10 Anson Road #05-01/15, International Plaza, Singapore 079903
Telephone: (65) 6227 8551 Fax: (65) 6225 1676 Website: www.acra.gov.sg

**MEDIA RELEASE**

# COMPANIES URGED TO IMPROVE PREPARATION OF UNAUDITED FINANCIALS
## – Study shows significant audit adjustments for some listed companies

**Singapore, 27 August 2014** – A study into the audit adjustments of Singapore-listed companies reveals uneven quality amongst financial statements prepared by companies prior to an audit. This was disclosed at the 9th Public Accountants Conference (PAC) today. Organised by the Accounting and Corporate Regulatory Authority (ACRA), the conference saw over 800 delegates discuss how company directors and auditors can tackle the root causes of financial reporting deficiencies to deliver reliable financial information to investors.

2. Trusted financial information is essential to promote investment and economic growth. Last year's PAC drew attention to the need for companies to take greater ownership over their financial statements. This year, ACRA commissioned the Singapore Management University to conduct a study to gauge the state of financial statements prepared prior to an audit. The proposed audit adjustments of 257 listed companies with an aggregated market capitalisation of $288.3 billion (or 31% of SGX's total market capitalisation) as of 31 December 2013[1] were studied.

3. Proposed audit adjustments give an indication of the gap between the unaudited financial statements as prepared by management and what is required under accounting standards. The study showed that this gap was significant for some companies.

**Audit Adjustments Matter - Study on the Proposed Audit Adjustments of Singapore Listed Companies**

4. The study, the first of its kind to use actual audit adjustments data, revealed a number of new key findings. These include:

[1] As of 31 December 2013, there are 776 companies listed on the Singapore Exchange with a total market capitalisation of $939.9 billion.

a. Auditors proposed a total of 3,222 sets of adjusting entries[2] with gross values adding up to $33.9 billion[3] in 257 listed companies. The average set of adjusting entries per company was 12 whilst the median was 5. This suggests that the quality of financial statements prepared by management varies, and for some, there is significant room for improvement.

b. A large majority of audit adjustments were from a minority of companies. Although these companies accounted for 13% of the surveyed population, they contributed to $24.7 billion (73%) of the proposed adjustments, with more than 20 proposed adjustments each. As the adjustments were mainly made up of factual discrepancies and misclassifications, this could indicate unevenness in the financial capacity and capability amongst listed companies. The companies with many audit adjustments need to accord more priority towards financial reporting.

c. The findings also suggest that companies in growth stages are prone to having more adjustments. Companies with market capitalisation between $100 million and $500 million (32% of population) accounted for $22.0 billion (65%) of the proposed adjustments. This could have arisen as a result of increased accounting complexity when companies scale up and expand operations, including overseas ventures.

5. Commenting on the results, Mr Kenneth Yap, Chief Executive of ACRA said: "This ground-breaking study has shown there is much room for improvement in the preparation of financial statements prior to audits. Companies with multiple audit adjustments need to shape up. Investors and company directors can and should also demand higher quality accounting from their companies. ACRA will continue to step up its enforcement of accounting standards to level the playing field and ensure the reliability of financial statements."

**Stronger focus on tackling risks and root causes of poor quality audits**

6. The conference also saw the unveiling of reforms to ACRA's audit inspection programme to make it more risk-based and to address ACRA's concerns about recurring audit deficiencies. With this reform, ACRA will focus on significant risk areas in audits and the audit firms, and thus cover more audits in greater depth. ACRA will also require audit firms to analyse the root causes of audit deficiencies and to implement action plans to prevent them from recurring.

7. To further aid the drive to reduce repeated inspection findings, ACRA has highlighted recurring and persistent audit deficiencies that will be regarded as risk

[2] One set of adjusting entry typically has at least two line adjustments, one debit line and one credit line. For these 3,222 sets of adjusting entries, there were 7,842 line adjustments, of which 3,931 were debit lines and 3,911 were credit lines.

[3] The $33.9 billion comprised the summation of the gross values of $16.95 billion worth of 3,931 debit lines and $16.95 billion worth of 3,911 credit lines.

areas under its enhanced programme, including the areas of revenue recognition, accounting estimates (including fair value measurement) and group audits. Details of the deficiencies in these key risk areas and the reforms are published in ACRA's Eighth Annual Practice Monitoring Programme (PMP) Public Report, also issued at the conference today. (*For details on the report, please refer to Annex 2*).

8. Said Mr Yap: "ACRA's audit regulation is moving from a cover to cover one-size-fits-all approach to a more targeted process that tackles the risks and challenges facing each audit firm and public accountant. This will increase the effectiveness while lightening the burden of such pre-emptive inspections on public accountants. ACRA will continue to engage audit firms on the root causes of audit deficiencies findings to ensure that they devise effective action plans, which ACRA will monitor."

**Driving improvement – stepped up engagement with Audit Committees**

9. Recognising the potential of the Audit Committees to drive improvements in financial reporting and audit quality, ACRA will work with Audit Committees to equip them with practical knowledge and best practices in financial reporting. Audit committees are in a position to see where the gaps are in the companies. They should work with the management and auditors to address them. With regard to audit quality, ACRA will explore providing selected information from ACRA's audit inspection activities to the Audit Committees.

10. For more information on the Public Accountants Conference 2014, please visit www.acra-pac.com. Published reports are available on www.acra.gov.sg.

*Attachments:*
*Annex 1: Key points from the Audit Adjustment Survey*
*Annex 2: Key Points from ACRA's Annual PMP Public Report 2014*

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**For media enquiries, please contact:**

Kate Hia
Assistant Director, Corporate Communications
Email: kate_hia@acra.gov.sg

Karen Lee
Senior Manager, Corporate Communications
Email: karen_lee@acra.gov.sg

## About ACRA

The Accounting and Corporate Regulatory Authority (ACRA) is the national regulator of business entities and public accountants in Singapore. ACRA also plays the role of a facilitator for the development of business entities and the public accountancy profession.

The mission of ACRA is to provide a responsive and trusted regulatory environment for businesses and public accountants. As at 31 July 2014, 449,964 business entities and 1,011 public accountants practising in public accounting firms, accounting limited liability partnerships and accounting corporations are registered with ACRA.

For more information, please visit www.acra.gov.sg

**Annex 1**

## Audit Adjustments Matter: Upholding Financial Reporting Quality

The study gathered rare insights into the characteristics, nature and extent of proposed audit adjustments to the financial statements of companies listed in Singapore. Commissioned by ACRA, the Singapore Management University's (SMU) School of Accountancy research team collected thousands of proposed audit adjustments communicated to the Audit Committees for the financial year ended 31 December 2013.

Proposed audit adjustments indicate the gap between the unaudited financial statements prepared by management and what is prescribed in the accounting standards. An analysis of these adjustments yields insights into the more commonly occurring misstatements and their root causes. This allows directors, management, accountants and auditors to identify ways to rectify or minimise them and improve the overall quality of financial reporting by companies.

**Research Process**

ACRA invited the accounting firms in Singapore that audit a number of SGX-listed companies to participate in this research. The seven audit firms who accepted were:

- BDO LLP
- Crowe Horwath First Trust LLP
- Deloitte & Touche LLP
- Ernst & Young LLP
- Foo Kon Tan Grant Thornton LLP
- KPMG LLP
- PricewaterhouseCoopers LLP

The participating 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 (or 31% of SGX's total market capitalisation) as of 31 December 2013[1].

These participating firms and other stakeholders also took part in focus group sessions and outreach activities during course of this study. The report includes a summary of the key views and selected quotes from the focus group.

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[1] As of 31 December 2013, there are 776 companies listed on the Singapore Exchange with a total market capitalisation of $939.9 billion.

**The key findings from the study are as follows**

1. **Companies must take more responsibility for their financial statements**

   Auditors proposed a total of 3,222 sets of adjusting entries[2] with gross values adding up to $33.9 billion[3] in 257 listed companies. The average set of adjusting entries per company was 12 whilst the median was 5. This suggests that the quality of financial statements prepared by management varies, and for some, there is significant room for improvements.

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 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.

[2] One set of adjusting entry typically has at least two line adjustments, one debit line and one credit line. For these 3,222 sets of adjusting entries, there were 7,842 line adjustments, of which 3,931 were debit lines and 3,911 were credit lines.

[3] The $33.9 billion comprised the summation of the gross values of $16.95 billion worth of 3,931 debit lines and $16.95 billion worth of 3,911 credit lines.

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.

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 and Actions required**

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 the auditors from devoting more attention on other aspects of an audit that will better demonstrate the value of an audit.

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.

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.

Please visit www.acra.gov.sg or www.smu.edu.sg for the full report.

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**For media enquiries, please contact:**

**Accounting and Corporate Regulatory Authority**
Kate Hia
Assistant Director, Corporate Communications
Email: kate_hia@acra.gov.sg

**Singapore Management University**
Themin Suwardy
Associate Professor of Accounting (Practice)
Email: tsuwardy@smu.edu.sg

**Annex 2**

## KEY INFORMATION FROM ACRA'S ANNUAL PMP PUBLIC REPORT 2014

### Key Observations from the Practice Monitoring Programme

1. ACRA places emphasis in communicating with public accountants to share the common areas of recurring findings so as to help public accountants focus their remediation efforts in these areas. The annual PMP Public Report is one of the means to achieving this. This year, ACRA has adopted a fresh approach in presenting its inspection findings. The findings in this report are featured as part of a case study, mirroring some of the observations and scenarios encountered during its inspections.

2. ACRA hopes this approach would enable public accountants to better understand the nature and circumstances in which the findings arise. By highlighting real life examples where the pitfalls occurred, ACRA also aims to provide greater clarity and transparency of its assessment on the adequacy of work performed by public accountants in these areas of concern.

3. The key findings highlighted in this year's report relate to the following broad themes:
   - Revenue recognition;
   - Accounting estimates and fair value measurement; and
   - Group audits.

   Given the recurrence of findings in these themes over the years, they will be included as risk focus areas under ACRA's enhanced risk-based approach.

4. Going forward, ACRA will also engage the firms on the root causes of findings to ensure that the action plans devised are appropriate and monitored for effectiveness. Firms should adopt a longer-term mind-set in implementing sustainable remediation initiatives and not resort to quick fixes.

### Enhancements to ACRA's Inspection Programme

5. ACRA's inspection programme, comprising both the firm-level and detailed engagement inspections, follows a risk-based approach. They are periodically reviewed for improvements to ensure that the inspection process remains effective, efficient and relevant. The latest review exercise, carried out in late 2013/early 2014, contains the most significant enhancements to ACRA's inspection programme since its commencement in 2005.

6. These enhancements were aimed towards achieving the following broad objectives:

- **Ensure inspections are risk focused**

  ACRA will move away from cover-to-cover inspections and focus only on significant risk areas. This heightened focus aims to protect public interest and delineate ACRA's role from that of an educator which can be more effectively performed by the accountancy professional bodies in Singapore. Further, ACRA is confident that firms and public accountants will be able to remediate the less significant risk areas without direct regulatory intervention.

- **Ensure remediation of root causes that led to audit deficiencies**

  In line with global efforts initiated by IFIAR to target remediation at the root causes that led to audit deficiencies, ACRA will be incorporating a post-inspection root cause analysis into the enhanced PMP methodology.

- **Streamlining inspection efforts to avoid duplication of resources**

  With the role of the FRSP in monitoring non-compliances of financial statements with the FRSs, the PMP inspection would correspondingly place little or no emphasis on aspects relating to financial statement disclosures in detailed engagement inspections. This is to better optimise the use of resources and prevent duplication of inspection efforts.

7. These enhancements are expected to lessen the inspection burden imposed on firms and public accountants whilst ensuring that they remain rigorous and challenging in areas that matter. It will also enable better use of ACRA's resources to more efficiently cover risks throughout the audit market.

8. These enhancements, covering both ACRA's firm-level inspections and detailed engagement inspections have been incorporated into inspections commencing from 1 May 2014.