towards the end of the audit, which may have a significant impact on the rest of the financial statements.

Auditors

6. Educate and communicate expectations

Given the auditors' experience with the accounting and finance processes of clients of different profiles, auditors can identify and share good accounting practices with the finance teams and audit committees. Besides explaining the rationale for the adjustments, auditors should make recommendations to their clients on how to improve the financial reporting processes so that such adjustments can be avoided in the future.

“Auditors and audit practices today are multi-skilled. Besides adding credibility to the financial statements, auditors also deliver value by providing insights on emerging trends to their clients, for example, through data analytics and benchmarking.”

Kon Yin Tong
President, Institute of Singapore Chartered Accountants

7. Engage the preparers early

Prior to the start of the audit, auditors should engage clients to discuss changes to the accounting standards or potential accounting issues. This can help reduce the frequency and extent of audit adjustments and allow auditors to focus on delivering high quality audits.

Professional Bodies, Educational Institutions and Regulators

8. Educate and drive collective responsibility to improve financial reporting

Professional bodies, educational institutions and regulators can play a part in strengthening the roles played by the various stakeholders in the financial reporting ecosystem. For a start, educational institutions provide a strong foundation to equip accountants with the necessary knowledge and skill-sets. Training programmes, guidance and support tools issued by professional bodies can help both preparers and auditors maintain their knowledge of relevant developments, understand emerging issues and their implications to financial reporting. Regulators should also encourage stakeholders to play their respective roles well, utilising the regulatory levers when necessary to improve the quality of financial reporting in Singapore.

“The accounting profession continues to revolve rapidly as new standards are promulgated to respond to the ever-changing challenges of the business world. To be effective, training must be kept up constantly to keep pace with changes – the right learning culture encouraged and supported by management is an unchanging hallmark of highly effective organisation and team. Technology may be useful, and artificial intelligence may be applied in future to pick up errors early. However, the investment must be supported by initiatives from the accounting professional bodies and regulatory authorities, including audit committees and Boards.”

Chua Hwee Song
Chief Financial Officer, Singapore Press Holdings Limited

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Accounting And Corporate
Regulatory Authority