ACRA
ACCOUNTING AND CORPORATE REGULATORY AUTHORITY

# PRACTICE MONITORING PROGRAMME

11th Public Report 2017

RAISING AUDIT QUALITY

# CONTENTS

## GLOSSARY OF TERMS

| | |
|---|---|
| ACRA | Accounting and Corporate Regulatory Authority |
| AOB | Malaysia's Audit Oversight Board |
| AQI | Audit Quality Indicator |
| EQCR | Engagement Quality Control Review |
| FRS | Financial Reporting Standard in Singapore |
| IAASB | International Auditing and Assurance Standards Board |
| IFIAR | International Forum of Independent Audit Regulators |
| ISCA | Institute of Singapore Chartered Accountants |
| GPPC | Global Public Policy Committee |
| PAOC | Public Accountants Oversight Committee |
| PMP | Practice Monitoring Programme |
| PPPK | Indonesia's Finance Professions Supervisory Center |
| SEC | Thailand's Securities and Exchange Commission |
| SSA | Singapore Standard on Auditing |
| SSQC | Singapore Standard on Quality Control |

# SECTION 1

EXECUTIVE SUMMARY

# SECTION 1: EXECUTIVE SUMMARY

## SAFEGUARDING THE RELIABILITY AND INTEGRITY OF FINANCIAL INFORMATION IN SINGAPORE

1.1 Singapore's growth into a leading financial hub has been underpinned by our reputation as a clean and trusted jurisdiction. It is therefore crucial that investors and other market stakeholders continue to have confidence in the quality and integrity of financial reporting and audits in Singapore.

1.2 To encourage high quality audits and finanical reporting, ACRA has adopted a holistic approach that encompasses the entire financial reporting eco-system. On the audit front, we continue to work with the public accountancy profession to deter repeated audit deficiencies and raise audit quality. Our PMP crossed a key milestone last year when it marked its 10th year of conducting independent audit inspections in Singapore. That same year, it was also recognised by the Asian Corporate Governance Association as being among the best in the region. As a high quality financial reporting process starts with companies and their committees, we set up in 2011, the Financial Reporting Surveillance Programme ("FRSP")[1] to review financial statements for compliance with Accounting Standards and emphasise that directors are accountable for the compliance.

1.3 However, sustainable improvement in financial reporting quality must be driven by a collective effort. All stakeholders – the directors and the audit committees, management, investors, the accounting profession and the regulator – have a role to play in strengthening the financial reporting value chain.

## RAISING AUDIT QUALITY

1.4 In this regard, it is encouraging to note that the public accountancy sector is stepping up to help raise the audit quality bar. In October 2015, ACRA issued the AQI Disclosure Framework, comprising eight audit quality indicators, to help Audit Committees better evaluate their auditors. This was made possible with the support and commitment of the Big-Four[2] audit firms who voluntarily adopted the AQI framework for their listed clients and agreed to provide comparable AQI data. Findings from this year's audit inspections carried out from 1 April 2016 to 31 March 2017, show positive steps being taken within the public accountancy sector to address audit deficiencies.

[1] In 2011, the scope of FRSP only include the reviews of financial statements with modified audit reports of listed companies. The scope was expanded in 2014 to include financial statements with 'clean' audit reports of listed companies.

[2] The Big-Four firms comprise Deloitte, EY, KPMG and PwC.

1.5 Last year, the bar for audit quality in the listed companies segment was raised with ACRA setting an audit quality target for the six audit firms that are part of the GPPC[3] networks that perform listed company audits. The target is to achieve a 25% reduction in the percentage of inspected audits of listed entity engagements with at least one finding over a four-year period from 2015 to 2019. It bodes well for the sector that this year's inspection findings show that we remain on track to meet this target. The key to addressing audit deficiencies lies in having a robust root cause analysis framework. ACRA's observations on the audit firms' root cause analysis processes are shared in Section 3. Notably, some firms in this segment are in the midst of rolling out an enhanced root cause analysis framework, which is an encouraging development.

1.6 ACRA also introduced six AQI targets in 2016 to provide audit firms which audit listed companies and audit committees, with a common yardstick to compare audit quality. In this 11th PMP report, inspection findings show continued improvements by audit firms to meet the three engagement level AQIs targets. For example, there were a higher number of engagements with at least 5% of time spent by engagement partners and at least 20% of time spent by engagement partners and managers compared to 2016. However, in terms of firm-level AQIs, the results were mixed. While there was general improvement in the AQIs for staff retention rates, only the Big-Four audit firms continued to show further improvements in the AQI for staff oversight ratios. More details can be found in Section 6 of the report.

1.7 For the non-listed companies segment, there was also a noticeable improvement in audit quality. Comparing the 2017 inspection results to 2016, the proportion of inspected audit engagements with at least one finding had reduced by 15%. This encouraging result can be attributed in part to some public accountants in this segment taking steps to address recurring audit deficiencies by addressing root causes and developing effective action plans. However, such efforts to improve audit quality are still fairly localised within this segment. For inspected audit engagements with at least one finding, the audit deficiencies continued to be recurring in nature and are mainly in relation to insufficient audit procedures performed on areas such as inventories, opening balances and functional currency translation. Case studies in Section 4 of this report illustrate this point.

1.8 To spur improvement and address the repeated findings of poor audit quality, ACRA introduced a key regulatory initiative last year where names of public accountants imposed with hot review or restriction orders on revisit inspections will be published on ACRA's website. This is effective for audit inspections commencing on or after 1 April 2017. ACRA therefore strongly urges public accountants in this segment to take heed of the findings, seek to understand and urgently address the root causes of these deficiencies.

[3] The six firms in the GPPC networks are BDO, Deloitte, EY, Grant Thornton, KPMG and PwC. In Singapore, as at 31 March 2017, Grant Thornton does not perform audits of listed entities.

## SCOPE OF ACRA'S AUDIT INSPECTIONS WIDENS

1.9 In an increasingly complex and dynamic business environment, ACRA must likewise keep pace and ensure our regulatory approach remains effective and relevant. ACRA continues to build up its inspection capabilities such as developing the capacity to inspect audits of specialised industries and IT audits. In the current year, ACRA has commenced the inspection of audit engagements in regulated industries such as financial institutions. Such inspections are also conducted by independent audit regulators in leading jurisdictions such as Australia, United Kingdom and United States of America.

1.10 As significant technology advances and the unprecedented pace of digitalisation continue to revolutionise the business landscape, ACRA has noted a corresponding trend in the increased use of data analytics in the audit of financial statements, particularly among the larger audit firms. Data analytics has the potential to enhance audit quality and the auditor's detection capabilities such as analysing patterns, deviations and inconsistencies, and extracting other useful information from the underlying data for the purpose of planning and performing the audit. The use of data analytics in audits will therefore be a new focus area for ACRA's audit inspections. More on the use of data analytics in audits can be found in Section 3 of this report.

1.11 As part of larger regulatory efforts to further strengthen Singapore's strong reputation as a trusted international financial and business centre, the scope of ACRA's audit inspections has been expanded to include EP 200 inspections on small and medium practitioners with effect from 2017. This includes inspections on public accounting entities that audit non-listed companies, which ISCA will carry out with oversight from ACRA.

## INTERNATIONAL PARTICIPATION

1.12 On the international front, ACRA continues to participate actively as a member of the IFIAR Board which drives coordinated improvements in audit quality globally. As a member of IFIAR's Global Audit Quality Working Group in which ACRA and other working group members meet the global leadership of the GPPC firms, ACRA contributes towards discussions on measures taken by audit firms globally to address root causes of common inspection findings. At a regional level, a significant step was taken towards raising audit quality in the region which augurs well for investor confidence in the region. ACRA together with the Indonesian, Malaysian and Thailand audit regulators and the Big-Four audit firms in these countries, collectively agreed on a measureable goal to improve audit quality. The goal is to achieve a minimum of 25% fewer listed companies' audits with inspection finding(s) over the next few years. More details on this new audit quality milestone for the region can be found in Section 2.

# SECTION 2

## ACRA'S REGULATORY AND INSPECTION SCOPE

# SECTION 2: ACRA'S REGULATORY AND INSPECTION SCOPE

## INTRODUCTION

2.1 Every year, ACRA issues a PMP Public Report to provide an overview of ACRA's assessment of the public accountancy profession and share new initiatives and upcoming developments affecting the profession. Such communication helps firms and public accountants understand the key areas for improvement so as to meet the requirements of the professional standards.

2.2 This section summarises ACRA's regulatory and inspection scope over the 12-month period ended 31 March 2017.

2.3 As with previous Public Reports, the findings in this report are not meant to be an exhaustive list of all findings from ACRA's inspections during this period, but instead to highlight the pertinent areas requiring attention from the profession.

## ABOUT THE PMP AND ACRA'S INSPECTION ACTIVITIES

2.4 ACRA carries out two key inspection activities under the PMP as follows:

(a) **Engagement Inspections**

This entails a review of an audit performed by a public accountant to assess whether the public accountant's work complies with the SSAs. Engagement inspections are backed by legislation. The PAOC[4] is the deciding authority on the outcome of these inspections.

In 2016, ACRA commenced the inspection of audits of financial institutions, in particular, bank audits. This is a significant milestone for ACRA as it brings ACRA in line with the inspection practices of the leading international audit regulators.

(b) **Firm–level Inspections**

The firm-level inspection assesses a firm's compliance with the SSQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*. The inspection includes a review of the effectiveness of the policies and procedures established by the firm in its system of quality control. Presently, firm-level inspections are conducted on an advisory basis on audit firms that perform audits of listed companies.

[4] PAOC is a committee comprising ACRA board members and is responsible for discharging ACRA's functions over the registration and regulation of public accountants in Singapore.

## EP 200 INSPECTIONS

2.5 EP 200 was issued by ISCA and took effect from 1 November 2014. EP 200 sets out mandatory anti-money laundering and countering the financing of terrorism requirements for professional accountants[5], and is part of the larger regulatory efforts to further strengthen Singapore's strong reputation as a trusted international financial and business centre. EP 200 has been adopted by the PAOC, and is applicable to professional firms and both professional accountants in public practices and in business.

2.6 Since 2015, ACRA has incorporated EP 200 inspections as part of the firm-level inspections for audit firms that perform audits of listed companies. From 2017, the scope of EP 200 inspections was extended to audit firms that audit non-listed companies for which ISCA will carry out the inspection under ACRA's oversight.

2.7 The Companies (Amendment) Act 2017 which came into effect on 31 March 2017 clarifies that a breach of EP 200 is a ground for disciplinary action under the Accountants Act, i.e., disciplinary action may be taken against public accountants and audit firms for any non-compliance with EP 200.

## THE PUBLIC ACCOUNTANCY LANDSCAPE IN SINGAPORE

2.8 Singapore's financial statements audit market can be segregated into two broad segments: audits of listed companies and audits of non-listed companies. It is serviced by about 700 audit firms and about 1,100 public accountants registered with ACRA as at 31 March 2017. The scope of ACRA's inspections cover all audit firms and public accountants providing public accountancy services in Singapore.

2.9 Audits of listed companies are concentrated in 16 larger firms comprising the Big-Four and medium-sized audit firms, while audits of non-listed companies are mainly serviced by the smaller audit firms, which consists of sole proprietorships and smaller partnerships.

[5] Professional accountants refer to an individual who is a member of ISCA.

## ACRA'S CALIBRATED INSPECTION APPROACH

2.10 ACRA's inspection activities are carefully calibrated in scope and intensity according to the nature and complexity of the audits and the level of public interest risks involved. This allows for more efficient use of limited resources and leads to more effective regulatory outcomes. Accordingly, ACRA categorises public accountants into two broad segments:

(a) Those practising in audit firms that perform audits of listed companies (listed companies segment); and

(b) Those practising in audit firms that perform audits of non-listed companies (non-listed companies segment).

2.11 ACRA's inspection approach is differentiated between the two segments of public accountants and audit firms. As at 31 March 2017, the number of audit firms and public accountants in the two segments are shown in Figure 1 below.

**Figure 1: Number of audit firms and public accountants in the listed and non-listed company segments**

| As at 31 March 2017 | Listed companies segment | Non-listed companies segment | Total |
|---|---|---|---|
| Number of audit firms | 16 | 690 | 706 |
| Number of public accountants | 346 | 748 | 1,094 |

2.12 In the audit of listed companies segment, the Big-Four audit firms in Singapore collectively audit about 60% of the total of about 750 companies listed on the Singapore Exchange (representing about 60% of the total market capitalisation) as of 31 December 2016.

2.13 Due to the higher element of public interest, inspections in the listed companies segment are carried out directly by ACRA's inspectors and the scope of inspection is as follows:

(a) Public accountants are subjected to engagement inspections; and

(b) Firms are subjected to firm-level inspections, which includes the review of the firms' quality control policies and procedures.

2.14 The scope of inspection for the non-listed companies segment covers engagement inspections for the public accountants. ISCA's inspectors perform the inspections on public accountants in this segment under ACRA's regulatory oversight. This arrangement enables ACRA to focus its limited resources on higher risk audits. As the PAOC is the authority that decides on the outcome of inspections in both the listed and non-listed companies segments, this ensures that consistent regulatory outcomes is achieved across all inspections.

2.15 Although the audit firms in the non-listed companies segment have yet to be subjected to firm-level inspections, ACRA would urge the firms in this segment to embark on ensuring that their system of quality controls and procedures are in accordance with the requirement of SSQC 1. This will ensure that the firms have in place robust systems to ensure high quality audits.

## INTERNATIONAL PARTICIPATION

2.16 ACRA continues to take active roles in international developments in audit oversight and regulatory activities through its membership in IFIAR and engagement with regulators in the South East Asia region. These international and regional platforms seek to foster closer collaboration amongst ACRA and other independent audit regulators to serve the public interest and enhance investor protection by improving audit quality. Participation in such platforms also allows ACRA to benchmark its regulatory activities against other leading independent audit regulators and ensure its PMP remains robust and relevant.

## INTERNATIONAL FORUM OF INDEPENDENT AUDIT REGULATORS

2.17 IFIAR's mission is to serve the public interest and to enhance investor protection by improving audit quality globally. Established in 2006 with 18 founding members including ACRA, IFIAR promotes global collaboration and consistency in regulatory activities, and sharing of practical experience among the audit regulators. IFIAR also actively engages the leadership of the six largest global audit firm networks (GPPC networks)[6], primarily through IFIAR Global Audit Quality Working Group (GAQ WG) with the objective of improving audit quality globally.

2.18 ACRA was elected to serve on the Board of IFIAR for a four-year term at the 2017 IFIAR Plenary meeting in Tokyo, Japan. The meeting also saw the establishment of IFIAR's permanent secretariat in Japan to provide dedicated resource and continuity on IFIAR's organisational matters.

2.19 There are a total of six Working Groups set up to coordinate and organise IFIAR's activities for members and with stakeholders. Besides serving on the IFIAR Board, ACRA has also been a member of the GAQ WG since 2011 and the Investor and Other Stakeholders Working Group[7] since 2014. Being part of the Working Groups, it allows ACRA to contribute and influence dialogue with audit networks, engage global leadership of the largest audit firms and be kept abreast of the networks' developments, and build close relations with and learn from key and progressive regulators in the Working Groups.

2.20 One of IFIAR's key initiatives has been its annual survey of inspection findings that aims to highlight common findings found globally by regulators and to measure changes in those findings. IFIAR released its fifth annual survey of findings on 3 March 2017. The survey comprises findings from inspections of 36 IFIAR members including ACRA, focusing on the GPPC audit firms' systems for quality control and their audits of listed public interest entities[8]. Broadly consistent with prior years' surveys and ACRA's own inspections, findings were observed in mainly the following categories:

(a) Accounting estimates, including fair value measurement;
(b) Internal controls testing;
(c) Revenue recognition; and
(d) Audit sampling.

[6] Each of the GPPC networks is comprised of a group of legally separate firms operating locally in countries around the world. The GPPC networks participate in the Global Public Policy Committee (GPPC), represented by the following entities: BDO International Limited, Deloitte Touche Tohmatsu Limited, Ernst & Young Global Limited, Grant Thornton International Limited, KPMG International Cooperative, and PricewaterhouseCoopers International Limited.

[7] The Investor and Other Stakeholders Working Group is responsible for coordinating IFIAR's ongoing dialogue with representatives from investors, audit committees and other stakeholders, with focus placed on enhancing audit quality globally and promoting investor protection.

[8] Listed public interest entities comprise entities that have securities (equity or debt) traded on securities markets and exchanges, including entities that have significant public interest because of their business, size, or the fact they have a wide range of stakeholders.

2.21 In response to the persistent deficiencies noted from the survey, IFIAR continues to work with the GPPC audit firms on improving audit quality via a reduction target of at least 25% in inspected audits of listed public interest entities with at least one inspection finding, as reported by the nine members of the GAQ WG by 2019. ACRA, with the support of the local Big-Four audit firms, has adopted a similar target for Singapore.

2.22 From 31 October to 4 November last year, ACRA also hosted the IFIAR Interim Meeting and the Global Audit Quality Working Group Meeting in Singapore. In conjunction with these meetings, IFIAR members also took the opportunity to mark IFIAR's decade-long efforts to raise global audit quality with a 10th anniversary celebration dinner held on 1 November 2016.

2.23 At the 11th IFIAR Inspection workshop held in Greece in February this year, ACRA met fellow independent audit regulators to share practical experiences and discuss best practices in audit inspection matters. This was the first time that ACRA co-hosted a Small Regulators Task Force session to share with other small regulators our experience in IFIAR. ACRA's officers were also the facilitators for some of the elective sessions attended by more than 100 inspectors from IFIAR members.

2.24 ACRA remains committed to supporting IFIAR in its global work to promote high quality audits. We will continue to contribute actively and collaborate closely with fellow IFIAR members to raise audit quality. ACRA's active participation in IFIAR enables Singapore to provide our insights and raise awareness to audit quality concerns in the Southeast Asia region. It also allows ACRA to benchmark its audit regulation against international practices and engage the international community on cross-border practices that may impact the delivery of high quality audits.

## REGIONAL ENGAGEMENT WITH AUDIT REGULATORS IN SOUTH EAST ASIA

2.25 In the South East Asia region, ACRA is part of an informal co-operation group ("the Group") which includes PPPK[9], Malaysia's AOB and Thailand's SEC. The Group's aim is to foster closer collaboration among the Group, and also to promote audit quality and achieve greater alignment in audit regulatory practices.

2.26 The Group's activities complement IFIAR's efforts to uphold the standards of audit quality by focusing on audit quality issues specific to this region. Some of the key initiatives are:

(a) **Annual Inspection Workshops** – these workshops are aimed at building capacity amongst the four audit regulators and other regulators in South East Asia. The topics discussed at these workshops include inspection developments, findings, best practices as well as emerging topics such as the use of data analytics to improve audit effectiveness and efficiency. The 5th annual inspection workshop hosted by Malaysia's AOB in February 2017 saw over 75 participants from 12 jurisdictions made up of the 9 South East Asian countries, China, Japan and Hong Kong. This year's workshop also marked the first collaboration with World Bank. To complement the Group's on-going efforts to raise the bar for audit quality, the World Bank's Centre for

[9] Also known as Pusat Pembinaan Profesi Keuangan ("PPPK").

Financial Reporting Reform ("CFRR"), in collaboration with experts from the East Asia Pacific region of the World Bank's Global Governance Practice, has secured funding from various sources and is providing technical assistance to boost capacity building efforts. Representatives from the World Bank also shared insights on various audit oversight models around the world to aid those in the process of establishing their audit regulatory regimes in this region.

(b) **Annual Meetings** – these are meetings held with the regional leadership and international representatives from the Regulatory Working Group of the GPPC audit firms to discuss current and emerging topics affecting audit quality in the region. This year's meeting was hosted by Thailand's SEC. Such periodical dialogues with the firms mirror IFIAR's GAQ Working Group meetings and are beneficial in achieving a collaborative approach towards addressing common audit quality challenges.

(c) **Other Initiatives** – the Group has undertaken other initiatives to raise audit quality and promote the value of audit in this region. A key audit quality milestone was set in place this year when the Group collectively agreed with the Big-Four audit firms in Indonesia, Malaysia, Singapore and Thailand on a measureable goal to improve audit quality. This new initiative is to achieve a reduction of at least 25% in the number of listed companies' audits with inspection findings. The progress towards this goal will be monitored and measured at a national level by the respective Group members on an on-going basis. For a start, the Group will focus its efforts on the Big-Four audit firms given that they collectively audit a significant number of listed companies in the region. This initiative complements a similar initiative by IFIAR as highlighted above. To achieve this goal, the Group will step up its engagement with the audit firms' leadership to address the root causes of recurring inspection findings.

# SECTION 3

## FIRM-LEVEL INSPECTIONS FINDINGS

# SECTION 3: FIRM–LEVEL INSPECTIONS FINDINGS

## INTRODUCTION

3.1 An effective system of quality control acts as a safeguard in ensuring consistent execution of quality audits. Although firm-level inspections are performed on an advisory basis, ACRA is heartened by and appreciates the level of cooperation accorded to its inspectors throughout the inspection process. We are also encouraged by the firms' proactive and timely approach towards remediating the findings.

3.2 This section highlights some areas of improvements based on ACRA's inspections of firm-level quality controls on three of the SSQC 1 areas. The findings listed in this section may also benefit the audit firms in the non-listed companies segment seeking to strengthen their firm-level controls.

## LEADERSHIP AND TONE AT THE TOP – ELIGIBILITY OF EQCR PARTNERS

3.3 In determining the criteria for the eligibility of EQCR partners, SSQC 1.39(a) states that the firm shall establish policies and procedures to address the appointment of engagement quality control reviewers and establish their eligibility through the technical qualifications required to perform the role, including the necessary experience and authority. SSQC 1.A47 further states that what constitutes sufficient and appropriate technical expertise, experience and authority depends on the circumstances of the engagement. For example, the engagement quality control reviewer for an audit of the financial statements of a listed entity is likely to be an individual with sufficient and appropriate experience and authority to act as an audit engagement partner on audits of financial statements of listed entities.

3.4 Firms need to ensure that the EQCR partners for listed engagements have sufficient and appropriate technical expertise, experience and authority to challenge the more experienced audit partners. ACRA noted an instance whereby the firm had assigned a new partner as the EQCR partner for 11 listed engagements although the partner was registered as a public accountant just a year ago, whereas the engagement partners for these listed companies had between five and 15 years of experience in their role as an engagement partner. ACRA also noted for another firm where newly promoted partners acted as EQCR partners for two listed engagements in their first year of partner appointment. In both cases, the effectiveness of the EQCR process may be compromised as the EQCR partners were more junior than the engagement partners and thus may not have sufficient authority to carry out their EQCR duties effectively.

## LEADERSHIP AND TONE AT THE TOP – IMPROVEMENT IN CLIENT ALLOCATION PROCESS FOR PARTNERS REQUIRED

3.5 SSQC 1.A5 states that of particular importance in promoting an internal culture based on quality is the need for the firm's leadership to recognise that the firm's business strategy is subject to the overriding requirement for the firm to achieve quality in all the engagements that the firm performs. This should include ensuring that there is effective supervision of the engagement including sufficient levels of engagement partner and EQCR partner involvement at the appropriate times.

3.6 ACRA has been communicating its expectations on the involvement of senior auditors as follows:

(a) Engagement partner to spend at least 5% of total engagement hours for an engagement with normal risk rating and 10%[10] for an engagement risk of higher risk rating; and

(b) EQCR partner to spend at least 13 hours[11] on an engagement.

3.7 In the client allocation process for partners, ACRA noted an instance where an engagement partner was allocated eight listed companies (with seven having the same financial year-end in December), and was also the EQCR partner for another seven listed companies (with six having the same financial year-end in December). The same firm had another two partners who were also allocated with similar heavy concentrated portfolios.

3.8 This raised serious concerns on whether the partners were spending sufficient time to supervise and review the work of their audit staff. ACRA investigated further and noted that the hours incurred by the engagement partners and EQCR partners on the audit of December financial year-end listed engagements were low. For 12 out of the 19 listed engagements, the time spent by the respective engagement partners was less than 5% of total engagement hours. For 13 out of the 17 listed engagements, the time spent by the EQCR partners was each below 13 hours.

3.9 In ACRA's 2016 PMP report, ACRA has communicated that an engagement partner's portfolio should not have more than five listed companies with the same financial year-end, unless supported by other partner-level resources. While this target, as well as other AQI targets, are provided as guidance only and not to be interpreted without an understanding of the underlying contextual factors, ACRA believes that firms should strive towards achieving these targets.

[10] Based on ACRA's 2012 PMP annual report

[11] Based on an activity-based estimate in ACRA's Audit Practice Bulletin No. 1 of 2011: Engagement Quality Control Review, accessible at https://www.acra.gov.sg/training-and-resources/publications/bulletins-and-guidance/audit-practice-bulletin

## ENGAGEMENT PERFORMANCE – TIME SPENT BY PARTNERS ON AUDITS OF FINANCIAL INSTITUTIONS ("FI")

3.10 ACRA has previously emphasised the importance of having sufficient involvement by the engagement partners and EQCR partners to allow for proper planning, review of audit work and assessment of the key judgments required in the audit. Adequate levels of involvement by senior personnel is critical as ACRA has noted instances where audit deficiencies could have been avoided had the senior personnel been more involved in the audit.

3.11 ACRA noted in two firms that there were high concentration of FI engagements with December financial year-end held by a few partners. This resulted in low involvement by the engagement partners and EQCR partners on their engagements. For one firm, one of the partners had 28 FI engagements, and was also the EQCR partner for another 18 engagements, all with December financial year-end. As a result, the amount of time spent on the FI engagements were low, with 24 out of 28 engagements registering engagement partner time spent of less than 5%[12]. In addition, the partner spent an average of two to six hours as EQCR partner on the engagements, far below ACRA's target of 13 hours.

3.12 For another firm, one of the partners had as many as 30 FI engagements with the same financial year-end. The engagement partner's time spent for each of the engagement was less than 5%.

3.13 The low engagement partner and EQCR partner hours are indicative that they may not be spending adequate time on the engagement. An appropriate allocation of engagements is critical to ensure that the engagement partner and EQCR partner spend adequate time to review and supervise the audit. Given the wide spectrum of FI engagements, ACRA urge the firms to review and set benchmarks for audits of engagements in the FI segment to ensure there is sufficient review and supervision by the senior audit personnel.

## ENGAGEMENT PERFORMANCE – USE OF DATA ANALYTICS ("DA") AND OTHER EMERGING TECHNOLOGIES

3.14 Techniques and processes, such as DA, mine data to discover and analyse patterns, identify deviations and inconsistencies, extract useful information and identify relationships from voluminous data. There is an evolution from the traditional approach to analytics (e.g. using Microsoft Excel) to the use of technology-enabled tools to examine data. Its evolution has been driven by the increasingly higher volumes of transaction data, rising complexities in businesses and a desire for more effective and efficient audits.

[12] General benchmark of 5% is used as FIs are included within ACRA's definition of public interest entities ("PIEs").

3.15 In the past, DA had been used in the execution of journal entries testing. From recent inspections, ACRA noted that there is an increasing trend in the use of DA for the following purposes:

(a) Recalculation of depreciation expenses by item;
(b) Recalculation of interest expenses;
(c) Performance of three-way match between purchase order, goods receipt report and vendor's invoice; and
(d) Analysis of margins and highlighting items with negative margins.

3.16 The benefits of the use of DA cannot be understated. It enhances audit quality through effective risk identification, which enables engagement teams to focus and direct their audit testing on higher risk areas that require more professional judgement. Results from DA are presented mostly in diagrammatic or graphical format, which allows for easy and quick analysis by the auditors for patterns, co-relationships, outliers and abnormalies in the underlying data for the purpose of an audit. Furthermore, DA enables analysis of entire data sets instead of testing the data on a sample basis.

3.17 While ACRA is cautiously optimistic about the potential of DA, there will be challenges faced by auditors in the adoption of DA. For instance, specialised skills set, such as that of a data scientist, may be required for more complex data analysis. Even for more general DA tools, firms would need to invest significantly in training and time resources to train its staff on the use of such tools, which may continue to evolve and hence necessitates continuous investment in resources. In addition, audit firms need to also ensure that whenever DA is used, the underlying data that is extracted from the client's information systems must be accurate and complete, including ensuring that the integrity of data is not compromised during the data transfer process. Finally, firms need to address data confidentiality and security issues, especially with unprecedented large amounts of data obtained from the clients.

3.18 To prepare staff for the use of DA, firms need to issue guidance on the extent of documentation and retention of audit evidence in the audit working papers. This should also include guidance on determining what would be an appropriate level of work for exceptions that are identified through DA, as well as clarifying the amount of documentation to be retained for the tests and analyses performed. In addition, firms should ensure that the staff deployed on the DA have sufficient industry, client knowledge and audit experience to analyse the DA results.

3.19 ACRA noted an increase in the number of engagements that employ the use of DA. During one of the firm-level inspections, ACRA noted an engagement where the results of DA on testing of journal entries (e.g. number of hits by parameters) were not retained in the audit working papers. As the results of DA (from the DA team) were typically not "archived" upon completion of the audit, and the DA results on journal entries testing were not retained in the audit working papers, the engagement team would not be able to demonstrate that the DA results were those that were obtained during the audit. Consequently, it was therefore not evident that the engagement team had assessed the results of DA and its subsequent impact on the substantive audit procedures performed by the audit team during the audit.

3.20 Arising from the above, ACRA recommends firms to ensure adequate documentation is retained in the audit working papers in relation to the results of DA and the subsequent audit approach of the audit engagement team to ensure the extent of documentation complies with the requirements of paragraph 8 of SSA 230 *Audit Documentation*. Additionally, the documentation should be sufficient to enable re-performance of the audit work executed and arriving at the same conclusion.

3.21 Along with DA comes other high potential game-changers – artificial intelligence and blockchain technology. Some of the audit firms are already starting to experiment with these new frontiers in technology. Disruptive technology will ultimately transform the existing audit model. Auditors and audit firms should keep abreast of such changes, analyse and utilise them to their advantage, especially with lower barriers to investments with the passage of time.

## ENGAGEMENT PERFORMANCE – DISCLOSURE OF AQIS

3.22 ACRA's AQI Disclosure Framework is a framework available for voluntary adoption by the audit committees of all listed entities in Singapore. It comprises eight comparable quality markers that correlate closely with audit quality. The aim is to enhance the discussions between the audit committees and audit firms on audit quality matters during the selection or reappointment of auditors. To enable meaningful discussions, the disclosure of AQIs should be consistent both within and across audit firms.

3.23 For example, in respect of the AQI disclosure on "Time Spent by Senior Audit Team Members", ACRA noted that there were inconsistencies noted in the computation and presentation of the AQIs by the engagement teams of one audit firm. For example,

(a) Engagement 1 - The engagement team had presented the AQI for the audit for the Singapore firm and the member firms of the same network separately. This was in accordance with ACRA's guidance issued in October 2015.

(b) Engagement 2 - The AQI that was disclosed to the audit committee excluded the hours incurred by certain team members but had included the budgeted hours to complete the audit assessed at the time when the AQI was presented to the audit committee.

(c) Engagement 3 - The AQI that was presented to the audit committee excluded the audit team's budgeted hours to complete the audit.

3.24 Given the above, ACRA recommends firms to provide further and specific guidance to engagement teams or enhance its existing templates available for use by the engagement teams.

3.25 The Big-Four audit firms had voluntarily adopted the AQI Disclosure Framework in January 2016. ACRA will continue its efforts to encourage the non Big-Four audit firms in the listed companies segment to adopt the AQI disclosure. ACRA will also step up its efforts to engage and educate the audit committees on the use of AQIs. Specifically, ACRA has been engaging the medium-sized audit firms in this segment on the adoption of AQIs and is planning for an enhanced set of AQI disclosure, which will apply to these audit firms.

## ENGAGEMENT PERFORMANCE – PREVENTING UNAUTHORISED AMENDMENTS TO AUDIT WORKING PAPERS AND GRANTING OF SUPER USER RIGHTS TO AUDIT SOFTWARE

3.26 During one of the firm-level inspections, ACRA noted an instance where the audit firm assigned super user rights to the audit software to six audit staff below managerial level. This enables them to:

(a) Assign audit software users with access to audit files;

(b) Create new user IDs and passwords for all audit software users; and

(c) Access to the passwords of all audit software users via the audit software email account.

3.27 The assignment of audit software super user rights to junior audit staff exposed the firm to potential risks, such as:

(a) Granting unauthorised access to confidential information in the audit files by super users to non-engagement team members; and

(b) Compromising the integrity of audit evidence in the audit files through unauthorised access.

3.28 In another audit firm, ACRA noted that edit or review access rights were given to all invited team members (assurance and non-assurance) within the audit software. This implied that any team member could potentially override the review previously made by the engagement partner and EQCR partner.

3.29 While the firm's audit software had the functionality to track amendments made to audit working papers previously reviewed by the engagement partner and EQCR partner, the responsibility lies with the engagement team to ensure that the engagement partner and EQCR partner were fully aware of changes made to critical audit working papers and re-reviewed them after the changes were made (e.g. evidenced by electronic sign-off in the audit software).

3.30 Arising from the above, ACRA urges firms to ensure there are processes and controls in place to prevent unauthorised amendments made to audit working papers, particularly on significant risks or areas involving management judgments and estimates, so as to preserve the integrity and confidentiality of electronic audit working papers. Firms should also perform periodic reviews of the existing audit software user ID accounts to detect any unauthorised access by non-engagement team members (including the super users) to the audit engagement files.

## MONITORING – DEFICIENCIES NOTED FOR INTERNAL REVIEWS

3.31 A robust monitoring process is one of the cornerstones of an effective system of quality control. Whilst one of the firms had performed a self-review on firmwide controls and rated itself as "good", ACRA noted six and 11 exceptions out of 20 samples tested each in the areas of ethical requirements and client acceptance and continuance respectively in its inspection. ACRA also noted repeated findings in the areas of timeliness of completion of assignment appraisal forms and orientation trainings for new joiners. ACRA further noted that there were no proper follow-up procedures performed on file archival exceptions noted from the firm's own internal testing. There is an indication that the firm's self-review on firmwide controls may not be robust.

3.32 For another audit firm, the post-issuance review for 15 out of the 25 engagements selected were not archived as at the scheduled date of the post-issuance review. Additionally, the post-issuance reviews of two of the 25 engagements with March year-end were completed in May/June of the following year. The effectiveness of the post-issuance reviews may be undermined if the quality review team reviews engagement files which were not archived at the point of review and/or if findings were not communicated to the engagement team on a timely basis.

3.33 Similar findings on late completion of internal reviews were also noted in many other audit firms in the listed companies segment inspected by ACRA last year. The lack of timeliness in the completion of the firm's internal reviews may compromise the expediency and effectiveness of the remediation process.

## MONITORING – ROBUST FRAMEWORK FOR ENGAGEMENT REVIEWS

3.34 A robust framework for engagement reviews should comprise the following elements:

a) Setting of clear assessment criteria to determine the ratings in the review questionnaire of the engagements reviewed – this should take into account the nature and severity of the findings before determining the ratings in the questionnaire.
b) Definition of a "severe" finding – clear guidelines should be set to define the severity of the findings.
c) Distinction between a "finding" versus a "documentation" finding – reviewers should not merely consider the findings as mere documentation findings. Clear criteria should be set to distinguish one from the other.
d) Direct linkage of the results to the partners' performance – there should be clear linkage of the review results to the partners' performance appraisals, including that for the EQCR partner.

## MONITORING – ROBUST FRAMEWORK FOR ROOT CAUSE ANALYSIS

3.35 ACRA views a robust root cause analysis and well-suited remediation plan as fundamental to enhancing audit quality. ACRA noted that while most firms had performed a root cause analysis and taken actions to remediate the findings raised during the firm's internal engagement reviews, the engagement findings continue to be repeated in the subsequent reviews. ACRA noted an instance where the firm's identification of root causes appeared too generic and not specific enough to the findings raised. For example, the same two root causes "*complex areas assigned to less experienced staff*" and "*review was performed too late and inadequate time spent to address issues identified*" were identified and applied to all findings. This indicated that the firm may not have deep-dived in finding out the real root causes for each finding as the root causes identified appeared too generic. The firm should continue to ask the five "whys" in order to get to the real underlying root causes. For instance, by asking the first "why", the firm may get the idea that the main root cause of the audit deficiencies was because the engagement partner had not spent adequate time in reviewing the engagements. However by continuing to ask the next "why" and rather than stopping at the first, the firm may find that the real cause of the reason that the engagement partner was not spending adequate time in the engagements was because he may be overwhelmed by his portfolio.

3.36 ACRA also noted that the firm's remediation plans lacked sufficient detail to demonstrate that they would be effective in addressing the findings.

3.37 In addition, ACRA expects the firms' root cause analysis framework for both internal reviews and external inspections to include:

(a) An evaluation of the effectiveness of actions taken to remediate findings noted; and

(b) An analysis of the effectiveness of the root causes identified in the prior year vis-a-vis repeated findings.

3.38 A robust root cause analysis is important to ensure proper identification of the underlying root causes for the findings and effective remediation plans are taken to address these root causes. ACRA will closely monitor the robustness of the root cause analysis and effectiveness of these remediation plans in follow-up inspections to help firms to improve.

# SECTION 4

## ENGAGEMENT INSPECTION FINDINGS

# SECTION 4: ENGAGEMENT INSPECTION FINDINGS

## INTRODUCTION

4.1 For this year, ACRA will be presenting the inspection findings using a hybrid approach, i.e., non-case study and case study. One of the more common inspection findings relate to construction contracts. However, as the pitfalls surrounding the auditing of construction contracts had been discussed extensively in 2015 PMP annual report through the use of case studies, the focus on construction contracts for this year will be more on deliberating the various aspects that public accountants should consider when auditing construction contracts.

4.2 Other engagement inspection findings are presented in the form of scenario-based case studies mirroring some of the recurring observations and scenarios that ACRA inspectors had come across during the inspections. Through providing a practical perspective on how the findings can be remediated, ACRA hopes that this would enable public accountants to better appreciate how such findings could have been avoided.

4.3 The current year's report focuses on the following topics where findings were observed in the most recent inspection cycle:

(a) Construction contracts

(b) Audit evidence and accounting estimates and fair value measurement

- (i) Case Study 1 – Opening balances
- (ii) Case Study 2 – Functional currency and change of functional currency
- (iii) Case Study 3 – Inventories
- (iv) Case Study 4 – Valuation of investment in subsidiary
- (v) Case Study 5 – Valuation of trade receivables
- (vi) Case Study 6 – Valuation of deferred tax assets

4.4 The case studies are presented in the following format, which is similar to the format of the inspection findings report:

(a) Background information;

(b) Work performed by the engagement team;

(c) Work not performed by the engagement team; and

(d) Finding.

## CONSTRUCTION CONTRACTS

4.5 With regard to audits on construction contracts, prior to making the decision to accept the audit client, public accountants should seek to understand the client's business and key risks and have a good understanding of both FRS 11 *Construction Contracts* and auditing of construction contracts. Firms must also ensure that the audit staff have sufficient knowledge of auditing of construction contracts and are able to properly execute the audit procedures for construction contracts. Without these in place, firms should not accept the audit engagement.

4.6 In cases where the public accountant noted that the audit client may have accounted for construction contracts incorrectly, the public accountant may educate the client so as to improve the quality of the client's accounting for construction contracts. This will also ensure improved quality of management accounts prepared by the client in future.

4.7 For complex audits of construction contracts, firm should allocate these audits to more experienced partners, managers and staffs. Public accountants may also wish to embark on voluntary pre-issuance or post-issuance reviews of engagement files which may improve the quality of the audit performed.

4.8 During the audit, if the public accountant assessed that management's cost projections were not robust, there is a need to then obtain alternative sources of evidence to ascertain the reliability of the total estimated costs. For example, if there are significant projects that are in progress as at year-end that will be completed subsequent to year-end, the public accountant could assess the reasonableness of the estimated costs by obtaining the total actual costs incurred and ensured that these costs are not materially different to the estimated costs. In the event that the projects are still on-going after year-end, the public accountant could alternatively assess the reasonableness of the estimated costs by making reference to similar projects which had been completed in the past.

4.9 In the extreme scenario, where proper records of the projects are not kept or records are incomplete, such as unable to obtain significant contracts with suppliers, subcontractors or customers, the public accountant needs to consider the impact of the limitation of scope on the audit opinion issued.

## AUDIT EVIDENCE AND ACCOUNTING ESTIMATES AND FAIR VALUE MEASUREMENT

For the case studies on audit evidence and accounting estimates and fair value measurement, please refer to Appendix 1.

# SECTION 5

## COMPLIANCE CHECKS ON PUBLIC ACCOUNTANTS

# SECTION 5: COMPLIANCE CHECKS ON PUBLIC ACCOUNTANTS

## COMPLIANCE CHECKS ON CONTINUING PROFESSIONAL EDUCATION

5.1 Meeting the Continuing Professional Education ("CPE") requirement is one of the conditions for the renewal of certificate of registration by public accountants. Public accountants are required to undertake CPE in accordance with the CPE syllabus and provide details of the CPE courses undertaken for each year in their annual renewal application. Public accountants who do not pass the practice reviews may also be required to attend a regulatory course conducted by ISCA and achieve another 48 structured CPE hours in Category 1 or Category 3 courses, including technical training in the audit of certain areas during a stipulated period.

5.2 ACRA, jointly with ISCA, conduct sample checks on selected public accountants' compliance with (a) the CPE requirements for the annual registration renewal; and (b) any applicable PAOC order to acquire additional CPE hours. The key observations arising from past compliance checks have been shared in the Audit Practice Bulletins ("APB") No. 1 of 2014 and No. 3 of 2016[13]. Public accountants should refer to the APBs for clarification and guidance relating to CPE compliance.

5.3 Based on the compliance check for 2017 renewal, ACRA noted an improved rate of CPE compliance, reflecting greater awareness of the CPE requirements as compared to the previous compliance checks. ACRA would like to highlight the following areas for public accountants to take note of:

### A. CLASSIFICATION OF COURSE ON INTERNAL AUDIT

5.4 A course on Internal Audit where standards pertaining to the International Professional Practice Framework and Standards of the Institute of Internal Auditors should be classified as "Other" relevant expertise area instead of Category 3. ACRA would like to clarify that for a course to be classified as Category 3, the learning activities must be *directly* related to Auditing Standards, Pronouncements and Methodology for the audit of financial statements.

### B. ADDITIONAL CPE REQUIREMENT UNDER THE PAOC ORDER

5.5 Public accountants who are subject to PAOC order under the PMP should note that the requirement to attend the regulatory course is in *addition* to the requirement to achieve 48 CPE hours, including specific technical training, such as in the audit of FRS 2 Inventories. Thus, the public accountant is required to attend separate technical training on the specified audit area even if these areas may have been covered in the regulatory course.

### C. MAINTENANCE OF CPE RECORDS

5.6 Public accountants should maintain proper CPE records which should be furnished for verification upon request. For the purpose of determining compliance with CPE requirements, ACRA would disregard CPE hours which were unsupported, or supported by evidence not indicative of course participation (such as confirmation of course registration). Therefore, in the event that the original

[13] Audit Practice Bulletin No. 1 of 2014 and Audit Practice Bulletin No. 3 of 2016 are respectively accessible at https://www.acra.gov.sg/training-and-resources/publications/bulletins-and-guidance/audit-practice-bulletin

certificate of participation is lost or misplaced, the public accountant should obtain a replacement certificate or confirmation of attendance from the course provider to enable ACRA to verify his course participation.

### D. ENFORCEMENT ACTION TAKEN

5.7 Under the current legislation, the PAOC may cancel the registration of public accountants on the basis that they have obtained their registration by misrepresentation as contrary to their declaration in the registration renewal, they have not for example, complied with an applicable PAOC order.

5.8 For the 2017 compliance check, having considered the circumstances and reasons provided by the public accountant, the PAOC decided not to cancel the registration of public accountants on the condition that the public accountants concerned make up for the shortfall in CPE hours and acquire additional hours within a certain timeframe and submit a list of their CPE courses attended together with supporting documents for ACRA's verification before filing their next renewal online.

## COMPLIANCE CHECK ON PAOC ORDERS

5.9 Public accountants who failed the PMP are subjected to one of the following sanctions according to the severity of the fail outcomes:

| PMP Outcome (ranked by severity) | Corresponding Sanction |
|---|---|
| a) Fail with revisit | Subject 3 audit engagements to peer review within a period of 12 months from date of order |
| b) Fail with hot review | Subject a certain number of audit engagements to be reviewed by approved hot review partner(s) within a period of 9 to 12 months from date of order |
| c) Fail with restriction followed by hot review | Restricted from performing any audit and reporting on financial statements of:<br>• Any public company that is not dormant;<br>• Any private company that is not dormant and not an exempt private company ("EPC"); and<br>• Any EPC that is not dormant and has annual revenue of more than $10 million* during the public accountant's restriction period.<br><br>Following the expiry of the restriction period, the public accountant will be subjected to a hot review order on a certain number of audit engagements over the following 9 to 12 months.<br>** - Threshold was set at $5 million prior to the effective date of the Companies Act amendments on 1 July 2015* |
| d) Fail with suspension | Suspended from practice as a public accountant over a period of time not exceeding 24 months |
| e) Fail with cancellation | Registration as a public accountant is cancelled |

5.10 ACRA performs an annual compliance check on PAOC orders issued, including hot review, restriction, suspension and cancellation orders and noted that there are public accountants who did not comply with the PAOC orders. For example:

### FOR HOT REVIEW ORDERS

a) Hot review engagements completed after hot review order period;
b) Partial completion of hot review engagements (for example, completing three out of five engagements to be subjected to hot review during the hot review period); or
c) Did not fulfil the hot review orders as no audit engagements were sent for hot review during hot review order period.

### FOR RESTRICTION ORDERS

a) Signed off on the auditor's reports for active private companies during the restriction period; or
b) Signed off soon after the restriction order period, which may imply that the public accountants could have performed the audit during the restriction order period.

### FOR SUSPENSION ORDERS

a) Signed off of audit engagements during their suspension period; or
b) Auditors' reports were signed and back-dated to prior to the start/after the suspension period.

5.11 Public accountants on suspension order are deemed not to be registered as a public accountant during the period of suspension. As such, during the suspension, he/she cannot practice as a public accountant, hold himself/herself out to be a public accountant or use any title or description giving the impression that he/she is a public accountant or are otherwise authorised to provide public accountancy services.

5.12 ACRA would like to remind all public accountants of the importance of complying with any future PAOC orders and that they should request for an extension of time at least one month prior to the expiry of the PAOC orders if they require more time to fulfil their orders.

# SECTION 6

## INITIATIVES TO IMPROVE AUDIT QUALITY

# SECTION 6: INITIATIVES TO IMPROVE AUDIT QUALITY

## INTRODUCTION

6.1 Enhancing audit quality requires the efforts of all stakeholders involved. The accountancy professional bodies in Singapore, such as ISCA work closely with ACRA to improve audit quality and some of the initiatives by ISCA are mentioned below. Another key stakeholder which plays an important role in raising audit quality is the audit committees which have oversight role over the external auditors. In August 2016, ACRA has rolled out the six AQI targets initiative to guide them in assessing the quality of auditors.

## INITIATIVES BY ISCA

6.2 With the objective to help public accountants to improve the quality of their audit practices and audit engagements, ISCA had rolled out the Quality Assurance Review Programme ("QARP"). The QARP is a voluntary programme, which involves review of signed-off engagement files, firm-level quality control system and/or control system to combat money laundering and terrorism financing. The reviews are conducted by a Quality Assurance Reviewer, who will provide feedback on improvements areas and share good practices.

6.3 Various publications[14] and guidance had also been published by ISCA to serve as guide to public accountants to help them in various areas such as financial reporting, application of SSAs and accounting standards.

6.4 In addition, ISCA also offers various continuing professional education courses which range from technical updates for auditors, specific accounting and audit topics and ethics courses.

6.5 Another initiative by ISCA is the Practical Audit Workshop ("PAW") series which is designed to provide detailed and comprehensive audit training for different levels of proficiency (associates, seniors and managers).

6.6 ISCA has also conducted a series of outreach seminars and published commentaries aimed at creating awareness and changing the mind sets of its members regarding auditing, accounting and ethical issues. Some of the notable ones that have been carried out and are on-going include:

(a) Seminars on new and upcoming accounting standards such as financial instruments, revenue and International Financial Reporting Standards ("IFRS") convergence;

(b) Seminars on auditing and ethics related matters; and

(c) Publishing of technical commentaries relating to accounting standards, auditing issues and ethical matters in ISCA Journal and other publications.

[14] Include the following:
a) Illustrative Quality Control Manual ("IQCM") which provides guidance on the implementation of SSQC 1;
b) ISCA Audit Manual for Standalone Entities ("ISCA AMSE") which is an illustrative guidance to help public accountants in the application of the SSAs; and
c) OJT Blueprints which provides guidance on structured in-house on-the-job training for audit staff

## AQI TARGETS

6.7 The introduction of the six AQI targets aims at providing the audit committees with a common yardstick to evaluate audit firms quality.

6.8 The six AQI targets are set forth below:

| | AQIs at firm-level | ACRA's Targets |
|---|---|---|
| 1 | Staff retention rate | Between 75% and 80% |
| 2 | Staff oversight ratio<br>-Staff per partner ratio<br>-Staff per manager ratio | <br>Less than 15<br>Less than 5 |
| 3 | Number of listed company audits with the same financial year-ends allocated to each public accountant | Not more than 5 |

| | AQIs at the engagement-level | ACRA's Targets |
|---|---|---|
| 4 | Engagement partner hours over total engagement hours | At least 5%<br>(normal risk engagements)<br>At least 10%<br>(higher risk engagements) |
| 5 | Engagement partner and manager hours over total engagement hours | At least 20% |
| 6 | EQCR partner hours | At least 13 hours |

6.9 With the six targets set above, this would help the audit committees in having meaningful audit quality conversations with the audit firms.

6.10 ACRA noted that larger audit firms which audit listed entities had taken effort to meet the targets set and is heartened to see improvements at engagement-level where from the engagements inspected, ACRA noted a higher number of engagements with at least 5% of time spent by engagement partners and increased number of engagements with at least 20% of time spent by engagement partners and managers. This is evidenced by the increased in the proportion of engagements inspected that met ACRA's expected partner involvement from 36% (in 2016) to 59% (in 2017) and engagements inspected that met ACRA's expected partner and manager involvement from 30% (in 2016) to 41% (in 2017). For the involvement of EQCR partners, ACRA also noted an improvement based on the minimum threshold of 13 hours. The proportion of engagements with at least 13 EQCR hours has improved by 10% as compared to last year.

6.11 Whilst improvement is noted on an overall basis in terms of engagements inspected with at least 5% of time spent by engagement partners, ACRA noted low hours spent by engagement partners on financial institution engagements inspected as mentioned earlier in Section 3 of this report. Although ACRA is cognisant that the nature and size of the financial institutions may differ from normal listed companies, ACRA recommends that firms review and set benchmarks for this segment to ensure that there is sufficient review and supervision by engagement partners.

6.12 For AQIs at firm-level, ACRA noted the Big-Four audit firms had shown improvement while the medium-sized audit firms which audit listed entities had shown mixed results as these firms had improved on average staff retention rates but had yet to improve on the staff oversight ratios. Whilst the Big-Four audit firms have improved on the AQIs, both the Big-Four and the medium-sized audit firms which audit listed entities need to continue with their efforts in achieving the targets sets.

## PUBLICATION OF INSPECTION OUTCOMES

6.13 With effect from inspections commencing on or after 1 April 2017, ACRA will publish the names of public accountants who failed with hot review or restriction orders on their revisit inspections.

6.14 This is an initiative to strengthen ACRA's message to raise audit quality and act as a deterrence to public accountants who continue to display recurring audit deficiencies at revisit inspections. In addition, this will also motivate the public accountants to perform a proper root cause analysis, develop and implement effective remediation plans to improve the quality of their audits before the revisit inspections.

# APPENDIX 1

CASE STUDIES
ILLUSTRATIVE AUDITED
ENTITY 1

# APPENDIX 1: CASE STUDIES
# ILLUSTRATIVE AUDITED ENTITY 1

## BACKGROUND INFORMATION:

Company A, the holding company, was a local investment holding company with one wholly owned subsidiary, Subsidiary S1. It also held investment properties located in United States of America.

Subsidiary S1 manufactured and sold wafer machines. Machines were assembled upon order from customers and inventories comprised mainly machine parts and work-in-progress. In addition, the subsidiary held consignment stocks in its warehouse.

## OTHER INFORMATION ON COMPANY A WAS AS FOLLOWS:

Financial year end: 31 December 2016

Audit opinion: Unqualified (Other matter paragraph which states "the financial statements of the Company for the year ended 31 December 2015 were audited by another auditor who expressed an unmodified opinion on those statements on 14 June 2016")

Overall group materiality was determined to be USD300,000

Note:

(a) ACRA would like to stress that the case studies below **only serve as guidance and are not meant to set any standard on the nature and extent of the audit work.** Public accountants and their audit engagement teams are **cautioned to consider the application of the principles and guidance,** based on the distinct characteristics of each engagement.

(b) As the case studies are also meant to be focused on specific areas of the audit and deficiencies noted, the listed audit procedures in the case studies below **may not be exhaustive** for purposes of addressing all the audit assertions relating to any particular account balance or transaction. Public accountants and their engagement teams need to **exercise sound professional judgement and knowledge** in ensuring that the necessary procedures are performed to cover all related audit assertions.

# CASE STUDY 1

## AUDIT OF OPENING BALANCES

**Case Facts:**

This was an initial audit engagement (i.e. first year of audit) for the public accountant. In the past years, Company A was audited by another public accountant. This was duly disclosed in the "Other Matter" paragraph of the audit opinion.

## WORK PERFORMED BY THE ENGAGEMENT TEAM

The engagement team documented that all the account caption balances disclosed in the statement of financial position in the audited financials for 31 December 2015 were agreed to Company A's general ledger as at 1 January 2016. Specifically, the following audit procedures were performed by the engagement team:

(a) Obtained the current year's opening trial balance and management accounts;

(b) Confirmed that the prior period's closing balances have been correctly brought forward to the current period or where appropriate had been restated; and

(c) Considered the risk of material misstatement in the current period's accounts due to errors in the brought forward figures.

## WORK NOT PERFORMED BY THE ENGAGEMENT TEAM

The required work to be carried out in accordance with SSA 510.6[15] *Initial Audit Engagements – Opening Balances* was partially addressed by the public accountant who had only agreed the opening balances of the balance sheet items in the general ledger to the 31 December 2015 audited financial statements.

In addition to the above, as outlined in SSA 510.6, the public accountant is required to perform one or more of the following:

(i) review the predecessor auditor's working papers to obtain evidence regarding the opening balances; and/or

(ii) perform specific audit procedures to obtain evidence regarding the opening balances.

**Finding:**

In the absence of other work performed, the public accountant failed to perform adequate work on opening balances.

[15] SSA 510 .6 states that the auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by: (Ref: Para. A1-A2)
(a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated;
(b) Determining whether the opening balances reflect the application of appropriate accounting policies; and
(c) Performing one or more of the following: (Ref: Para. A3–A7)
(i) Where the prior year financial statements were audited, reviewing the predecessor auditor's working papers to obtain evidence regarding the opening balances;
(ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
(iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

# CASE STUDY 2

## FUNCTIONAL CURRENCY AND CHANGE OF FUNCTIONAL CURRENCY

**Case Facts:**

Company A changed its functional and presentation currency from Singapore Dollars ("SGD") to United States Dollars ("USD") during the financial year ended 31 December 2016 and accounted for the change prospectively. There was no change to the company's underlying transactions during the year and the change was as a result of management realising that the functional currency was incorrectly assessed as SGD instead of USD. Consequently, in the 31 December 2016 financial statements, all the comparatives in the statements of financial position, statements of comprehensive income, statements of changes in equity for both group and the company, as well as the consolidated statement of cashflows had been translated from SGD to USD using the same exchange rate of 1 USD: 1.4 SGD as at 31 December 2015.

Extract of statements of financial position as at 31 December 2015:

| Details | Recorded by management (USD Million) |
|---|---|
| Investment properties | 6 |
| Investment in subsidiary | 4 |

## WORK PERFORMED BY THE ENGAGEMENT TEAM

A checklist was completed by the engagement team to determine the functional currency of the company. The currency for all primary and secondary indicators was indicated to be USD. The engagement team then concluded that "*As discussed with director, Mr X, the Company has adopted the USD as the functional currency from 2016 onwards.*"

## WORK NOT PERFORMED BY THE ENGAGEMENT TEAM

As this is a correction of a prior period error, the change in functional currency should have been applied retrospectively in accordance with FRS 8.42[16] *Accounting Policies, Changes in Accounting Estimates and Errors*.

The incorrect application of FRS 21 could have a significant impact on the financial statements since:

(a) The investment properties (measured based on the cost model) were acquired 3 years ago when the exchange rate were significantly different at 1 USD: 1.2 SGD;

(b) Subsidiary S1 was incorporated on 30 April 2011, when the exchange rate was at 1 USD: 1.3 SGD; and

(c) The Company presents consolidated financial statements, and the share capital and reserve accounts, in particular the translation reserve arising from consolidation, could be materially different.

**Finding:**

Given that there was no change in the underlying transactions, events and conditions of Company A from the previous years and the change was made due to management realising that the functional currency was incorrectly assessed to be SGD instead of USD, the change should have been accounted for retrospectively.

[16] Subject to paragraph 43, an entity shall correct material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by:
(a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or
(b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

# CASE STUDY 3

## AUDIT OF INVENTORIES

**Case Facts:**

Inventories balance for Subsidiary S1 amounted to USD15 million as at 31 December 2016, representing 40% of total assets.

It was disclosed in Note 2(j) to the financial statements that inventories were stated at "*the lower of cost and net realisable value…Cost is determined on a weighted average basis…*".

Information on the age of the inventories were not available. The engagement team had noted consignment inventories at the various inventory locations and requested management to identify the consignment inventories. Management then identified consignment inventories amounting to USD1.5 million and reversed this from the inventory balance via an audit adjustment.

The machines sold carried 7 years warranty and a provision for warranty of USD500,000 was recorded as at 31 December 2016.

During the year, there were significant fluctuations in raw material prices. Machines sold generally had thin gross profit margins, ranging from 5% to 8%.

## WORK PERFORMED BY THE ENGAGEMENT TEAM

### UNIT COST

For testing of accuracy of costing for raw materials, the engagement team selected 20 inventory samples for raw materials and compared the unit cost recorded in the inventory listing to the unit cost recorded in the latest purchase invoices. The differences which arose (ranging from 3% to 7%) were not identified as exceptions.

### NET REALISABLE VALUE ("NRV")

The engagement team performed the following audit procedures for testing of NRV on a sample of 17 machines which were partially completed as at year-end:

(a) Performed test of details by vouching to supporting documents for the material and labour costs additions during the year for each of the 17 machines; and

(b) Compared the budgeted costs of the 17 machines against the latest available transacted prices.

- (i) six out of 17 machines were compared against selling prices subsequent to year-end; and
- (ii) 11 out of 17 machines were compared against selling prices from current and prior year's sales as there were no sale of these machine models subsequent to year-end, up to the date of audit fieldwork in mid-February 2017.

The engagement team noted that the inventories were correctly valued at lower of cost and NRV.

### CONSIGNMENT INVENTORIES

The engagement team filed the following documents:

(a) A listing of the consignment inventories showing the company code, location code, item code, description, vendor code, unit cost, quantity and value of each consignment inventory;

(b) The agreement between one of the two consignment vendors with Subsidiary S1 dated 30 September 2013; and

(c) An email correspondence dated 16 July 2016 between the regional sales director of the other consignment vendor and Subsidiary S1 reconfirming some key operational aspects of the consignment arrangement between the two parties. In addition, an inventory listing as at 31 May 2016 was also attached by the vendor.

### INVENTORY OBSOLESCENCE

The engagement team indicated *"Done, none noted"* on the audit program for the audit procedure: *"review the inventory listings and ensure that any items identified as damaged, slow moving or obsolete have been correctly written down"*.

It was also documented in the auditing working paper that:

- *"The director is in the opinion that the items can be sold and no obsolete nor slow-moving stocks noted."*
- *"There were no shelf life for inventories and they are not perishable"*.
- *"There were no obsolete or slow moving stocks noted during stock take."*

The engagement team also documented in the physical inventory count memos for the various count locations that there were slow moving and obsolete stocks which were kept separately.

### PROVISION FOR WARRANTY

The engagement team had documented that the warranty was based on assessment by management using 10% of the value of the inventories sold. They assessed that as this was consistent with FY2015, this was considered reasonable.

## WORK NOT PERFORMED BY THE ENGAGEMENT TEAM

The public accountant had not performed sufficient appropriate work in the following areas:

### UNIT COST

The audit procedures performed were not effective in testing whether the cost of raw materials were stated correctly in accordance with the weighted average costing formula given that there was no basis for:

(a) Comparing the unit costs of the samples selected only to the unit costs stated in the latest purchase invoices during the year, and

(b) Concluding that the resulting differences arising from (a) above, which ranged from 3% to 7%, were not exceptions.

The engagement team should perform audit procedures to test the costing formula to ensure that the unit costs of the samples are in accordance with the company's accounting policy. In addition, it was not evident that the engagement team had performed sufficient audit procedures to follow up on the differences and assessed if extension of samples are required.

### NET REALISABLE VALUE ("NRV")

(a) The engagement team had not assessed and considered that the actual cost to complete each machine approximated its budgeted cost as:
   (i) the material and labour costs incurred as at balance sheet date for all 17 WIP machines were not checked for completeness;
   (ii) there was no review on the costs-to-complete to assess that the budgeted cost was an appropriate proxy of the cost of a completed machine, and

(b) The engagement team had not assessed if it was appropriate to use the sales price for dated transactions as a proxy, instead of the sales order price agreed with customers, to compare against the budgeted costs of the 11 WIP machines to conclude that the margins for these machines were positive.

As a result, the work performed to ascertain that WIP was carried at the lower of costs and NRV was ineffective.

### CONSIGNMENT INVENTORIES

There was no work on consignment inventory of USD1.5 million either by confirmation with the consignment vendors or via alternative work to verify existence and completeness of consignment inventories.

### ALLOWANCE FOR INVENTORY OBSOLESCENCE

There was no work performed to corroborate management's assessment that no allowance for inventory obsolescence was necessary.

### PROVISION FOR WARRANTY

There was no work performed to corroborate management's assessment that a provision for warranty amounting to 10% of the value of the inventories sold was reasonable.

**Findings:**

The public accountant had not performed sufficient and appropriate work to address the existence, rights and valuation assertions of the inventory balance, and there was a lack of corroborative work performed to assess the basis and adequacy of provision for warranty.

# ILLUSTRATIVE AUDITED ENTITY 2

## BACKGROUND INFORMATION:

Company B, the holding company, is in the business of distributing electrical appliances. It sells these electrical appliances to both local departmental stores as well as retail customers.

Company B has a wholly owned subsidiary, Subsidiary S2, whose principal activity is that of manufacturing and trading of electrical appliances.

Both Company B and Subsidiary S2 were incorporated in Singapore and audited by the same public accountant. Company B prepared consolidated financial statements as it did not meet the criteria for exemption from presenting consolidated financial statements.

## OTHER INFORMATION ON COMPANY B AND S2 WERE AS FOLLOWS:

Financial year end: 31 December 2016
Audit opinion: Unqualified
Group's materiality was determined to be $2 million.

**Note:**

(a) ACRA would like to stress that the case studies below **only serve as guidance and are not meant to set any standard on the nature and extent of the audit work.** Public accountants and their audit engagement teams are **cautioned to consider the application of the principles and guidance,** based on the distinct characteristics of each engagement.

(b) As the case studies are also meant to be focused on specific areas of the audit and deficiencies noted, the listed audit procedures in the case studies below **may not be exhaustive** for purposes of addressing all the audit assertions relating to any particular account balance or transaction. Public accountants and their engagement teams need to **exercise sound professional judgement and knowledge** in ensuring that the necessary procedures are performed to cover all related audit assertions.

# CASE STUDY 4

## VALUATION OF INVESTMENT IN SUBSIDIARY

**Case Facts:**

Company B's investment in Subsidiary S2 as at 31 December 2016 was $50 million, representing 20% of the Company's total assets. Subsidiary S2 was loss-making for both FY2015 and FY2016 after deduction of operating expenses. The net total assets of Subsidiary S2 was $40 million and $45 million as at 31 December 2016 and 31 December 2015 respectively. This subsidiary also generated negative cashflows of $5 million from operating activities for 31 December 2016 (31 December 2015: $4 million)

## WORK PERFORMED BY THE ENGAGEMENT TEAM

The engagement team performed the following procedures over the investment in Subsidiary S2:

(a) Agreed the closing balance to the general ledger;

(b) Agreed the opening balance to prior year's audit working papers; and

(c) Agreed the company's shareholdings to extract of information relating to Subsidiary S2 from ACRA's BizFile.

Based on the sole procedure of enquiring with management, the engagement team agreed with management that there was no indicator of impairment for investment in S2 and no allowance for impairment was required as Subsidiary S2 was recently in final negotiation with potential new customer to secure a huge sales order amounting to $100 million.

## WORK NOT PERFORMED BY THE ENGAGEMENT TEAM

There was no work performed to corroborate management's assessment that no allowance for impairment was required for the investment in Subsidiary S2 as at year-end. This was despite:

(a) The cost of investment in Subsidiary S2 of $50 million has exceeded Subsidiary S2's net total assets of $40 million by $10 million as at year-end;

(b) Subsidiary S2 generated losses in FY 2015 and FY 2016; and

(c) Subsidiary S2 had negative cashflows from operating activities.

In view of the impairment indicators, the public accountant should have considered the need to obtain a discounted cash flow forecast from management to assess whether the recoverable amount of the investment in Subsidiary S2 is higher than the carrying amount of the investment as at balance sheet date.

In addition, there was also no supporting documents available to evident the potential sales order of $100 million from a new customer.

**Finding:**

Other than obtaining management's representations that Subsidiary S2 was in final negotiation to secure a huge order, the public accountant had not obtained corroborative evidence that the potential huge order would materialise. Accordingly, it was unclear how the public accountant had evaluated and concurred with management that no impairment allowance was required for the investment in Subsidiary S2, despite the indicators of impairment.

# CASE STUDY 5

## VALUATION OF TRADE RECEIVABLES

**Case Facts:**

As at 31 December 2016, trade receivables of Company B amounted to $15 million, representing 6% of total assets. Company B did not offer credit period to its customers. Therefore payment was supposed to be made upon delivery. As at year end, 61% of Company B's trade receivables were past due more than 90 days.

## WORK PERFORMED BY THE ENGAGEMENT TEAM

The engagement team selected 15 samples, totalling $11.25 million or 75% of the total trade receivables outstanding to check for subsequent receipts after year-end. It was noted that $3.4 million or 30% of the $11.25 million was subsequently paid by the debtors.

The engagement team represented that they had concurred with management that no impairment of trade receivables was necessary since Company B had no history of bad debts and that there had been subsequent receipts after year end.

## WORK NOT PERFORMED BY THE ENGAGEMENT TEAM

The aging profile of the trade receivables balance outstanding as at year end, after accounting for the subsequent receipts of $3.4 million was as follows:

| Overdue by: | $ million | % |
|---|---|---|
| 0 to 30 days | 0.9 | 8% |
| 31 to 60 days | 0.8 | 7% |
| 61 to 90 days | 0.7 | 6% |
| More than 90 days | 9.2 | 79% |
| Total trade receivables | 11.6[17] | 100% |

No work was performed to assess the collectability of the long outstanding debts, particularly the amounts which had been overdue for more than 90 days.

**Finding:**

There was inadequate work performed to address the valuation assertion as no work was performed to corroborate management's assessment on the recoverability of the remaining overdue trade receivables of $9.2 million that were aged more than 90 days.

Upon inquiry, the public accountant represented that the Company had no history of bad debts. Nevertheless, sole reliance on the company's past history of not having bad debts would not be considered sufficient audit evidence obtained to concur with management's representation that there was no recoverability issue on the overdue trade receivables as at balance sheet date.

[17] Derived from the total receivables of $15 million net of subsequent receipts of $3.4million

# CASE STUDY 6

## RECOGNITION OF DEFERRED TAX ASSETS

**Case Facts:**

Company B is the sole distributor of a particular brand of consumer electronics in Singapore. Sales from this brand of consumer electronics contributed to 80% of total sales for Company B. During the year, due to a bad scandal associated with this brand of consumer electronics, sales had dropped drastically and as a result, Company B experienced a sharp decrease in profit before tax from $10 million in FY2015 to $5 million during the current year.

As disclosed in the financial statements, the deferred tax assets as at year-end amounted to $27.5 million, representing 11% of total assets.

This deferred tax asset was recognised on the deductible temporary differences arising from the provision of warranties.

## WORK PERFORMED BY THE ENGAGEMENT TEAM

The work performed by the engagement team was limited to the arithmetical computation of the deductible and taxable temporary differences arising from the provision for warranties and depreciation respectively as at year-end.

The public accountant represented that Company B had been profitable historically and had been paying income taxes in the past, and that management was confident that Company B would remain profitable.

## WORK NOT PERFORMED BY THE ENGAGEMENT TEAM

There was no work performed to assess the appropriateness of the recognition of deferred tax assets amounting to $27.5 million in the current financial year, considering the sharp decrease in the profits during the year.

**Findings:**
There was no evidence on file to demonstrate that the public accountant had considered and evaluated that there would be sufficient profits generated in the future against which deductible temporary differences can be utilised.

The public accountant made the representation that Company B was profitable and had paid income taxes historically. The public accountant had relied on management's representations without performing any corroborative work to assess whether there would indeed be sufficient taxable profits available in the foreseeable future in assessing the extent to which deferred tax assets can be recognised. This was especially critical as there was significant decrease in the profitability of Company B.

ACCOUNTING AND CORPORATE
REGULATORY AUTHORITY

Accounting and Corporate Regulatory Authority

10 Anson Road
#05-01/15 International Plaza
Singapore 079903
www.acra.gov.sg

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