
YEAR 2000 ISSUE - PART II

We have introduced the Year 2000 ("Y2K") issue and the general responsibilities of the management in our earlier issue of Around Us - Year 2000 Issue - Part I in January 1999. In this second part of the Y2K Issue article, we are focusing our attention on the auditors' role - what are the responsibilities of the auditors towards the Y2K issue and what they should consider during their audit in order to arrive at their audit opinion.

In the Statement of Auditing Practice ("SAP") 20, Implications for Management and Auditors of the Year 2000 Issue, it clarifies the effect of the Y2K issue on audits of financial statements. The SAP:

- assists in clarifying the respective responsibilities of the auditor and management;
- suggests enquiries for an auditor to make of management;
- suggests matters that might be reported to management;
- provides assistance in the application of Singapore Standards on Auditing ("SSA") to this issue;
- outlines circumstances where an auditor may issue a modified report; and
- assists in overcoming the risk of an audit expectation gap arising.

What are the general responsibilities of the auditor?

Per SAP 20, to avoid doubt or misunderstanding, the auditor should explain to the management that the Y2K issue does not create any new responsibilities for the auditor, and that it will be addressed by the auditor only in so far as it affects existing audit responsibilities. Therefore the auditor's responsibility relates to the detection of material misstatements in the financial statements being audited, whether caused by the Y2K issue or some other cause.

Accordingly, the auditor may wish to inform management in an engagement letter that :

- (a) the Y2K issue will be considered only to the extent of the auditor's responsibility to express an opinion on the financial statements;
- (b) management, not the auditor, is responsible for ensuring that the entity is prepared for the Y2K date change;
- (c) the audit is not intended, designed or performed to identify or detect problems that may result from the inability of computer hardware, software, or other automated processes to properly process dates, which include issues related to the Y2K;
- (d) the auditor has no responsibility with regard to the entity's efforts to make its systems, or any other systems, such as those systems of the entity's suppliers, customers, or any other third parties, capable of properly processing dates, including Y2K; and
- (e) the auditor has no responsibility to provide assurance on whether the entity has addressed, or will be able to address, all of the affected systems on a timely basis.



Because of the inherent risk that an entity may face, which could be impacted by both internal and external factors, the auditor will not be able to provide assurance that an entity's remedial efforts will be successful, because this is not within the scope of an audit of financial statements. Nevertheless, the auditor may be able to make observations on the entity's process for identifying, managing and remedying its Y2K problem that come to the auditor's attention during the normal course of the audit.

What are the steps to consider during audit with regards to Y2K?

Included in SAP 20 are the following :-

- **Initial risk assessment at the planning stage**

An auditor should confirm the knowledge of the entity's business by enquiry of management about:

- (a) the significance of computers and date sensitive aspects of business operations generally;
- (b) the nature of the key computer systems which generate specific accounting information; and
- (c) the dependence of the entity's systems and activities on third parties (for example outsourcers, customers, suppliers) where failure of the third party systems would have a direct impact on amounts or disclosures in the financial statements.

An auditor can enquire more specifically in order to understand management's views on :

- (a) any increased risk of fraud or error in accounting information or other information supporting items in the financial statements;
- (b) the possible impact on specific financial statement amounts or disclosures; and
- (c) the potential impact, if any, on the going concern basis.

The auditor's responsibility is to assess the risk that the financial statements being audited will be misstated because of the effects of the Y2K issue.

- (a) If the inherent risk is not considered significant, no further audit work is necessary unless information to the contrary comes to the auditor's attention during the audit;
- (b) If the risk is considered significant, the auditor will need to obtain an understanding of management's analysis and detailed plans to deal with the Y2K issue and should follow the requirements set out in SSA 6, Risk Assessment and Internal Control.



- **Audit evidence**

In considering management's analysis, the auditor may enquire about general factors such as :

- (a) whether the impact analysis was carried out systematically and the quality of records documenting that process;
- (b) whether all significant business units were involved in the process;
- (c) information (or test results) obtained from IT suppliers on packaged systems and outsourced systems; and
- (d) the skills, knowledge and experience of the staff involved in the impact analysis.

- **Management representation**

An auditor will need to consider obtaining management representations on Y2K issues where no other evidence can reasonably be expected to be available. Representations should be obtained on matters that are material to the financial statements and may, for example, include:

- (a) the disclosures included in the financial statements and/or in the notes to the financial statements;
- (b) the potential impact of system failure on the entity's business; and
- (c) management's commitment to resolve Y2K issue.

- **Using the work of other auditors**

Taking into account knowledge of the activities of subsidiary entities, the principal auditor considers whether other auditors have made enquiries about the Y2K issue in relation to the entities they are auditing, particularly in those subsidiaries that comprise major parts of the group's business.



• **Potential impact on the Audit Report**

It is important to recognise that there could be situations requiring a modified report in respect of the Y2K issue as follows:

- (a) an **emphasis of matter** paragraph may be required where the notes to the financial statements include information relating to a going concern problem or a significant uncertainty relating to Y2K issues;
- (b) a **qualified** or **adverse** opinion may be required where there is a disagreement with management about the manner in which Y2K issues are dealt with in the financial statements, or where there is inadequate disclosure of matters that the auditor considers material in relation to the financial statements; or
- (c) a **qualified** or **disclaimer** of opinion may be required where there is a limitation on scope where necessary evidence that does, did or should exist in relation to the impact of Y2K issues is not available to the auditor.

Source : Statement of Auditing Practice (SAP) 20.

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