



The Value of Enhanced Auditor's Reports

A Review of Expanded Disclosures



01
Foreword

03
Introduction:
The Enhanced Auditor's Report



04
Roundtable on the
Enhanced Auditor's
Report



07
About the Study

08
Analysis



12
Sector
Deep Dive

19
Other Observations

20
Conclusion

Foreword

The financial upheaval first unleashed by the Global Financial Crisis of 2008-09, and the resulting economic turbulence and uncertainty which has lingered throughout the last decade, brought the role of audit to the fore. How can auditors play a more effective role in promoting good company stewardship?

Such is the driving question which has led us to enhanced audit reporting today. Enhanced audit reporting, in brief, places a greater focus on sharing information with all stakeholders around the discussions and perspectives of external auditors and audit committees.

Enhanced audit reporting and disclosures of key audit matters (KAM) facilitates deeper dialogues between management, audit committees and board directors on the work of the auditor, their insights and judgement. This dialogue is a critical element of the governance that is important to the financial reporting process of companies.

The disclosure of KAM in the audit report allows all company stakeholders to understand the key issues, judgments and estimates made by management and boards and considered by the external auditors to derive the audit conclusion, beyond the historic binary pass-fail opinion.

We conducted this study to understand how KAM was being implemented in various developed markets such as Australia, the United Kingdom (UK), Hong Kong (HK) and Singapore, and considered the experience of Singapore companies in the first year of its implementation.

Looking beyond just publicly available information, we also conducted a roundtable with The Business Times in Singapore to discuss the pertinent issues

with CFOs, audit committee chairpersons, regulators and investors. The overwhelming view was that the reporting of KAM was a positive step forward in good governance by providing insight into previously private discussions between auditors and boards. The call was for continued progress from year one where innovations such as voluntary disclosure of findings were made and a word of caution that these disclosures do not become sanitised over time.

We are pleased to note that, following the first year of implementation, most issuers have moved beyond the historic 'boilerplate' style of reporting. They have provided more company specific information about judgments made by management and boards, and the impact on key audit risks and the auditor's approach.

We have also observed a fairly consistent average number of KAM, and types of KAM issued across various countries which are adopting this for the first time, including those in Australia and HK.

We hope you will find this report useful in your consideration of enhanced audit reporting, and welcome any questions you have.



Roger Tay
Head of Audit
KPMG in Singapore



Introduction: The Enhanced Auditor's Report

On 30 July 2015, the Institute of Singapore Chartered Accountants issued new and revised auditor reporting standards that require auditors in Singapore to expand their audit reports to include disclosures on KAM and the auditor's approach to these areas. These new and revised standards are mandatory for all public listed companies in Singapore with annual periods beginning on or after 15 December 2016. A few companies also chose to adopt the revised standards early, and reflected the new requirements in their FY2015/16 annual reports.

What are the main changes to the auditor's report?

Central to the revised standards are the inclusion of KAM. KAM are matters that, in the auditor's judgment, are of most significance in the audit of financial statements. These are generally extracted from the matters communicated to 'those charged with governance', such as the audit committee or board of directors. As such, the KAM provide greater transparency into the audit process.

The revised auditor's report includes a description of why the matter is a KAM, how the matter was addressed in the audit and in some cases, the results of the audit procedures performed. In this way, users of financial statements will better understand a company and where management judgement was exercised.

Other key changes to the auditor's report relate to the auditors' comments on the consistency of "other information" attached to the financial statements.

The auditor's report also includes comments that should provide users of financial statements with a fuller understanding of what the auditors considered in order to form the opinion that an entity was operating as a going concern.

Key audit matters in other jurisdictions

The revised auditor reporting standards are consistent with those issued by the International Auditing and Assurance Standards Board, the Financial Reporting Council in the UK and a growing number of global jurisdictions. For example, HK and Australia have introduced similar changes to the external auditor's report for audit reports issued on or after 15 December 2016.

In the UK, the revised standards have been mandatory for listed entities for the last three reporting years and provide some precedent guidance in applying these new requirements. However, the UK's implementation experience suggests that there is still room for improvement.¹

Investors in the UK have expressed the view that many audit reports still do not go far enough in explaining how previously assessed risks were evolving from one year to the next and more enhancements could be made to the auditor's report. The suggestions include providing more complete information about: the sensitivity ranges used in testing, the assessment on quality of internal controls, and the auditor's view on the appropriateness of management's use of estimates.

¹ <https://www.frc.org.uk/getattachment/76641d68-c739-45ac-a251-cabbfd2397e0/Report-on-the-Second-Year-Experience-of-Extended-Auditors-Reports-Jan-2016.pdf>

Roundtable on the Enhanced Auditor's Report

KPMG- The BusinessTimes Roundtable on the value of enhanced auditor reporting

In July 2017, KPMG in Singapore, together with The BusinessTimes, facilitated a roundtable with key stakeholders, including representatives of management, audit committees, investment firms, the regulator, and the accounting profession, to further examine how the revised auditor reporting standards impact the audit process and the users of financial statements.

The discussion concluded that enhanced audit reports are a welcome move away from the rigid formats of the past, and improve the quality of disclosures and understanding about a company among stakeholders. There is concern, however, about whether companies and auditors will adopt boilerplate and watered-down language in subsequent reports.

Key benefits: Flexibility for qualitative discussion

The benefits from enhanced audit reporting stem chiefly from the move away from the binary, pass-fail nature of the old reporting standards.

The discussion of KAM gives auditors and companies an invaluable opportunity to shed light on the nuances and assumptions that lie behind the financial statements.

For companies, the enhanced report can help officers of the company to gain a more holistic understanding of what factors are considered important from the auditor's perspective, enabling them to take additional steps to strengthen internal processes.

For users of financial statements in general, the additional information enables users to better identify risks and uncertainties in relation to the financial statements of the company.

Key challenges: Effective communication

For those involved in producing the enhanced audit report, the most common challenges relate to communicating the new content. Such challenges include: figuring out how much to disclose in the report; how to provide a meaningful discussion of assumptions without providing forecasts; and how to reflect the appropriate tone in discussing KAM.



"It takes some of the mystery out of what actually the auditors do, and what audit committees do, and how finally the opinion is arrived at, and I think the educational impact of this whole process cannot be underestimated."

Gautam Banerjee
Independent Director and Audit Committee Chairman,
Singapore Airlines Ltd



For example, in discussing goodwill, a company might use forward-looking projections that extend over the next 10 or 20 years. But sharing those projections must be done in a way that does not imply that the company is making a prediction.

Moving forward

While the outlook for the enhanced auditor's report is positive at this early stage, the question is how to further improve the reports in subsequent years.

Some stakeholders, particularly participants from the buy side, are keen to see the auditor's report go beyond the obvious financial matters to consider issues of strategy, sustainability and resilience. They are interested primarily in commentary rather than in processes and governance, and insights into how certain decisions were arrived at.

Companies and auditors, on the other hand, may be reluctant to veer too far away from the traditional format of the report. The auditor's report typically looks ahead only until the next report, 12 months later, and is chiefly concerned with the financials.

While further expansion of the auditor report's scope will potentially provide extra benefit to users, its implementation, especially of the more subjective points, will be difficult for those preparing it.

Persistent issues: The boilerplate approach

The key test for the new auditor reporting standards will come in the years ahead. As the impact of the new standards continues to play out, and preparers of financial statements refine their approach to addressing the requirements, the question is whether subsequent reports will revert to boilerplate discussions against the spirit of the new standards.

That scenario could occur if auditors and companies are worried about investors raising too many questions, and choose to "play it safe" as a result.

Smaller companies may be at higher risk of going down that path, because of the additional burden they may feel in having to raise their reporting standards. Companies that do not receive as much scrutiny from shareholders are also more likely to revert to a boilerplate approach after the initial



"How do you communicate enough to let the people know – these are the challenges, but don't worry, your board has understood the issues, dealt with them and the auditors agree?"

Yap Chee Keong
Independent Director and Audit Committee Chairman,
Sembcorp Industries Ltd



"Consider this outcome: you issue an unqualified report, and then you have to list out KAM. Unless you are very careful about what is said, people will ask: why is this an unqualified report? No one likes to have to answer such questions. Hence there will be a tendency to water down the report's content."

Lee Chong Kwee,
Chairman, Mapletree Logistics Trust Management



disclosures. At the end of the day, the users of financial statements will play a critical role in staving off that outcome.

We thank our roundtable participants for their valuable contributions: Gautam Banerjee, chairman of Blackstone Singapore, board member of Singapore Airlines and a number of listed and private companies; Lee Chong Kwee, chairman of Mapletree Logistics Trust Management; Neelamani Muthukumar, chief

financial officer of Olam International; Malcolm Ramsay, KPMG in Singapore audit partner; June Sim, head of listing compliance at the Singapore Exchange; David Smith, head of corporate governance at Aberdeen Asset Management Asia; and Yap Chee Keong, a veteran director who sits on a number of boards and audit committees.



"If you look, for example, at non-performing loans or certain sector exposures in banks, you'll see language along the lines of, 'We were satisfied with our classification'. But what we will always look for is commentary around the process through which this decision was reached."

Dr David Smith, Head of Corporate Governance,
Aberdeen Asset Management

About the Study

To better understand how enhanced audit reporting requirements are being implemented, we took a snapshot comprising the annual reports of 994 listed entities and companies across Singapore, UK, HK and Australia as at 28 April 2017.

We analysed the number and types of KAM communicated in their auditor reports, by geography, risk types, and industry.

Breakdown of analysed reports by industry sector and geography

The majority of reports in our sample (43%) were from companies listed on the Singapore Exchange. In addition, we analysed reports from companies listed on the London Stock Exchange (35%), the Hong Kong Stock Exchange (16%) and the Australian Securities Exchange (7%)².

By industry sector, the majority of reports came from companies in the real estate sector (15%), followed by the banking and financial services sector (10%) and the manufacturing sector (9%). The full breakdown of reports analysed is shown in Figure 1.

Figure 1 – Reports by industry sectors and geography

Industry Sectors	Australian Securities Exchange	Hong Kong Stock Exchange	London Stock Exchange	Singapore Exchange	Total
Real Estate	8	30	32	78	148
Banking and Financial Services	9	13	62	18	102
Manufacturing	1	13	14	66	94
Energy and Natural Resources	18	10	26	32	86
Construction and Engineering	5	5	9	45	64
Electronics	1	17	10	34	62
Consumer	-	13	20	15	48
Food and Beverage	1	5	16	25	47
Shipping, Transport and Logistics	2	6	10	26	44
Healthcare	2	5	16	15	38
Others	23	39	130	69	261
Grand Total	70	156	345	423	994

² **Singapore** – All listed companies with year ends in calendar year 2016, with issued reports under Singapore Standards of Auditing (SSA) and International Standards of Auditing (ISA) as at 28 April 2017.

London – Constituents of Financial Times Stock Exchange (FTSE) 100 and FTSE 250 with year ends in calendar year 2016, reporting under ISAs as at 28 April 2017.

Hong Kong – All listed companies with year ends in calendar year 2016, with issued reports under Hong Kong Standards of Auditing (HKSA) as at 28 April 2017.

Australia – All listed companies with year ends in calendar year 2016, with issued reports under Australia Standards of Auditing (ASA) as at 28 April 2017.

Analysis

By Geography:

Key takeaway: The number of KAM reported is affected by the unique characteristics of the entity's jurisdiction.

We observed a clear difference in the number of KAM reported in each jurisdiction. Reports from the UK had the highest number of KAM, followed by Australia, Singapore, and HK. The number of KAM by geography is illustrated in Figure 2.

Reports with higher number of KAM

The UK reports are notable for the higher number of KAM communicated. On average, UK reports communicate up to 33% more KAM than reports from the other jurisdictions.

Three elements may drive this difference. Firstly, this may reflect the relatively tougher economic environment in the UK in the light of Brexit, which may have led to more audit issues requiring reporting. Secondly, it may reflect the relatively longer experience that UK auditors have in reporting KAM. The UK is in its third year of implementation, while the other jurisdictions in this study are in the first year. Finally, it may reflect the size of the companies in the jurisdiction. Many of the larger UK entities have relatively larger global operations and therefore face more complex issues. In comparison, listed companies on the other exchanges are often smaller and more regionally focused, although there are still many companies with global operations.

Reports with no KAM reflected

Of the 994 independent auditor reports that were reviewed, 10 reports from the Singapore Stock Exchange (2% of SGX reports reviewed) and 1 report from the London Stock Exchange (0.3% of LSE reports reviewed) had no KAM reflected.

Of the 10 reports issued in Singapore, 2 explained that there were no KAM as the entity falls under the

definition of a "cash company" under Rule 1017 of the Listing Manual Section B: Rules of Catalist of the SGX-ST. Seven others did not report KAM as a disclaimer of audit opinion was issued.

This is in line with the SSA paragraph 16 which states that if the auditor determines, based on the facts and circumstances of the entity and the audit, that there are no KAM to communicate, the audit report will include a statement to this effect. The remaining Singapore-issued report and the one UK-issued report provided no explanations of the circumstances that resulted in no KAM.

By risk types:

Key takeaway: KAM across all jurisdictions and all sectors most commonly relate to the carrying value assessments of assets, followed by revenue, taxation and acquisitions.

When the KAM communicated in the audit reports were broken down by risk type, the top 10 KAM topics represented 70% of all KAM communicated. Furthermore, out of these 10 topics, 7 related to the carrying value assessments of assets. This comes as no surprise.

We observed that the common reasons cited as driving auditor's attention include (1) significance of the carrying amount on the balance sheet, (2) accounting requirement to test impairment on an annual basis, such as goodwill and (3) the significant judgments applied by management on forward looking projections in valuation models, which is highly subjective. These assessments can be particularly challenging in sectors experiencing constrained economic conditions.

The second largest single category of KAM reported was revenue (non-fraud-related). The full breakdown of KAM by jurisdiction and risk type is illustrated in Figure 3.

Figure 2: Number of KAM by geography

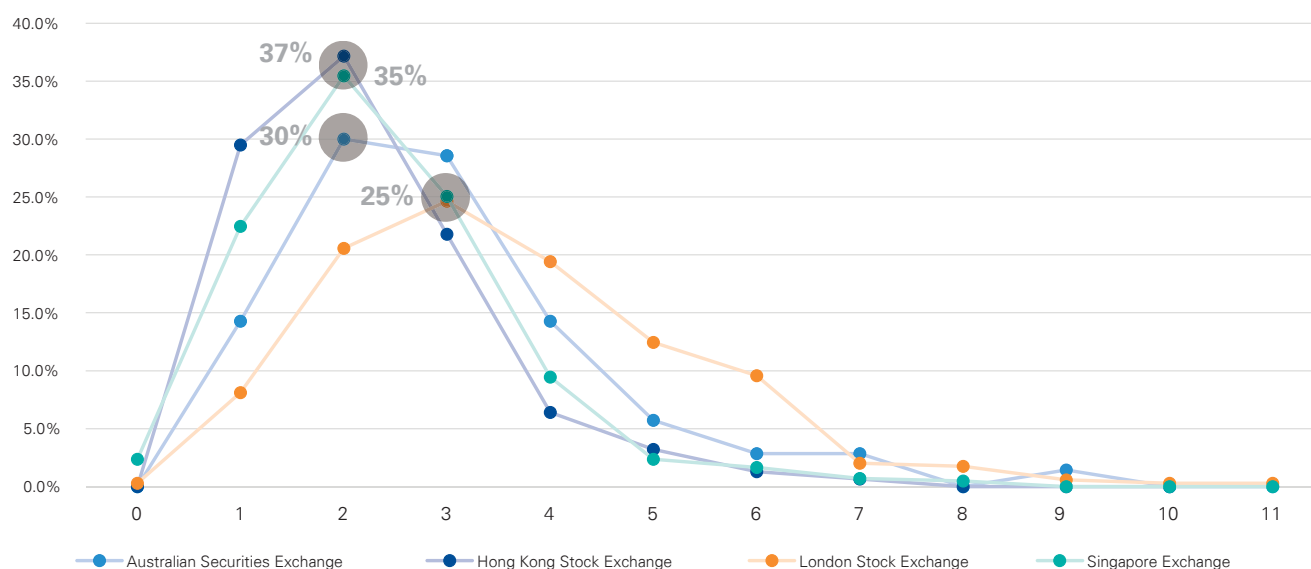


Figure 3: Top 10 KAM reported by risk type

Risk Types		Percentage of KAM reported on risk type				
		Australian Securities Exchange	Hong Kong Stock Exchange	London Stock Exchange	Singapore Exchange	Total KAM
A. Carrying value assessments	Goodwill	33%	18%	37%	22%	27%
	Receivables and allowances	11%	42%	15%	32%	26%
	Property, plant and equipment – Impairment	26%	17%	14%	30%	23%
	Inventories	14%	22%	16%	28%	22%
	Intangible assets	30%	17%	29%	8%	18%
	Investment properties	10%	19%	8%	17%	13%
	Investments – Valuation	4%	6%	15%	8%	10%
B.	Revenue – Non fraud related	30%	29%	48%	25%	34%
C.	Taxation	26%	8%	34%	7%	18%
D.	Acquisitions	16%	9%	17%	11%	13%

Why the top 10 KAM drive auditor attention

Goodwill

- The accounting standards require at least an annual goodwill impairment review, therefore goodwill assessment applies across all sectors with goodwill as an asset item in the balance sheet.
- There are significant judgments applied by management on forward looking projections in the valuation models, which are inherently subjective.
- "Value in use" discounted cash flow models with time horizon of approximately 5 years and longer are inherently judgmental.

Receivables and allowances

- 26% of the entities reported a KAM on receivables and allowances, predominantly in the financial services, manufacturing and electronics sectors.
- In the financial services sector specifically, it is observed that the common reasons cited as driving auditor's attention were due to exposures to certain sectors (specifically oil and gas support services and other commodities sectors) and the use of complex models to predict the probability of default.
- Other reasons include the significance of the balances and challenging economic conditions increasing the risk of default.
- We expect KAM on receivables and allowances to increase in the next financial year as entities adopt the new FRS 109 *Financial Instruments* standard where entities are now required to provide for allowances under an expected loss model (as opposed to the current incurred loss model) and incremental audit attention will be applied addressing the estimates and judgments applied by management in determining the allowances to be made.

Property, plant and equipment – Impairment

- Property, plant and equipment impairment review is often triggered by an indicator(s) of impairment.
- The KAM are mainly included in the construction and engineering, electronics, food and beverage, energy and natural resources, real estate and shipping sectors. Property, plant and equipment are commonly a significant balance on the balance sheet of the companies in these sectors.
- The challenging economic conditions, impacting market risk premium, and uncertainty of future cash flows are common reasons cited in the reports for significant audit efforts.

Inventories

- Inventories KAM were featured predominantly in the reports of companies in the electronics, manufacturing and real estate sectors.
- For electronics and manufacturing, the net realisable value of inventories and the recoverability of work in progress were the focus of audit efforts.
- Inventories of real estate sectors were related to development properties for sale. Weak demand and uncertainty in the economic environment may exert downward pressures on the property prices on certain markets, therefore increasing the risks of losses.

Intangible assets

- Acquired intangible assets are often assessed together with goodwill where applicable.
- Capitalised development costs are applicable predominantly in the healthcare sector where there is significant judgment applied in assessing research and development programmes (whether early or late stage) and the ability to obtain clinical and regulatory approvals.

Investment properties

- Not surprisingly, most of the companies in the real estate sectors contributed to the KAM on the valuation of investment properties.
- We observed that the majority of the entities in the real estate sector have opted to use the fair value model for measurement of investment properties subsequent to initial measurement. The fair value model requires an entity to measure the properties at fair value at each reporting date, with changes in fair value recognised in profit or loss.
- The estimate of fair values and the use of experts was consistently raised as a focus area.

**Investments –
Valuation**

- The majority of the KAM on investments valuation were raised in the audit reports of entities in the financial services and investment management sectors.
- The reports focus on valuations on level 3 financial assets which include unobservable inputs in the assessment, making it inherently subjective.
- Under the new FRS 109 *Financial Instruments* standard, entities are no longer permitted to measure their investments in unquoted equity investments at cost. There may therefore be an increase in KAM on investments valuation when the new standard is adopted.

**Revenue –
Non fraud
related**

- 34% of entities reported a KAM on revenue, primarily resulting from the audit effort applied to assessing the estimates used in determining the revenue to be recognised, such as: estimates used in stage of completion assessments for construction, manufacturing and shipping sectors, estimates used in determining the effects of rental incentives for real estate lease agreements, estimates used in rebates, discounts and returns for consumer sectors.
- We expect revenue KAM to increase in the next financial year as entities adopt the new FRS 115 *Revenue from Contracts from Customers* where incremental audit attention will be applied addressing the significant developments in entities accounting and reporting for revenue and its impact on their financial report.

**Taxation – Tax
provision and
contingencies**

- Taxation KAM are predominantly included in the UK (34%) and Australia (26%) issued reports as compared to Singapore (7%) and HK (8%) issued reports.
- Most of the energy and natural resource sectors featured KAM on taxation. Specific audit focus was on assessing the recognition and recoverability of deferred tax assets, and the assessment of uncertain tax positions in foreign tax jurisdictional matters.
- Taxation related KAM were not reported in most of the reports issued in Singapore and HK, which could be attributed to the tax regime in those countries having attractive tax incentives and corporate tax rates that promotes economic growth of the countries.
- These findings are also generally consistent with the earlier observation that the number of KAM reported is affected by the circumstances of individual jurisdictions.

Acquisitions

- Acquisition KAM were normally included in the reports when the entities had specific acquisitions and were related to the estimation uncertainty included in the purchase price allocation of the acquired entities/assets.
 - The audit efforts were focused on the estimates applied by management on the forward looking projections used in the valuation models.
 - As these are normally event driven KAM, they are not expected to recur on a yearly basis for individual companies.
-

Sector Deep Dive

We examined in detail the most common KAM reported for each sector and the reasons cited for increased audit efforts in these areas. We also identified certain sector-specific characteristics that may have contributed to KAM reported.

Key takeaway: Across all sectors, the factors most likely to give rise to KAM include: challenging economic conditions, uncertainty in forecasting, and the need for specialist knowledge.

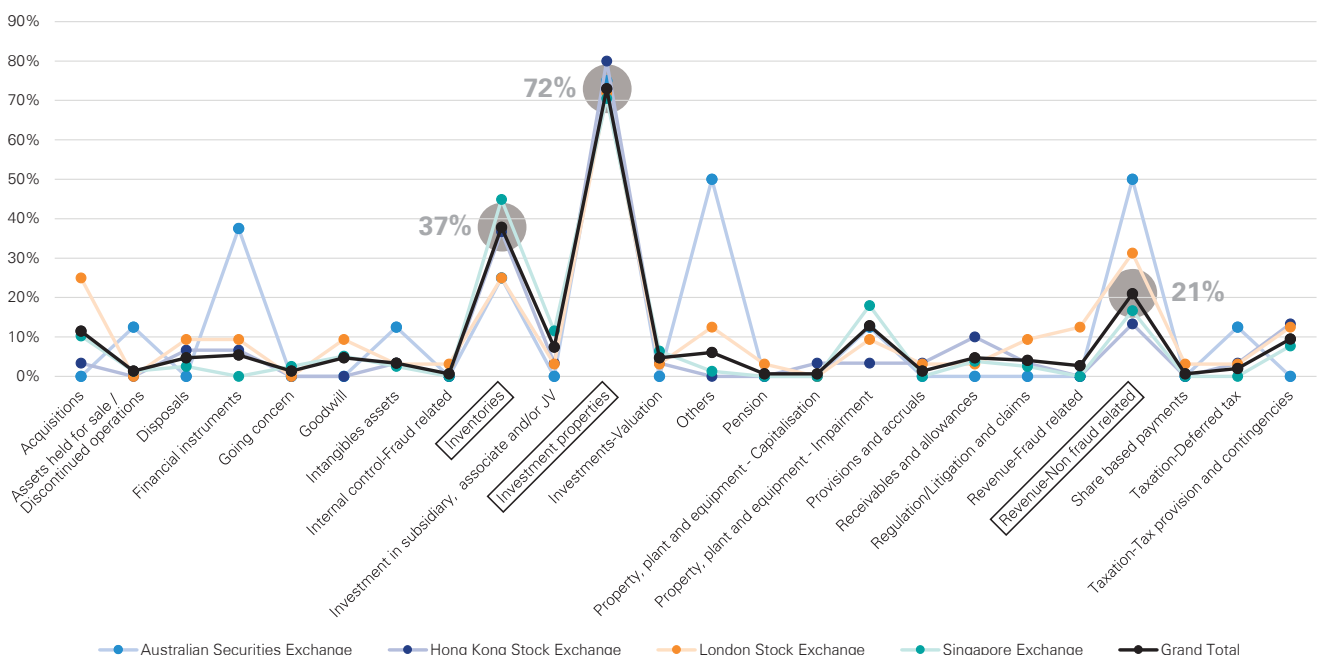
Real Estate

The top KAM under the real estate sector relate to valuation of investment properties (72%), inventories (37%) and revenue (21%).

Valuation of investment properties: (72%)

- The most common KAM relate to the valuation of investment properties. The accounting standards permit a choice on carrying the investment properties at cost or fair value. The majority of the entities (93%) in our samples have opted for the fair value model, with the resultant fair value gains/losses being recognised in profit or loss. Only 7% opted to carry their investment properties at cost.
- The KAM on investment properties carried at fair value include the auditor's approach in assessing the estimates and judgment applied by management and third party valuers in the valuations as well as an assessment on the objectivity and independence of third party valuers.

Real Estate



- Entities which opted for the cost model are required by the accounting standards to disclose the fair values of the investment properties and we noted that 30% engaged an external valuer for the fair value assessment, while the remaining 70% used internal valuation models to determine the fair value for disclosure purposes.
- Given that investment properties generally represent the single largest asset category on the balance sheet, we expect the KAM on valuation of investment properties to be a recurring KAM.
- With the introduction of IFRS in Singapore providing an opportunity for real estate businesses to choose a new accounting policy for investment properties, it will be interesting to see if any move back to the cost basis of accounting.

Inventories (37%)

- Entities which develop properties for subsequent sale classify them as inventories. The audit effort focuses on the analysis of the lower of cost or net realisable value assessment in determining the appropriateness of the carrying amount.
- The analysis is often impacted by the outlook of the property market, with weak demand and oversupply of units in certain countries and uncertain economic outlook being indicators of risks that the subsequent selling prices may be below the carrying amount as at the reporting date.

Revenue (21%)

- 21% of the reports reviewed of the real estate sector included a KAM on revenue recognition.

- The common reasons cited for the increased audit efforts relate to:

1. **Rental income** – Diverse lease terms, including rent incentives and guaranteed rent increases.
2. **Timing of recognition of sale** – The standards under IFRIC 15 *Agreements for the Construction of Real Estate*, provide guidance on assessing whether a real estate development contract is in scope of IAS 11 *Construction Contracts* (a construction service) or IAS 18 *Revenue* (delivery of goods). Revenue for development units in the scope of IAS 18 is recognised when the risks and rewards of ownership of the units passes, which often coincides with the transfer of legal title or the passing of possession to the buyer. Revenue is recognised as the construction activity is completed for contracts within the scope of IAS 11.

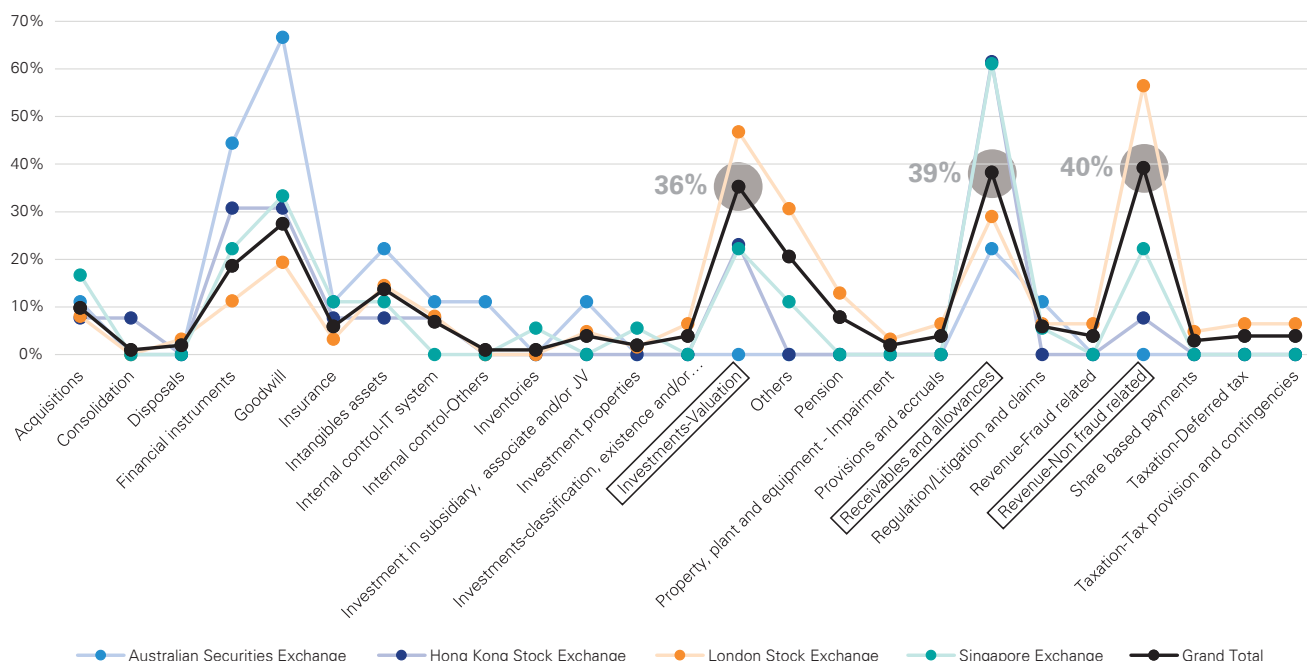
- The KAM includes an assessment of the appropriateness of the revenue recognition policies and includes the assessment of the stage of completion adopted by the entities to measure the progress of the construction activities.
- We expect that the adoption of IFRS 15 *Revenue from Contracts with Customers* in 2018 will result in an increase in KAM on revenue recognition for the entities in the real estate sector when IFRIC 15, IAS 11 and IAS 18 are withdrawn. The withdrawal of IFRIC 15 is likely to be of particular relevance to real estate developers who relied on the guidance to determine if the sale of real estate is to be accounted for as a good or service.

“With investment properties being the main driver of income for real estate entities, the valuation of investment properties is the top KAM raised in the audit report. While accounting standards provide an option for entities to either state their investment properties at cost or fair value, most elect the fair value option. The assessment of fair values involves the use of assumptions and judgement. The valuation of investment properties as a KAM is expected to be prevalent.”

Lo Mun Wai,

Audit Partner and Leader for the Real Estate Sector, KPMG in Singapore

Financial Services



Financial Services

- The top KAM reported by the entities in the financial services sector relate to revenue (40%), receivables and allowances (39%) and valuations of investments (36%).
- The reports are further segregated into banks and non-bank financial institutions ("NBFI").

Banks:

- Of the 102 reports reviewed, 17 were banks.
- 2 key KAM were prevalent across the reports that were reviewed.

1. Receivables and allowances (100%)

100% of the reports had a KAM related to receivables and allowances. Two key reasons noted were the significance of the carrying amounts of receivables on the balance sheets and exposures to debts due from customers in challenging economic conditions, particularly in the shipping, oil and gas services sectors

2. Investments – Valuations (65%)

100% of the banks in Singapore and Australia, and 50% of the banks in HK and UK reported a KAM on the valuation of financial instruments, specifically on level 3 financial assets, which includes complex and illiquid financial instruments. The valuations of such instruments demand greater audit effort due to significant estimation uncertainties and the

lack of active market. In respect of the other banks in HK and UK which did not report a KAM on valuations of financial instruments, it is noted that the carrying amounts of such financial instruments were relatively insignificant as compared to other balance sheet items.

Non-bank financial institutions

- The NBFI were a more diverse mix of entities comprising investment holding and other related financial services.
- Over 40% of the reports reviewed had a KAM on Revenue and valuation of investments.

Revenue (45%)

- 61% of the UK issued reports in this sector reported a KAM on revenue as compared to 27% in Singapore, 11% in HK and 0% in Australia.
- The reasons commonly cited were relating to significance of the revenue balances, and the manual adjustments in rates to be applied, judgments applied on loan's behavioral life impact the recognition of interest income.
- The UK reports were focused on the internal controls over the revenue process and the assessment of estimates used where applicable.

Valuations of investments (42%)

1. Over 50% of the UK issued reports included a KAM on valuation of investments, as compared to 27% and 33% of the Singapore and Australia issued reports respectively.
2. Similar to the banks, the KAM were mainly relating to the valuations of Level 3 financial assets which requires greater audit effort due to significant estimation uncertainties and lack of active market.

“Banks are facing headwinds of a weaker global market and credit exposures from oil and gas sectors. The uncertainties demand heightened auditor focus on the potential impact on asset valuations, as evident from the observation that 100% of the banks reported a KAM on receivables and allowances. The fair value assessments of complex and illiquid investments is a KAM that is expected across banks due to the significance of balances and significant estimates and judgements applied”

Leong Kok Keong,

Audit Partner and Head of Financial Services, KPMG in Singapore

Energy and Natural Resources

- The top 3 KAM reported by the entities in the energy and natural resources sector relates to property, plant and equipment impairment (50%), taxation (33%) and goodwill (30%).
- On an overall basis, exploration and evaluation assets related KAM were raised in 28% of the reports reviewed. Of these, 42% and 33% of the UK and Australia issued reports had a related KAM on exploration and evaluation assets as compared to 19% and 10% for Singapore and HK respectively.

Property, plant and equipment – impairment (50%)

- 43 out of 86 companies reported a KAM on the impairment assessment of property, plant and equipment.
- The depressed commodities and oil prices were key drivers of enhanced scrutiny on management's impairment assessments.

Taxation (33%)

- Taxation related KAM were featured in the auditors' report of over 60% of the entities in UK and Australia, as compared to 0% and 3% identified in HK and Singapore respectively.
- Various activities of the companies in the energy and natural resources sector trigger various tax

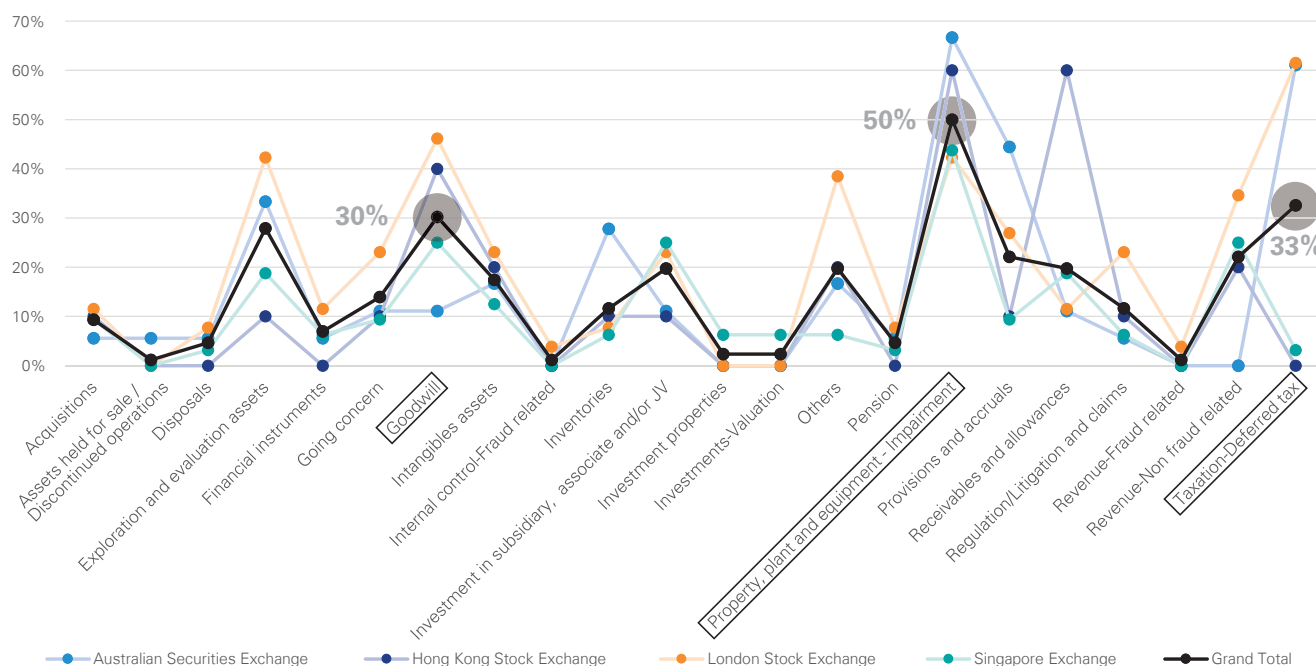
obligations such as corporate tax, royalties, and other resource and production based taxes and employment related taxes. The prevalence of taxation related KAM is expected for global players largely listed in the Australia and London stock exchanges.

- The UK and Australia reports cited the following as reasons for the audit focus:
 1. Uncertain tax positions due to interpretation of relevant tax legislations;
 2. Involvement of tax specialists in the evaluation of tax positions adopted by the companies;
 3. Recoverability of deferred tax assessments, which involves an assessment of management's forecasts of future taxable income.

Goodwill (30%)

- 26 out of 86 companies identified this as a KAM.
- The accounting standards require goodwill impairment evaluation, at least on an annual basis.
- Significant judgments are applied in forecasting future revenue, profits and growth rates are highlighted specifically.

Energy and Natural Resources



“Operating across multiple countries and tax jurisdictions, global energy and natural resources companies are faced with judgements interpreting in-country tax legislations and cross border tax issues. Taxation related KAM are expected to continue. With volatility in energy markets, oil and gas companies are also facing significant estimation uncertainty forecasting future revenue and profits, resulting in heightened audit focus”

Jonathan Chiang,

Audit Partner and Leader for the Energy and Resources Sector, KPMG in Singapore

Shipping, Transport and Logistics

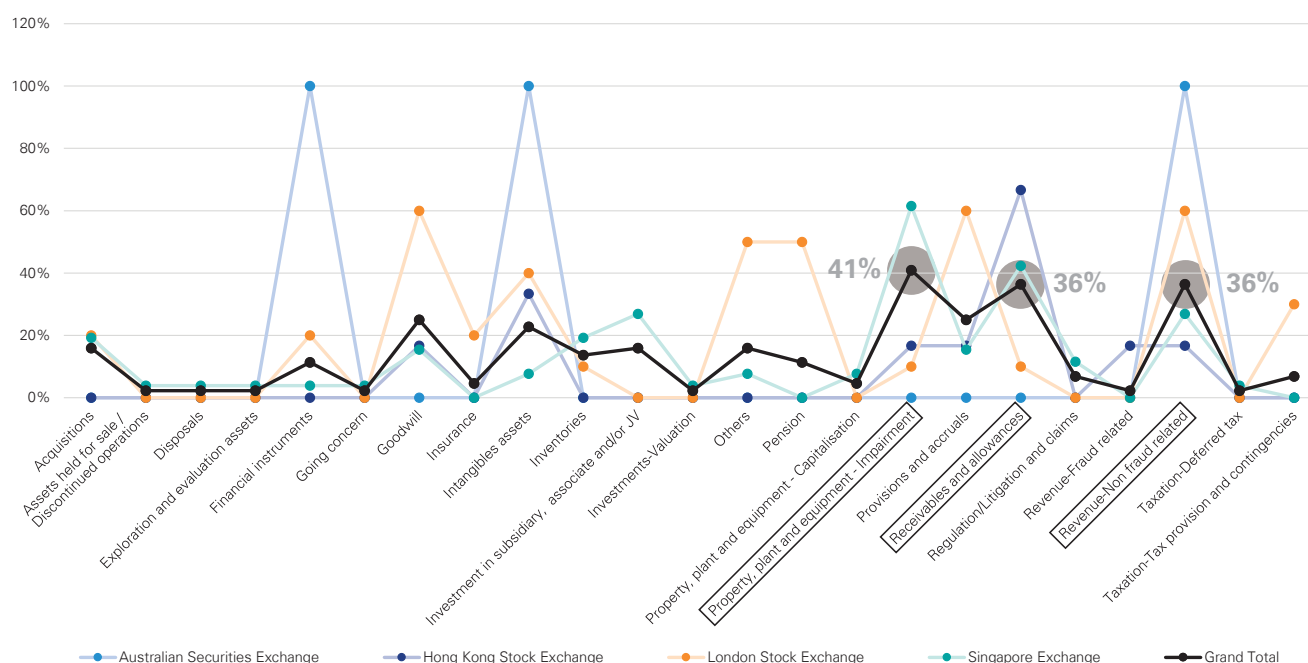
- The top KAM reported by the entities in the shipping, transport and logistics sector relates to property, plant and equipment impairment (41%), receivables and allowances (36%) and revenue (36%).

Property, plant and equipment – impairment (41%)

- 18 out of 44 companies identified this as a KAM. Of the 18, 16 were based in Singapore.
- Shipping makes up a significant proportion of the Singapore listed companies and the sector has been under significant stress over the last couple of years with sluggish market conditions in the offshore oil and gas marine sector as well as low bulk and containerised freight rates.

- Common reasons cited as driving auditor attention include:
 - Forecasting revenue including charter hire rates for vessel owners;
 - Current state of the market and the difficulty in forecasting orders;
 - Expected usage of logistics assets and physical wear and tear;
 - Considering commercial obsolescence;
 - Forecasting capital expenditure;
 - Reviewing of discount rates;
 - Where assets valued at fair value versus value in use, assessing expert valuer report and methodologies.

Shipping, Transport and Logistics



Receivables and allowances (36%)

- 16 out of the 44 companies identified this KAM. 11 of the 16 were based in Singapore and 4 in HK. As a result whilst overall the percentage of companies with this KAM was 36%, for Singapore companies it was 42% and 67% for HK.
- In Singapore, auditors in the offshore marine sector focus on receivables for the construction of offshore marine vessels.
- Auditor focus was also placed on the size of these balances and the impact of current economic conditions on collectability of receivables.

Revenue (36%)

- Common reasons cited as driving auditor's attention include:
 1. Complex long term contract accounting and contract modifications;
 2. Complex contracts for different services agreements;
 3. Complex industry systems and agreements;
 4. Timing of revenue recognition;
 5. Agent versus principal recognition;
 6. Estimating the impact of price adjustments on provisional sales.

"While there is alignment in the KAM raised in the reports, sectoral headwinds means that the forward looking projections used to support asset valuations are heightening the audit focus in assessing management's judgment and estimates. The sluggish offshore marine sector is also facing risks of more cancellations in light of weak demand, oversupply and these are exerting downward pressures on the carrying values of assets and additional audit scrutiny in challenging management's assumptions and estimates"

**Malcolm Ramsay, Audit Partner, KPMG in Singapore,
ASPAC Head for Transport and Global Head of Aviation, KPMG**

Healthcare

- The top KAM reported by the entities in the healthcare sector relate to goodwill (40%), intangible assets (40%) and revenue (37%).

Goodwill (40%)

- Common reasons cited as driving auditor's attention include:
 - Goodwill commonly arises from acquisitions made by the companies and is tested for impairment at least on an annual basis.
 - The impairment assessment includes a review of forward looking projections which are inherently subjective, therefore with a heightened audit focus.

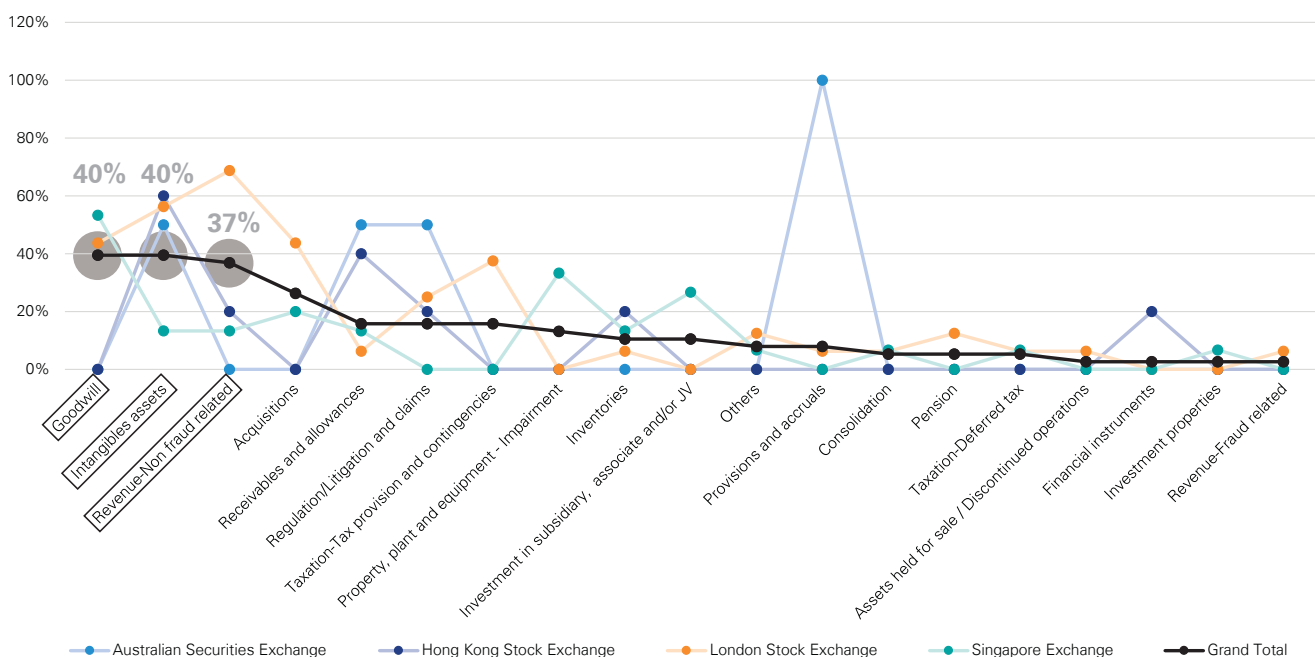
Intangible assets (40%)

- The pharmaceutical companies contributed to the prominence of intangible assets related KAM.
- Intangible assets commonly features capitalised development costs and includes estimation uncertainty concerning early and late stage research and development programmes, and ability to obtain clinical and regulatory approvals.

Revenue (37%)

The analysis of rebates, discounts, allowances and returns were commonly featured in the KAM of pharmaceutical companies, and medical equipment manufacturers. The significance of revenue amounts were commonly cited for healthcare service providers.

Healthcare



“The consolidation of private sector specialists is causing auditors to focus on the value of goodwill in these transactions. Off-shore, as large pharmaceutical companies spend more on long term R&D, we can see the external auditors scrutiny is on the capitalised R&D costs which are treated as intangible assets.”

Karen Lee,
Audit Partner and Leader for the Healthcare Sector, KPMG in Singapore

Other Observations

Reporting of findings on KAM

Under the revised standards, the disclosure of KAM and how the auditor plans to approach them is mandatory for SGX listed companies. In 47% of the Singapore issued reports we reviewed, companies took it a step further, and disclosed findings in relation to each of the KAM.

In one third of the reports which included findings, we observed that the auditors provided specific commentaries on their assessment, including:

- comments on management's judgment ("cautious", "aggressive", "prudent");
- highlights of specific errors; or
- agreement that methodology applied was in line with market practice.

For the remaining two thirds of reports, notwithstanding that findings were included, they contained fairly generic statements such as "reasonable", "within an acceptable range" and "appropriate".

Audit committee's commentaries on KAM for Singapore listed entities

In January 2017, ACRA, MAS and SGX made a joint announcement to all audit committees of listed entities in Singapore, 'strongly urging' them to share their views on and responses to the KAM reported in the auditors' report. In particular, audit committees were asked to comment on:

- Significant financial reporting matters, including the audit committee's perspectives on the KAM reported by the external auditors;
- How the audit committee assessed and concluded on each significant matter, which could include discussions with management, auditors and other subject matter experts;
- Significant judgment calls made, which could include assessments of management's judgments and estimates, and the sources of assurance drawn upon as the bases for the audit committee's agreement with the management's conclusion.

Based on a survey of 396 listed companies with financial year ended 31 December 2016, we observed different approaches taken by listed companies with regard to the audit committee's commentary as follows:

Observations	Overall
Report did not include audit committee's commentary	60%
Report included audit committee's commentary:	40%
• Specific comments on the respective KAM in the audit report	27%
• More generic references to the audit committee's consideration of the KAM in the audit report	13%

Conclusion

Enhanced auditor reporting undeniably provides value to the users of financial statements. Within just one year of introducing the revised standards in Singapore, the quality of audit reports has observably increased, with better and more information provided about judgements made by management on KAM and the approach the auditors took.

This improves transparency and trust in the audit process, and enhances communication between companies and stakeholders.

At the same time, our study of audit reports from across 4 jurisdictions clearly shows that KAM are not merely technical points raised to comply with standards. KAM are closely related to issues that are at the core of businesses: economic conditions, operating environment, the value of an entity's assets and earnings, and so on.

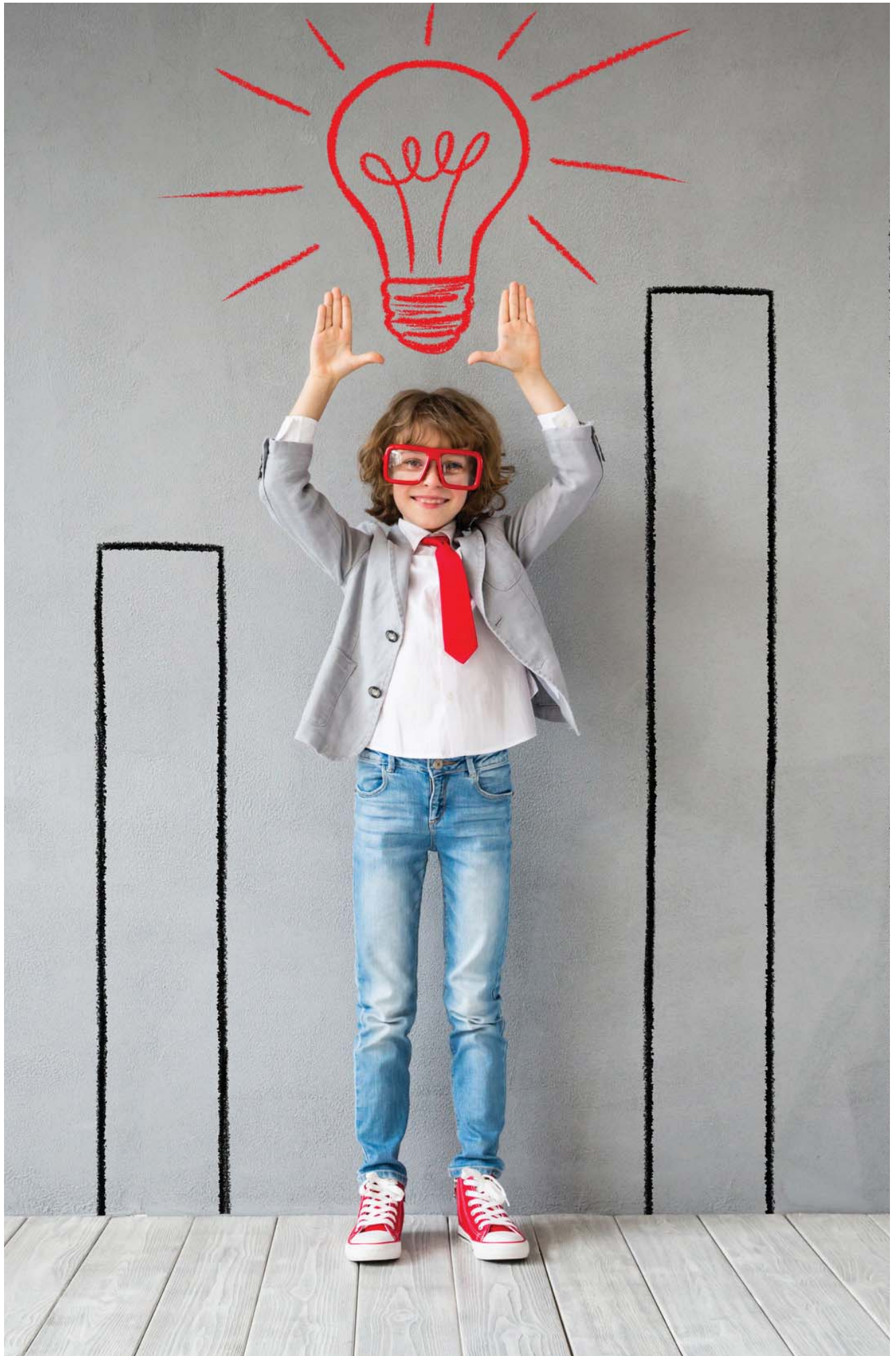
Given the relevance of KAM to users of financial statements, it is important that audit reports should

not relapse into "boilerplate reporting," or that reporting entities water down the information presented in order to avoid too many questions being raised. Discussions from our roundtable suggest that this is the greatest challenge auditors will face moving forward.

For the enhanced auditor report to continue providing value and meet its objective of greater transparency, there must be active and positive participation from all stakeholders. Shareholders in particular have a major role to play in driving the correct implementation of enhanced auditor reporting. They must be willing to request transparency and greater communication.

In the coming year, as the second auditor report is issued by auditors in Singapore on the audited financial statements of companies listed on the Singapore Exchange, we will see a more complete picture of how enhanced auditor reporting is being implemented, and the level of transparency it bears on the audit process.





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