Submission to IAASB

Invitation to Comment: Improving the Auditor’s Report

1. I believe the proposed additional wordings will blur the line of who is responsible for the preparation of the financial statements, and at the same time will result in additional audit cost, delay the timely release of audited financial statements especially for listed companies, micro questioning from shareholders at annual general meetings, and the possibility of higher liabilities for both the auditor and directors.

2. The additional wordings risk being nothing more than new boiler plate statements which make the auditor’s report less understandable to read and may therefore have the opposite effect of trying to be more useful.

3. Putting aside the possibility that in quite a number of reported cases, deficiency in audit methodology or audit work may have contributed to the failure in uncovering manipulations or frauds committed by management over a prolonged period of time, we should focus on fixing accounting standards, not auditing standards, as it is the deficiencies in accounting standards that have contributed to the inadequate disclosure in the first place.

4. We have already seen welters of “reforms” or proposed “reforms” in the USA or Europe that fail to address the real problems. The proposed wordings are also unlikely to result in early warnings for cases like Lehman Brothers or MF Global where the companies were judged to be perfectly healthy going concerns. As we understand from publicly available information, these companies failed due to liquidity issues resulting from a sudden and drastic fall in the market value or lack of market of certain large financial investment positions. Therefore, to solve the issue of lack of disclosure, the accounting standards should be revised to require companies to highlight the amount of significant investment positions, on or off balance sheet, where any significant price movement may trigger material liquidity events. For example:
   a. A company with $10 billion of net equity, $1 billion in cash and invests half of the cash in financial instruments would not require the additional highlight because the company should not be facing liquidity problems even if the whole $500 million investment went bad.
   b. On the other hand, a company with $10 billion in net equity, $1 billion in cash but has $20 billion in financial derivatives would have to highlight this risk because a moderately unfavourable movement in the price of the derivatives could trigger a major liquidity issue for the company.

5. For financial institutions in particular, the auditor should be required to comment on the existence of an effective risk management organization structure that is independent of executive management. A company’s risk management organization should not be viewed as effective and independent if the chief risk officer reports to the CEO or an Executive Chairman.

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