ACRA
ACCOUNTING AND CORPORATE REGULATORY AUTHORITY

PRACTICE MONITORING PROGRAMME

8TH
Public Report
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The Accounting and Corporate Regulatory Authority ("ACRA") is the national regulator of business entities and public accountants in Singapore. ACRA also plays the role of a facilitator for the development of business entities and the public accountancy profession. The mission of ACRA is to provide a responsive and trusted regulatory environment for businesses and public accountants.

SCOPE / DISCLAIMER

ACRA's oversight of the profession has been stringent and its inspection methodologies have evolved to be more rigorous but also more targeted and risk based. Therefore the observations in this report, while raising some concerns, reflect a rigorous approach and a high benchmark reflecting the need to maintain a high degree of confidence in the financial information that underpins Singapore's markets.

In presenting the specific findings in this report, efforts have been made to provide as much of the context as possible under which these findings arose in the PMP. The findings should not be read in isolation or regarded as creating mandatory rules in addition to the auditing standards. Public accountants should read and assess the applicability and severity of each of the findings in the broader context of upholding the profession's standards and in careful consideration of the uniqueness of individual audit engagements.

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ACRONYMS

AARG	ASEAN Audit Regulators Group
FRS	Financial Reporting Standards
IFIAR	International Forum of Independent Audit Regulators
PAOC	Public Accountants Oversight Committee
PIE	Public Interest Entity
PMP	Practice Monitoring Programme
SSA	Singapore Standard on Auditing
SSQC 1	Singapore Standard on Quality Control 1

Contents

1 Executive Summary

- **ACRA's regulatory and engagement strategy aims to strike a right balance amongst the various stakeholders in the financial reporting value chain.**
- **To achieve a high quality of audit, all stakeholders need to put in a collective effort to continuously improve and diligently discharge their duties.**

Financial Reporting: Striking a New Balance

1.1 Singapore has a strong competitive advantage of being a **trusted financial and business hub**. For the eighth straight year, the World Bank has ranked Singapore as the world's easiest place to do business. More recently, based on the Economist Intelligence Unit's Business Environment ranking, Singapore is expected to retain the top spot for doing business over the next five years. This will not be an easy task, considering the heightened demands and competition in the marketplace.

1.2 To make Singapore the trusted and best place for business, **ACRA continuously reviews its regulatory strategy on various fronts** to ensure it remains effective, relevant and progressive. On the financial statement preparation front, ACRA has **enhanced its Financial Reporting Surveillance Programme ("FRSP") and expanded its scope** to reinforce preparers and directors' **responsibilities in preparing financial statements**.

1.3 On the auditing front, ACRA has carried out a reform to **enhance its risk-based inspection programme** for firms and public accountants. These enhancements, as detailed in **Section 4** of the report, aim to improve the effectiveness of its inspections and focus its inspections on risk areas.

1.4 In addition, ACRA will step up its engagement with other stakeholders such as academics, audit committees and investors. For example, ACRA collaborated with the Singapore Management University ("SMU") on a survey to study **the prevalence of audit adjustments made to financial statements of listed companies in Singapore**. The survey, published in August 2014, re-affirmed the importance of the auditors' work in improving the reliability and accuracy of financial statements. Recognising the **importance of audit committees**, ACRA will discuss the results of this survey as well as the updated Guidebook for Audit Committees in Singapore with audit committees.

1.5 In summary, **quality financial reports require the involvement of various stakeholders in the financial reporting value chain**. ACRA's regulatory and engagement strategy is to strike a right balance amongst these stakeholders. This balanced approach is key to safeguarding stability and public confidence whilst ensuring efficiency and competitiveness in the marketplace.

Strengthening Audit Quality to Enhance Investor Confidence

1.6 ACRA carries out the Practice Monitoring Programme ("PMP") to inspect the public accountants' work. This year, the findings are presented in case studies in **Section 3** of this report to mirror the observations encountered during ACRA's inspections.

1.7 By highlighting these practical examples, ACRA hopes to provide greater clarity on how it assesses the adequacy of the public accountant's work. Given the recurrence of findings in the key themes such as revenue recognition, accounting estimates (including fair value measurement) and group audits over the years, these themes will be included as risk focus areas under ACRA's **enhanced risk-based approach**.

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

1.9 ACRA participates and engages the international audit regulator community regularly on audit quality matters via its involvement in the IFIAR[1] and AARG[2]. A summary of these activities is included in **Section 2** of the report. **Recognising the accountancy professional bodies' role in educating the profession, Section 5** of the report highlights the key initiatives aimed at helping public accountants remediate the audit deficiencies arising from the PMP inspections.

1.10 **To achieve a high quality of audit, all stakeholders need to put in a collective effort to continuously improve and diligently discharge their dutie**s. Whilst ACRA seeks to improve the profession's work and communicate the value of audits, it also needs the profession's commitment to deliver quality audits that engender trust and investor confidence in the marketplace.

1 Established in 2006, the International Forum of Independent Audit Regulators ("IFIAR") brings together independent audit regulators from 50 jurisdictions to promote collaboration and consistency in regulatory activity and share knowledge on the audit market environment.

2 The ASEAN Audit Regulators Group ("AARG") is an informal cooperation group comprising ACRA, Malaysia's Audit Oversight Board (AOB), and Thailand's Securities and Exchange Commission (SEC).

2 Overview of the PMP

- **ACRA highlights key findings to focus auditors on priority areas of remediation and inform stakeholders seeking assurance over financial statements.**
- **ACRA works closely with international counterparts to help ASEAN establish strong audit oversight and protect the public investing in globalised businesses.**

Introduction

2.1 The Annual PMP Public Report provides an overview of the inspection activities of ACRA. **Greater transparency on its inspection activities and findings** not only helps to focus public accountants on the priority areas of remediation but also provides information to stakeholders (e.g. audit committees, investors) who have an interest in ensuring quality work is performed by auditors over financial statements they wish to rely upon.

2.2 This public report, now into its eighth edition, reports on key findings and observations gathered from the PMP inspections during the period from 1 April 2013 to 31 March 2014. Similar to prior years' reports, the findings in this report are not meant to be exhaustive and instead highlight the areas requiring attention from the profession.

The Public Accountancy Landscape in Singapore

2.3 The financial statements audit market in Singapore is serviced by more than 600 public accounting firms. For PMP inspection purposes, they are categorised into two broad segments to reflect the different level of public interest risks of audits conducted:

i) Firms that perform audits of PIEs; and
ii) Firms that perform audits of non-PIEs.

2.4 As at 31 December 2013, the number of public accounting firms and public accountants in both segments are as follows:

Figure 1: Number of Public Accountants and Public Accounting Entities

As at 31 Dec 2013	PIE segment	Non-PIE segment	Total
Number of public accounting entities	18	627	**645**
Number of public accountants	303	704	**1,007**

2.5 In terms of market structure, audits of PIEs are largely dominated by the Big-Four[3] audit firms. These firms audit approximately 62% of entities listed on the Singapore Exchange, comprising 76% of market capitalisation as at 31 December 2013.

2.6 Majority of the firms in the non-PIE segment are sole proprietorships. These small practices audit mainly small and medium private companies.

Summary of Inspection Activities

2.7 The PMP is ACRA's most significant audit oversight regulatory activity as it covers all public accountants providing public accountancy services in Singapore. It **assesses whether public accountants have complied with the auditing standards**, thus providing direct supervision over the performance of auditors. Its **inspection activities are carefully calibrated** in accordance to the two broad segments below:

PIE Segment

2.8 Firms in the PIE segment are inspected directly by ACRA. Given the high level of public interest of the audited entities in this segment, the inspection scope is naturally more extensive compared to the non-PIE segment. Its scope covers the following:

i) An inspection of the firm's quality control policies and procedures ("firm-level inspections"); and

ii) Individual engagement inspections of selected audit engagements.

3 The Big-Four firms comprise Deloitte, EY, KPMG and PwC.

2.9 Due to the larger operation of firms in the PIE segment, **quality controls are key** in ensuring audits are conducted consistently across the firm in **compliance with the auditing standards**. For this reason, ACRA conducts firm-level inspections as a form of pre-emptive regulation to detect systemic risks which inspections of individual audit engagements might not reveal. Such inspections mainly comprise the following:

- **Understanding the design of the firms' quality controls** in each of the six overlapping Singapore Standard on Quality Control 1[4] ("SSQC 1") *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* elements;
- **Assessing** the continuing **effectiveness** of compliance with and/or **implementation of such controls**; and
- **Evaluating the remediation efforts** carried out by firms in respect of previous firm-level inspection findings raised.

2.10 In respect of individual engagement inspections, ACRA's approach in performing inspections for firms in this segment comprise a mixture of:

- Detailed engagement inspections of public accountants to assess whether the public accountants' work had been conducted in compliance with the Singapore Standard on Auditing[5] ("SSA"). The Public Accountants Oversight Committee ("PAOC") is the deciding authority on the outcome of these inspections; and
- Conducting engagement inspections in the course of firm-level inspections to assess compliance and consistency with the firm's policies, procedures and audit methodology under the fifth SSQC 1 element of "Engagement Performance".

Non-PIE Segment

2.11 The inspection of firms in this segment is outsourced to Singapore's national accountancy professional body, the Institute of Singapore Chartered Accountants ("ISCA"), with appropriate **oversight by ACRA**. As the PAOC is the same authority that decides on the outcomes of inspections in this segment, ACRA is able to ensure that the same benchmark of compliance with the SSA is being maintained across all inspections.

2.12 Due to the size and operation of firms in the non-PIE segment, the scope of inspection on these firms focuses only on detailed engagement inspections. This is a more effective way of monitoring audit quality in this segment.

4 The SSQC 1 is based on the equivalent of the International Standard on Quality Control 1 issued by the International Auditing and Assurance Standards Board ("IAASB").

5 The SSA is based on the equivalent International Standards on Auditing issued by the IAASB, with necessary modifications for local statutory reporting requirements.

International Activities

2.13 **ACRA participates actively and represents Singapore's interests** at various international platforms that promote and develop audit oversight and regulatory activities. Two such important platforms are the IFIAR and the AARG, both of which seek to foster closer collaboration among audit regulators to uphold the standards of audit quality.

International Forum of Independent Audit Regulators ("IFIAR")

2.14 ACRA's participation in IFIAR enables Singapore to **benchmark** its audit regulation **with international practice**. Such international platforms also give ACRA the opportunity to engage the international accounting community on audit developments and issues that affect Singapore and the region.

2.15 ACRA continues to play an active role in IFIAR through its on-going involvement in the following:

- Member of the IFIAR Advisory Council[6] for a four-year term since April 2013;
- Member of IFIAR's Global Public Policy Committee ("GPPC") Working Group[6] since 2011.

2.16 In 2014, ACRA became a member of IFIAR's Investor and Other Stakeholders Working Group[6]. This Working Group is responsible for organising IFIAR's dialogue with investor representatives and other stakeholders such as economists, audit committees and academics, with the aim of enhancing investor protection and improving audit quality based on recommendations by stakeholders with an interest in audit-related matters.

2.17 In addition, ACRA also actively contributes to the initiatives of other Working Groups in IFIAR. For instance, at the 8th IFIAR Inspection Workshop organised by the Inspection Workshop Working Group in Kuala Lumpur from 10-12 March 2014, ACRA presented and facilitated several topics at the workshop.

2.18 In conjunction with the IFIAR Inspection Workshop, ACRA also presented at an outreach seminar for non-IFIAR members from Asia who are interested in establishing independent audit regulation. This was one of the latest in ACRA's and IFIAR's efforts to encourage such regulators to set up independent audit oversight and thus strengthen the quality of their financial information and confidence in their markets. Increasingly, as businesses cross borders, the development of independent audit oversight in foreign jurisdictions will also benefit Singapore investors who want to be assured of the reliance on financial information of overseas operations.

6 Further information on the IFIAR Advisory Council and IFIAR's Working Groups can be accessed at www.ifiar.org

2.19 ACRA also contributed to IFIAR's global survey[7] of audit inspection findings. The annual survey is aimed at communicating common areas of deficiencies found worldwide in the audits of public companies, including systemically important financial institutions inspected by IFIAR members.

ASEAN Audit Regulators Group ("AARG")

2.20 The AARG is an informal cooperation group formed in 2011, comprising ACRA, Malaysia's Audit Oversight Board ("AOB"), and Thailand's Securities and Exchange Commission ("SEC"). Its formation is aimed at fostering closer collaboration among audit regulators **to promote audit quality in the ASEAN region**.

2.21 The AARG **complements IFIAR's efforts** to uphold the standards of audit quality by focusing on audit quality issues specific to this region. Annual meetings are held with the regional leaderships of the Big-Four audit firms to raise awareness of those issues and discuss how to address them.

2.22 At the most recent meeting held in Bangkok, Thailand from 15-16 May 2014, AARG members agreed to jointly work together on plans to improve financial reporting and audit quality in the region. One **potential area of collaboration would be the engagement of audit committees** to understand their challenges in effectively discharging their responsibilities to ensure high quality financial reporting by the company and its auditors. Joining in the discussions as observers for the first time, were representatives from the Accountant and Appraiser Supervisory Centre ("PPAJP") of Indonesia's Ministry of Finance which became an IFIAR member in April 2013.

2.23 Representatives from the Regulatory Working Group ("RWG") of the GPPC firms[8] also joined the meeting to contribute their views from a global perspective. The topics discussed include ways to encourage greater ownership of financial reporting by companies as well as potential opportunities and challenges in implementing the expanded auditor's report[9].

2.24 At the May 2014 meeting, the AARG also held separate discussions with each of the Big-Four firms to address common issues identified during the AARG's respective audit inspections and the firm's own internal quality reviews. Consistent with the discussions held between IFIAR and the GPPC firms at the global level, AARG's engagement with the firms on these topics focused on identifying the root causes of audit deficiencies and the effectiveness of the firms' proposed action plans to remediate those deficiencies. The meeting also discussed the results of IFIAR's most recent global survey of audit inspection findings.

7 The survey can be accessed at www.ifiar.org/IFIAR-Global-Survey-of-Inspection-Findings.aspx.

8 The GPPC firms comprise the six largest international audit firm networks (BDO, Deloitte, EY, Grant Thornton, KPMG, and PwC).

9 The IAASB is undertaking an on-going project to expand the scope of the current audit report to provide greater insights into the audit. Key proposals include descriptions on key audit matters that were of significance to the audit and the auditor's assessment on the use of going concern basis by management.

3 Key Observations of the PMP

- **ACRA will focus on revenue recognition, accounting estimates and fair value measurement and group audits in upcoming inspections.**
- **Engagement teams must ensure adequate work is performed to address significant areas of audit risks when forming their conclusions.**
- **Remediation of findings should be targeted at the root causes and the implementation of broader firm-wide actions plans.**

Introduction

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

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

3.3 The key findings highlighted in this year's report relate to the following **broad themes**:

- Revenue recognition;
- Accounting estimates and fair value measurement; and
- Group audits.

3.4 The discussion on each theme starts with the facts of the case and the nature and extent of audit work performed by the public accountant. This is followed by an explanation of the observed deficiency (i.e. what work was not performed even though required by the auditing standards) and why it constitutes an inspection finding.

3.5 Unlike previous years, ACRA has not segregated its findings into the PIE and non-PIE segment in this year's report. Instead, **common findings** noted across the audits of entities in the Singapore market have been presented in the form of case studies. Some of these findings, such as those related to accounting estimates may be more prevalent in the PIE segment due to the nature and complexity of the audited entities inspected. Nonetheless, the findings highlighted in the respective themes reflect those that have occurred and could potentially recur in both segments.

Illustrative Audited Entity: Background Information

3.6 Brief background information of an illustrative audited entity inspected for the case study is as follows:

Simple Company Limited (holding company or the "Company") and its subsidiaries (the "Group")

- Financial year end: 31 December 2013.
- Number of subsidiaries: 4 wholly owned subsidiaries.
- Functional and presentation currency of the Group and holding company: Singapore Dollars.
- Principal activities of the Group: Trading of goods and renovation sub-contractor.
- Overall, the Group is profitable with positive net assets.
- The holding company acquired a 100% interest in Subsidiary A in October 2011 and recorded a goodwill of $1.8 million.

Audit Considerations

- The group engagement team had identified the significant risk areas as follows:
  - Revenue recognition;
  - Assessment of management estimates over the impairment of goodwill and provision for liquidated damages; and
  - Group reporting from component auditors.

- The group engagement team identified the following significant components:

Figure 2: Principal Activities and Significant Components of the Group

Companies	Country of incorporation	Principal activity	Significant Component for Group Reporting?
Holding company	Singapore	Investment Holding and Trading	Not applicable
Subsidiary A	Singapore	Trading	Yes
Subsidiary B	Singapore	Renovation subcontractor	Yes
Subsidiary C*	China	Trading	Yes
Subsidiary D*	Malaysia	Trading	No

** The audits for these subsidiaries were performed by overseas audit firms.*

For purposes of this case study, it is assumed that the ACRA inspection team had independently assessed and agreed:

(i) with the significant risk areas identified by the group engagement team; and

(ii) that the materiality threshold set for the Group, holding company and its significant components were appropriate, unless otherwise stated.

Note:

(i) ACRA would like to stress that the case studies below **serve only as guidance and is not meant to set any standard on the nature and extent of 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.

(ii) As the case studies are also only 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 audit engagement teams need to **exercise sound professional judgement and knowledge** in ensuring that the necessary procedures are performed to cover all related audit assertions.

Revenue Recognition

Case Study 1

Addressing the Sales Cut-off Assertion

Case Facts:

The Company has on average, 10 daily sales transactions, comprising about 50% local sales and 50% export sales. The average inventory delivery cycle is 2 days for local sales and 7 days for export sales.

Work Performed by the Engagement Team

3.7 The engagement team had selected the following acknowledged delivery notes to test sales cut-off:

- 5 samples of local sales with delivery date on 31 December 2013; and
- 5 samples of local sales with delivery date on 2 January 2014.

3.8 The basis for the selection of samples for the cut-off test was not documented in the engagement team's audit working papers. Upon ACRA's enquiry, the engagement team represented that a pre-fixed number of sample size (five samples) was used consistently by the firm in all engagements and the selection basis is to examine the last five and first five transactions before and after the year-end.

Work Not Performed by the Engagement Team

3.9 The work performed by the engagement team was inadequate on two counts. Firstly, the engagement team **had not selected export sales** in testing the sales cut-off even though export sales made up about 50% of total sales. For effective testing, the samples selected should comprise the right proportion of local and export sales that mirror the actual sales mix.

3.10 In addition, the work performed by the engagement team **did not cover the Company's inventory delivery cycle**, which were 2 and 7 days before and after the year-end for local and export sales respectively. The use of a pre-fixed sample size, covering only one day before and after year-end is not sufficient in testing the risk of cut-off errors.

Finding: The engagement team did not consider the sales mix (local versus export) and inventory delivery cycle in setting the scope of sample selection for sales cut-off test. As a result, the audit had not fully addressed risks of inappropriate revenue recognition due to inaccurate cut-off.

Case Study 2

Understanding the Terms of Trade

Case Facts:

The Company's export sales comprise either one of the following terms of trade:

- Delivered at Terminal ("DAT"), where the risks and rewards of ownership transfer from the Company (seller) to the buyer when the goods arrive at the buyer's port; or
- Free on Board ("FOB"), where the risks and rewards of ownership transfer from the Company (seller) to the buyer when the goods leave the Company's port in Singapore.

The Company's delivery cycle is 7 days for export sales.

Approximately 80% of the Company's export sales are traded on DAT terms and the remaining 20% are on FOB terms. The Company recognises revenue from all its export sales based on the bill of lading date, which would be the date when the goods leave the Company's port in Singapore.

Work Performed by the Engagement Team

3.11 In testing the occurrence of revenue to ensure the validity of sales transactions, the engagement team had performed substantive test of details by selecting 30 samples[10] of sales invoices and traced each of them:

- to the bill of lading to ascertain that the sales has occurred; and
- to the entry in the sales journal to check that the sales were recorded based on the bill of lading date.

No work was performed to test the cut-off of export sales as highlighted in *Case Study 1* above.

Work Not Performed by the Engagement Team

3.12 The engagement team **had failed to appropriately consider the different terms of trade** in the Company's sales invoices **when testing the occurrence of sales transactions**. Whilst the bill of lading date was correctly used in assessing the occurrence of goods sold on FOB basis, it would however be incorrect to use the same date to ascertain the point of revenue recognition for goods sold by the Company under DAT terms.

10 For purposes of the case study, it is assumed that the number of samples selected had been assessed to be appropriately derived based on the 'Sample Selection Planning' document in ISCA's Audit Manual for Small Companies.

3.13 For sales of goods with DAT terms, the Company should only recognise revenue when its goods reach the buyer's port as it reflects the point in which risks and rewards of ownership are transferred to the buyer. This would be 7 days after the bill of lading date. Given that 80% of the Company's sales were on DAT terms, this may give rise to inaccurate sales cut-off and pre-mature recognition of revenue at year end.

Finding: The engagement team had failed to consider the different terms of trade for the Company's export sales contracts. As a result, the audit had not fully addressed the potential risks of inappropriate revenue recognition arising from the incorrect use of bill of lading dates to record sales with DAT trade terms.

Case Study 3

Auditing 'Bill and Hold' Sale Transactions

Case Facts:

The Company has an annual promotion in the month of December during which it would offer attractive discounts to clear some of its older inventories. One of the Company's customers placed a substantial $2 million order on **16 December 2013** to take advantage of the annual promotion. Although the Company normally delivers within 7 days from the date of order, the customer had specifically requested for delivery to be delayed by a month due to space constraint at the customer's warehouse. The goods were set aside and ready for delivery from the warehouse before the year-end.

On **23 December 2013**, the customer acknowledged a sales contract with the following key terms:

- Delivery will be deferred to **15 January 2014**;
- The seller (the Company) will be absolved from any unintentional damage to the goods stored at its warehouse; and
- Standard payment terms of 30 days from the contract date of 23 December 2013 will be applied.

The goods were subsequently delivered to the customer on 15 January 2014 and the sale transaction was recorded as such on that date.

Work Performed by the Engagement Team

3.14 The engagement team had:

- reviewed the sales contract as part of 'sales cut-off' test and noted the 'bill and hold' arrangement entered into by the Company;
- vouched to the acknowledged delivery order indicating that the goods were delivered to the customer subsequent to year-end on 15 January 2014; and
- traced to the entry in the sales journal to check that the sale was recorded based on the acknowledged delivery order date.

The engagement team concurred with management for the transaction to be recorded based on 15 January 2014 which is the date the goods were delivered to the customer.

Work Not Performed by the Engagement Team

3.15 Whilst noting the 'bill and hold' arrangement, the engagement team had not considered if it was appropriate to recognise revenue based on the delivery date of 15 January 2014 vis-à-vis the guidance in the Illustrative Examples accompanying FRS 18 *Revenue* which explains that **revenue for 'bill and hold' sales are recognised when the buyer has taken title**, provided:

- It is probable that delivery will be made;
- The item is on hand, identified and ready for delivery to the buyer at the time the sale is recognised;
- The buyer specifically acknowledges the deferred delivery instructions; and
- The usual payment terms apply.

3.16 Notwithstanding that delivery was made on 15 January 2014, the case facts indicated that the customer had already taken title of the goods on 23 December 2013:

- On 23 December 2013, the customer had acknowledged on the sales contract the deferred delivery conditions and had agreed to bear the risk of any losses for damage to the goods placed at the Company's warehouse;
- Standard payment terms were used in the sales contract i.e. payment was due 30 days from the sales contract date and not from the delivery date;
- On 23 December 2013, there were no indications that the delivery on 15 January 2014 would not be probable; and
- The goods had been specifically set aside for the customer and ready for delivery by 23 December 2013.

Hence, the sale transaction should have been recorded in the financial year ended 31 December 2013.

Finding: The engagement team failed to consider the appropriate revenue recognition criteria to be applied for the 'bill and hold' sales transaction. As a result, revenue recognition for the year ended 31 December 2013 was not appropriate.

Accounting Estimates and Fair Value Measurement

Case Study 4

Assessing Goodwill Impairment

Case Facts:

As provided under background information, the Company acquired 100% ownership of Subsidiary A in October 2011. The goodwill arising from the acquisition amounted to $1.8 million. Subsidiary A manufactures consumer electronics and 90% of its sales were mainly derived from LCD TVs, its flagship product. It was initially profitable in 2011 but subsequently incurred losses for the financial years ended 31 December 2012 and 2013.

The losses were incurred due to several factors, namely declining sales of LCD TVs over the last two years due to the introduction of LED TVs at relatively affordable prices. In addition, a fire in one of its production facility in December 2012 had also caused significant damage to its machineries and as a result, led to reduced production output in 2013.

Work Performed by the Engagement Team

3.17 The engagement team noted indicators of goodwill impairment such as losses in the last two years, declining sales, loss of technological advantage and damages to its production machineries resulting in lower production outputs. Hence, the engagement team proceeded to assess the goodwill amount for impairment.

3.18 In performing the impairment assessment for goodwill, the engagement team had tested a 5-year discounted cash flow forecast prepared by management. An extract of the forecast and the engagement team's assessment is as follows:

Figure 3: Impairment Assessment Performed by the Engagement Team

	FY2014	FY2015	FY2016	FY2017	FY2018
Discounted Cash Flows ($)	350,000	430,000	550,000	650,000	780,000

Value-in-use: Total discounted cash flows (2014 – 2018) (A)	**$2,760,000**
Goodwill on acquisition (B)	**$1,800,000**
Available headroom assessed by engagement team (A - B)	**$960,000**

3.19 Based on the assessment, the engagement team concluded that no impairment was necessary due to the "headroom of $960,000" when comparing the future cash flows of Subsidiary A against the goodwill amount. It was further noted that the net tangible assets of Subsidiary A was $1.2 million as at 31 December 2013.

Work Not Performed by the Engagement Team

3.20 The engagement team had **wrongly compared the value-in-use amount against the goodwill only**. Subsidiary A relies on the continued use of its assets to derive the cash flows as projected by management. Hence, as required under FRS 36.90 *Impairment of Assets*, in assessing goodwill for impairment, the value-in-use (recoverable) amount should be compared against the carrying amount of the asset plus the goodwill. The results of the comparison would be as follows:

Value-in-use: Total discounted cash flows **(A)**	**$2,760,000**
Goodwill on acquisition **(B)**	**$1,800,000**
Net tangible assets of Subsidiary A as at 31 December 2013 **(C)**	**$1,200,000**
Summation of goodwill and net tangible assets **(B + C = D)**	**$3,000,000**
Impairment **(A - D)**	**($240,000)**

Had the value-in-use amount be compared against the summation of goodwill and net tangible assets of Subsidiary A, this would have resulted in a different conclusion, requiring an impairment adjustment of $240,000 to be made to the goodwill.

3.21 Despite reminders in previous years, ACRA continues to observe such fundamental deficiency in inspections. This **demonstrates a lack of understanding over the requirements of the standard**. ACRA urges public accountants to better equip themselves and their staff with technical knowledge as well as to exhibit sufficient levels of supervision and review over the audit work performed.

Finding: The engagement team had erroneously compared the value-in-use (recoverable) amount against the goodwill only, resulting in an incorrect conclusion that no impairment was required on the goodwill.

Case Study 5

Testing Cash Flow Assumptions for Impairment Assessment

Case Facts:

Cash Flow Assumptions

Management had prepared a 5 year cash flow forecast for Subsidiary A on 2 January 2014 based on the following:

- Revenue was expected to increase by 8% year-on-year;
- Cost of materials were expected to increase by 3% year-on-year;
- Profit-after-tax was used as a proxy for the cash flows. Profit-after-tax was net of income tax at 17% and included depreciation of plant and equipment and unrealised foreign exchange gains;
- Discount rate of 5% per annum was computed by management using only the costs of its borrowings; and
- Debt-equity ratio of Subsidiary A was 1:1

Historical Growth Rate of Revenue and Cost of Materials for Subsidiary A

The growth rate of revenue and cost of materials for Subsidiary A over the last 3 years were as follows:

Figure 4: Subsidiary A's Growth Rate of Revenue and Cost of Materials

	FY2011 (Actual)	**FY2012** (Actual)	**FY2013** (Actual)	**FY2014 - 18** (Forecast)
Revenue	7%	3%	1%	8% p.a.
Cost of materials	10%	10%	10%	3% p.a.

Capital Expenditure Items

Based on minutes of Directors' meetings in November 2013, management of Subsidiary A has outlined plans to purchase new machineries in 2014 to replace those destroyed in the previous fire and to improve the features of its LCD TVs to re-capture market share. The Board of Directors of Subsidiary A has approved the decision to purchase the new machineries at a cost of $2 million.

Events Subsequent to Year-End

- On 15 January 2014, one of Subsidiary A's major customer which contributes over 50% of the company's sales has announced that it would not be renewing its sales contract with Subsidiary A as consumer preference had clearly shifted to LED TVs.
- On 31 January 2014, one of Subsidiary A's competitors announced that it is sponsoring the research into the production of LED TVs using materials that will cost less than half of current prices.

Work Performed by the Engagement Team

3.22 The work performed by the engagement team were as follows:

- Verified the amounts in the cash flow forecast for mathematical accuracy;
- Inquired management on the methods and assumptions used; and
- Relied on management's representations and concluded that the assumptions applied were reasonable based on "their extensive years of experience in the industry".

The engagement team did not perform any other procedures to corroborate the basis of assumptions used for the forecast.

Work Not Performed by the Engagement Team

3.23 The engagement team had not complied with SSA 540.13 *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures* which requires the auditor to test how management has made the accounting estimate and the data in which it is based. Limiting the work performed to **inquiry alone would not be sufficient** as the engagement team **needs to test the underlying data to ascertain that the methods and assumptions used were appropriate and reasonable**.

3.24 The engagement team had not tested the key assumptions as follows:

- **Growth Rates**

  The engagement team **had not assessed the reasonableness of projected growth rates vis-à-vis the historical growth rates actually achieved by Subsidiary A in the last 3 years**. The engagement team should have objectively challenged the basis of the revenue growth rate of 8% when (i) the highest historical growth rate achieved in the past three years was only 7% and (ii) the growth rates had declined in the past three years. Similarly, there was no objective assessment of the reasonableness of the cost of materials growth rate projected at 3% when historical growth rates reached 10%.

  These discrepancies should have led the engagement team to probe deeper and question the reasonableness of the projected growth rates used.

- **Non-Cash Items and Income Tax**

  The engagement team **did not appropriately consider the implications arising from the use of profit-after-tax as a proxy for projected cash flows**. The cash flows prepared in this respect was inadequate on two counts:

  - Estimates of cash flows should exclude income tax receipts or payments as provided for under FRS 36.50 *Impairment of Assets*;
  - Adjustments should have been made to exclude non-cash flow items, which in this case included the depreciation of plant and equipment and unrealised foreign exchange gains.

- **Capital Expenditure Items**

  The engagement team **failed to take into account management's plans to purchase new machineries** which have been outlined and approved in Subsidiary A's minutes of meeting. Such capital expenditure would have reduced the net cash flows forecast and accordingly lowered the value-in-use.

- **Discount Rates**

  In assessing how the discount rate of 5% per annum was derived, the engagement team **had not considered Subsidiary A's capital structure**. Given that the subsidiary is funded equally by debt and equity, the use of costs of borrowings solely as the discount rate, without taking into account the cost of equity (e.g. computed based on Weighted Average Cost of Capital) would be inappropriate.

- **Events Subsequent to Year-End**

  The engagement team also **did not consider the termination of the contract by a significant customer occurring subsequent to year-end** and how the loss of sales would impact the viability of its cash flows and growth targets. The forecast may have to be revised downwards should there be no concrete plans on its achievability given the loss of this significant customer.

3.25 In assessing the reasonableness of the underlying data above, the engagement team should also **stress test the inputs** on revenue growth as well as discount rates and **analyse how susceptible the results would be to changes in these parameters**. This would help focus the engagement team's efforts in challenging management's estimates on areas that are subjected to a high degree of estimation uncertainty.

Finding: The engagement team had not performed audit procedures to:

i) independently assess the appropriateness of the revenue and costs of materials growth rates and discount rate used;

ii) ensure the exclusion of tax and non-cash items (depreciation and unrealised foreign exchange gains) and the inclusion of cash outflows from approved capital expenditure; and

iii) validate management's representations and obtain corroborative evidence on the achievability of the cash flow forecast.

Case Study 6

Assessing Management Estimates in Providing for Liquidated Damages

Case Facts:

Subsidiary B had three renovation contracts which were supposed to be delivered on 30 November 2013. Due to unforeseen circumstances, these projects were instead anticipated to be completed and delivered to its customers on 31 January 2014 (subsequent to the financial year ended 31 December 2013). These contracts carried a liquidated damage clause requiring Subsidiary B to compensate its customers for any delay in project delivery (from the contracted delivery date of 30 November 2013). Based on the terms of the contract, management had tabulated a schedule to reflect the potential liquidated damages for the delay as follows:

Figure 5: Computation of Liquidated Damages

Contract number	1	2	3
Liquidated Damages per day ($)	2,600	2,000	2,400
Number of days to estimated completion on 31 January 2014	62	62	62
Contractual Liquidated Damages ($)	161,200	124,000	148,800
Estimated rate of payout	50%	50%	50%
Provision for Liquidated Damages ($)	80,600	62,000	74,400
Total Provision ($)	**217,000**		

The management of Subsidiary B had represented that they were optimistic in negotiating for a reduced pay-out of no more than 50% of the contractual liquidated damages. Hence, the total provision amounted to $217,000 as shown above. No negotiation had been carried out with the customers as at the date of the audit on 20 January 2014 although there were e-mail correspondences on that date indicating that Subsidiary B would meet the customers on 7 February 2014 to discuss the liquidated damages pay-outs.

Historical Rate of Pay-Out for Liquidated Damages

The average three-year historical rate of pay-out for similar delays was 80%.

Events Subsequent to Year-End

On 7 February 2014, Subsidiary B entered into negotiations with the three customers. The 50% settlement proposed by Subsidiary B was rejected and the customers of Contracts 1 and 3 and Subsidiary B subsequently agreed on a settlement as follows:

Figure 6: Liquidated Damages Agreed with Customers

Contract number	1	2	3
Agreed rate of pay-out	90%	50%	75%
Agreed Liquidated Damages to be paid ($)	145,080	62,000	111,600
Total Liquidated Damages to be paid ($)		**318,680**	

According to management, the customer of Contract 2 was satisfied with the quality of work performed and hence was willing to accept a 50% pay-out. Subsidiary B then signed an acceptance letter with each of the three customers stating the above agreed liquidated damages payable on 14 February 2014 before the audit report was signed off on 28 February 2014. The difference of $101,680 between the provision made ($217,000) and the actual amount paid ($318,680) was above Subsidiary B's performance materiality.

Work Performed by the Engagement Team

3.26 The work performed by the engagement team up to the last date of audit fieldwork on 20 January 2014 was as follows:

- Verified the liquidated damages rate per day against the signed contracts;
- Re-computed the number of days in which the projects were delayed up to the estimated completion date; and
- Enquired management on the basis of the provision made and re-computed the provision based on the 50% rate represented by management.

Based on the above procedures, the engagement team concluded that the provision of $217,000 was reasonable. The engagement team did not perform any follow-up work or re-assessment of the provision subsequent to 20 January 2014.

Work Not Performed by the Engagement Team

3.27 Whilst the engagement team had enquired management on the basis of the provisioning, the engagement team **did not take additional steps to independently assess and challenge management** on whether the 50% estimated pay-out rate was reasonable.

- The engagement team did not assess the reasonableness of the provision made on a 50% pay-out rate against the average historical pay-out rate of 80%; and
- The engagement did not follow-up on the assessment after 20 January 2014 till 28 February 2014 (date of audit sign-off). The 20 January 2014 e-mail correspondences between the customers and Subsidiary B on the 7 February 2014 meeting to discuss the pay-outs should have alerted the engagement team to perform the necessary follow-up procedures. Further, before the sign-off, the team could have enquired with management if any agreement with customers on the liquidated damages payable had been reached.

3.28 As a result of the inadequate audit procedures above and given the materiality of the shortfall in provision to Subsidiary B's financial statements, adjustments to the provision amount would have been necessary.

Finding: The engagement team had failed to:

i) independently validate management's representation and obtain corroborative evidence on the sufficiency of provision for liquidated damages made; and

ii) consider events occurring subsequent to year-end and make the adjustments as necessary to the provision amount.

3.29 Accounting estimates and fair value measurements are fairly complex areas of audit requiring acute professional judgment and heightened display of professional skepticism. Hence, the audit of these areas should involve **greater levels of participation and supervision by senior members** of the engagement team, particularly in challenging management's assumptions in relation to these estimates. In instances where the subject matter requires specialised skills or knowledge, such as valuation of employee share options, unlisted securities, etc, **consideration should also be given to involve experts or specialists** as prescribed under SSA 540.14.

Group Audits

Case Study 7

Determining and Communicating Component Materiality

Case Facts:

Subsidiary C was assessed to be a significant component of the Group. The group engagement team instructed the component auditor of Subsidiary C to conduct a full scope audit. The component auditor performed the audit and reported to the group engagement team based on its local statutory audit materiality which was 20% higher than the overall group materiality.

Work Performed by the Group Engagement Team

3.30 The group engagement had appropriately assessed Subsidiary C to be a significant component and duly sent instructions for a full scope audit to be performed based on "local materiality set by the component auditor", which was complied with by the component auditor.

Work Not Performed by the Group Engagement Team

3.31 The group engagement team had **failed to determine and assign a component materiality** for Subsidiary C. This is a requirement under SSA 600.21 *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)* which states that the group engagement team is to determine the component materiality for components where the component auditors will perform an audit or a review for purposes of the group audit.

3.32 The group engagement team also **did not assess whether the materiality used by the component auditor was appropriate**. As a result of this omission, the local materiality used by the component auditor was higher than the overall group materiality. This runs contrary to the requirements in SSA600.21(c) which sets out that the **component materiality should be lower than the materiality for the group financial statements as a whole**. The audit was hence exposed to a higher risk that the aggregate of uncorrected and undetected misstatements may exceed the materiality of the group financial statements, which may consequently affect the overall opinion issued.

Finding: The group engagement team had failed to:

i) determine and assign the component materiality for Subsidiary C; and

ii) assess the appropriateness of the materiality used for group reporting purposes by the component auditor.

Case Study 8

Assessing the Professional Competence and Objectivity of the Component Auditor

Case Facts:

The component auditor of Subsidiary C is a member firm of a large international audit firm network and has a significant presence in Subsidiary C's country of operation, China. Subsidiary C's audit was led by a new engagement partner for the financial year in question. The group auditor was a member firm of a smaller network which had yet to establish any presence in China. During the financial year, Subsidiary C had also commenced a new business activity in the area of property development.

Work Performed by the Group Engagement Team

3.33 The group engagement had assessed that component auditor is competent and objective since it was a large sized firm in China and it was a member firm of an international network.

Work Not Performed by the Group Engagement Team

3.34 The fact that the component auditor was a large sized firm and affiliated with an international network should not be the sole justification for placing reliance. In evaluating the professional competence and objectivity of the component auditor, the group engagement team **had not considered the experience and qualification of the engagement partner and team**.

3.35 Given that it was the partner's first year on the engagement, the group engagement team had not enquired further on the profile of the engagement partner, such as the partner's past audit experience in similar industries, whether he/she has been subjected to audit regulatory or internal inspections previously and what were the results, etc. Additionally, discussions relating to the component audit team's experience in auditing construction contracts were also not held, considering the new property development activity undertaken by Subsidiary C.

Finding: The group engagement team had not considered the experience and qualification of the engagement partner and team in evaluating the professional competence and objectivity of the component auditor.

Case Study 9

Assessing the Work of the Component Auditor

Case Facts:

Subsidiary C contributed significantly to the Group's overall results (40% of net assets and profit before tax respectively). The group reporting memorandum submitted by the component auditor indicated that the subsidiary's accounting policy for inventory was based on weighted average cost basis. This differed from the Group's policy of 'first in, first-out' ("FIFO"). The impact on inventory balance arising from the difference in accounting treatment was material to the Group.

There was also rapid expansion in Subsidiary C's new property development venture, with several construction projects in progress as at year end. The revenue recognised from these projects were higher than the overall group materiality.

Work Performed by the Group Engagement Team

3.36 The group engagement team had ensured the timely receipt of completed audit questionnaires and reporting memorandum from the component auditor. The group engagement team focused on the following three questions when reviewing the reporting memorandum:

- "Were there any exceptions noted during the audit?" which the component auditor responded "No";
- "What were the key audit risk areas?" which the component auditor responded "Same as last year: revenue recognition, inventory obsolescence, trade receivables impairment"; and
- "Do you propose any adjustments to the accounts for the purposes of group reporting" which the component auditors responded "No".

Work Not Performed by the Group Engagement Team

3.37 Given the significance of Subsidiary C's contribution to the Group as well as the new property development venture, the group engagement team **had not performed adequate procedures to review the work of the component auditor**. Besides reviewing the questionnaire and reporting memorandum, the group engagement team:

- Had not considered the need to review the audit working papers of the component auditor which was last performed 3 years ago;
- Had not questioned why the component auditor had not raised any new audit risk areas relating to Subsidiary C's new property development venture which was material to the Group (above group materiality); and
- Had not checked that adjustments to Subsidiary C's accounts were needed to align the accounting policy for inventory from weighted average to the FIFO basis.

3.38 Whilst it may not be necessary for the group engagement team to review the component auditor's working papers every year, given the significance of Subsidiary C to the Group, the group engagement team should at the very least adopt a rotational review plan. This is to provide on-going assurance over the quality of the work performed by the component auditor and to ensure that significant audit risk areas are adequately and appropriately identified.

Finding: The group engagement team had not:

i) reviewed the work of the component auditor; and

ii) considered the impact arising from differences in the inventory accounting policy between the Group and Subsidiary C and whether any adjustments were necessary.

Case Study 10

Assessing the Work of the Component Auditor

Case Facts:

Subsidiary D has a single revenue source derived from the sale of state-of-the-art bladeless fans manufactured by Subsidiary A to retailers in the country. It had been loss making in the financial years ended 31 December 2011 and 2012 due to its inability to generate sufficient sales volume and penetrate the consumer electronics market in the country. However, after a technical magazine reported on the state-of-the-art bladeless fans, Subsidiary D experienced a significant turn-around and recorded a substantial increase in sales for the year ended 31 December 2013. The contribution of Subsidiary D to key financial statement items of the Group is as follows:

Figure 7: Contribution (%) of Subsidiary D to key financial information of the Group

Financial Statement Item	% of Contribution to Group for FY2013
Net assets	25%
Revenue	30%
Profit after tax	1%

Work Performed by the Group Engagement Team

3.39 The group engagement team had assessed whether Subsidiary D should be a significant component and duly documented that it was not, based on the net profit contribution of only 1% to the Group.

3.40 As a result, they concluded that Subsidiary D is not a significant component of the Group for the financial year ended 31 December 2013 and no audit instructions were sent to Subsidiary D's auditor for group reporting purposes.

Work Not Performed by the Group Engagement Team

3.41 The group engagement team **had not performed a sufficiently robust assessment in determining whether Subsidiary D is a significant component of the Group**. The group engagement team should consider both **quantitative and qualitative factors** in this assessment. In respect of the quantitative considerations, the group engagement team should consider the use of several benchmarks instead of merely relying on a single benchmark to determine its financial significance. Given that Subsidiary D contributed 25% to Group assets and 30% to Group revenue, there were strong indications that Subsidiary D was materially significant to the Group.

3.42 The engagement team had also not considered qualitative factors such as the market acceptance of Subsidiary D's new innovative product and how that had boosted its contribution to the Group.

3.43 Based on the qualitative and quantitative assessment above, Subsidiary D should have been identified as a significant component of the Group and accordingly, the group engagement team should have performed the additional procedures as required under SSA 600.

Finding: The group engagement team had not considered all quantitative and qualitative factors in assessing Subsidiary D to be a non-significant component of the Group and hence failed to obtain sufficient and appropriate audit evidence regarding the financial information of Subsidiary D.

3.44 The case studies above highlight only the findings but not the resultant PMP outcome and sanctions. Depending on the severity of the findings, ACRA's PAOC may order the public accountant to undertake remedial actions or impose sanctions. ACRA's website[11] provide further examples on the types of PMP outcomes and sanctions based on the nature and extent of findings.

Steps to Address Common Findings

3.45 A number of findings covered in the case studies above are similar to those highlighted in prior years for both the PIE and non-PIE segments, thus reinforcing the need for public accountants to pay greater attention to these areas. **ACRA remains concerned over such recurring findings**, which suggest there are deeper issues underlying these findings that the firms and public accountants are still not getting right.

11 The examples can be accessed at: https://www.acra.gov.sg/public-accountants/practice-monitoring-programme-pmp/pmp-orders

3.46 This is likewise reflected in IFIAR's 2nd global survey of audit inspection findings, which continues to indicate persistent deficiencies in important aspects of the audit. Particularly, the following top five findings (by decreasing order of frequency) were noted with respect to the audits of listed PIEs:

- Fair value measurement
- Internal controls testing
- Adequacy of financial statements and disclosures
- Revenue recognition
- Group audits

These results, particularly fair value measurement, revenue recognition and group audits, were largely consistent with ACRA's areas of concern, as elaborated in the earlier part of this report.

3.47 Given the **recurrence of findings**, ACRA's inspections **will focus on revenue recognition, accounting estimates and fair value measurement and group audits** in upcoming inspections performed under its enhanced risk-based inspection approach.

Understanding the Root Causes is Key to Improving Audit Quality

3.48 Action plans to address these findings should not only be effective for the short term but sustainable in the long run. Hence, public accountants would **first need to understand the root causes** giving rise to audit deficiencies before devising remediation plans to address these root causes.

3.49 ACRA is **heartened to note that there has been momentum** in moving towards this direction. The larger audit firm networks, for example, have expanded their international quality monitoring programmes to require their member firms perform an assessment of the root causes of the audit deficiencies identified. Aggregation and analysis of these assessments at the global level allows the networks to develop cohesive action plans for common issues and recommend leading practices noted in certain member firms which can be implemented in others.

3.50 Similarly, ACRA has also **incorporated the root cause analysis into its inspection programme**. The public accountant is now required to identify the root causes for the findings raised and tailor corresponding remediation and action plans to address these root causes. Recognising that this process is still relatively new and challenging, ACRA would **closely engage public accountants** in robust discussions and analysis to ensure that the **appropriate root causes are identified for remediation**.

3.51 From ACRA's past inspections, most of the root causes of audit deficiencies can be attributable to the following **broad categories**:

- Structural and organisational issues such as staff shortage, staff turnover, or excessive workload concentration, etc.;
- Accountability issues such as the lack of supervision and review or excessive delegation of work to less experienced or junior staff;
- Behavioural issues such as lack of professional skepticism or lack of willingness to challenge management representations and estimates; and
- Knowledge and competency issues stemming from insufficient understanding of the business/industry, financial reporting or auditing standards' requirements.

Firm-wide Actions Needed for Sustainable Improvements

3.52 Key to addressing these root causes is to recognise the levels in which they need to be resolved. Whilst the cause(s) of certain findings may at times appear to be engagement specific, the public accountant also **needs to evaluate whether there are wider pervasiveness amongst or implications to other engagements** of the firm. Ideally, action plans should be implemented throughout the firm and not be confined to only the individual public accountant or engagement.

3.53 This is particularly relevant given that consistency **in audit execution remains a major challenge** for firms and public accountants, regardless of whether they are from the PIE or non-PIE segment. Hence, **broader firm-level remediation initiatives would be more effective** in mitigating the occurrence of similar findings across a wider breath of engagements audited within the firm.

3.54 In many cases, ACRA has observed that the **causes of findings from engagement inspections are intricately linked and can be remediated from a firm-wide quality control perspective**. For instance, findings due to insufficient partner and manager supervision and review could potentially be addressed via initiatives aimed at improving the partner and manager accountability framework, creating disincentives for low levels of involvement and reviewing the client and portfolio allocation system. This is also a more productive approach as it concurrently addresses a multitude of findings associated with the root cause.

3.55 The action plans implemented by the firms will be periodically **evaluated by ACRA for effectiveness and sustainability**. Through regular engagements and discussions with the profession at large, ACRA also aims to identify drivers leading to consistency of quality audit execution and make recommendations as appropriate to help firms and public accountants stay on the right track for improvement.

4 Enhancements To ACRA's Inspection Programme

- **Enhancements to ACRA's inspection programme seek to ensure that risks areas are covered in greater depth to detect issues of significance to the audit.**

- **A post-inspection root cause analysis will be introduced to ensure that remediation efforts will reap wider benefits and prevent the recurrence of audit deficiencies across all future audit engagements.**

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

4.2 These enhancements were aimed towards achieving the following broad objectives:

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

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

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

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

4.4 The key enhancements to ACRA's inspection programme are summarised below. These enhancements, covering both ACRA's firm-level inspections and detailed engagement inspections have been incorporated into inspections commencing from 1 May 2014.

Firm-level Inspections

4.5 ACRA currently conducts firm-level inspections on firms in the PIE segment on an advisory basis. In line with global regulators around the world, ACRA continues to believe that having a strong and effective system of firm-level quality controls is the only way to sustain consistent delivery of audit quality on all engagements. Hence, to place emphasis on firm-level inspections, ACRA will be amending the Accountants Act by late 2015/early 2016 to place firm-level inspections on a statutory footing. Firm-level inspections will initially be statutorily required for firms auditing listed companies.

Calibrating Inspection Frequency in Accordance to Public Interest Concentration Risks

4.6 Inspection frequency will be adjusted according to public interest risks. Previously, firm-level inspections were typically conducted biannually for the Big-Four firms and once every three years for the remaining firms in the PIE segment. ACRA recognised that firms with higher portfolios of PIEs, particularly listed company clients, posed greater public interest risks. As such, ACRA will **calibrate the inspection frequency to better manage these risks and align with the norms of international inspection practices**.

4.7 The following inspection frequency is now introduced as a general guide for firms in the PIE segment:

- Firms auditing > 10% share of market capitalisation of listed companies will be subjected to **annual inspections**; and
- Firms auditing < 10% share of market capitalisation of listed companies will be subjected **triennial inspections**; unless there are significant control lapses which will then subject the firm to more frequent inspections.

4.8 This change in inspection frequency ensures that inspection **resources are focused** on firms with greater exposure to public interest. Currently, the Big-Four firms[12] each audit more than 10% share of the market capitalisation of listed companies and hence shall be subjected to annual inspections. The remaining firms in the PIE segment will continue with the current practice of being inspected once every three years.

12 The Big-Four firms in Singapore collectively audits approximately 76% of the total market capitalisation of SGX listed companies of $940 billion as at 31 December 2013.

4.9 The change to annual inspection for the Big-Four firms is **consistent with** the practices of **well-established audit regulator jurisdictions** such as the United States, United Kingdom and Canada. This practice is also widely adopted by majority of the IFIAR members, where the market dominance of these firms is similarly significant.

4.10 Besides the inspection frequency, the scope and extent of inspections carried out during each visit was also re-examined and discussed further below.

Providing Scalability to the Scope and Extent of Inspection

4.11 ACRA will **customise the scope and extent of inspection** to focus on areas of greater risk and weakness in each firm. Previously, firm-level inspections were carried out on the same depth and intensity across the firms inspected during each visit. The inspection would comprise:

- understanding the design of the firms' quality controls, policies and procedures in each of the six SSQC 1 elements ("test of design"); and
- assessing the continuing effectiveness of compliance with and/or implementation of such controls, policies and procedures ("test of operating effectiveness").

4.12 Having completed two cycles of firm-level inspections since 2007, ACRA has seen **commendable improvements made by firms** in implementing and enhancing their system of quality controls. Through these inspections, ACRA has also obtained a deeper understanding of the areas of strength and weakness in each firm.

4.13 Going forward, a **3-tier risk rating criteria** will be assigned to each SSQC 1 element based on the results of the previous inspections as follows:

Figure 8: 3-Tier Risk Rating Criteria

Satisfactory	Needs Improvement	Not Satisfactory
• Policies and controls are substantially in place **and / or** • No significant procedural lapses in implementation	• Policies and controls exists with some deficiencies **and / or** • Procedural lapses in implementation but are not pervasive and ad-hoc	• No policies and controls or severe deficiency in design **and / or** • Procedural lapses in implementation that are either: - Prevasive; or - Breaches of laws and regulations; or • Non-compliance with requirements imposed

4.14 This risk rating, which will be communicated to the firms, will determine two important aspects of the next inspection carried out on each SSQC 1 element:

i) The **frequency in which a full scope testing**, comprising both a test of design and test of operating effectiveness **would be carried out** on an SSQC 1 element; and

ii) The **intensity of work performed** in between full scope testing, which could range from re-confirmation procedures to limited tests of design and operating effectiveness on areas of weakness.

The risk rating result for each element will be revised only after it has been subjected to a full scope testing.

4.15 Figure 9 below provides an overview of the extent of inspection work to be performed under each risk rating category:

Figure 9: Scope and Extent of Inspection for each Risk Rating Category

Results of previous visits	**Satisfactory**	**Needs Improvement**	**Not Satisfactory**
Full scope on:	**3-cycle testing**	**2-cycle testing**	**1-cycle testing**
First visit	• Reconfirming design of controls • Operating effectiveness of controls not tested	• Test of design and operating effectiveness are performed on areas of weakness only	**Full scope testing**
Second visit	• Reconfirming design of controls • Operating effectiveness of controls not tested	**Full scope testing**	
Third visit	**Full scope testing**		

4.16 With these enhancements, greater attention will be given to the weaker areas of quality control and the remedial actions taken by firms. The scalability of inspection in accordance to the risk rating also allows ACRA to efficiently conduct its inspections and **lessen the inspection burden on firms with good controls, policies and procedures**.

Detailed Engagement Inspections

Refining the Risk-Based Public Accountant / Engagement Selection Process

4.17 Following a holistic review to refine the selection methodology, ACRA has formulated a **risk-based selection model** to rate and identify public accountants and subsequently, determine the respective engagement to be inspected. The PMP selection process relies largely on identification and assessment of risk factors relevant to the public accountant / engagement. This is crucial as it ensures that ACRA's inspections are targeted towards areas where the potential risks and impact of audit failure are greatest.

4.18 The selection methodology for public accountants considers an **extensive range of risk factors**, including:

- Public accountant risk factors (e.g. results of prior PMP inspections and firm's internal engagement reviews, experience levels, etc);
- Engagement portfolio risk factors (e.g. portfolio concentration, size and complexity of engagements held by the public accountant); and
- Firm risk factors (e.g. the audit firm's risk profile based on past reviews, results and robustness of the firm's internal reviews, where applicable, etc).

To add rigour to the selection process, elements of **unpredictability and thematic areas** of focus (e.g. inspections focused on the audits of construction contracts or application of new FRSs) will also be considered.

4.19 The engagement selection process has been similarly enhanced to ensure that the **most appropriate engagement is chosen** to assess the public accountant and that it **commensurate with the risks that the audit engagement poses** to external stakeholders (e.g. the investing public). This process takes into account a wide range of factors such as country risk, the size of entities in the public accountants' audit portfolio, engagements with complex accounting treatments or issues, engagements with restatements or changes in audit opinion, engagements with significant reduction in audit fees without commercial basis and complaints.

Engagement Inspections – Focus on Significant Risk Areas

4.20 ACRA's inspection of an audit engagement file has now shifted from a cover-to-cover approach to one that **focuses only on significant risk areas** of an audit. This change in methodology further augments ACRA's inspection approach to be more risk focused and to entrust the role of educating the profession to the accountancy professional bodies. Similarly, firms are also expected to take ownership in resolving all other quality issues not inspected by ACRA.

4.21 This approach would place emphasis on key audit areas having the highest risk of potential errors or misstatements that may impact the audit opinion. These areas are **generally material in nature and** typically include financial statement items or transactions that:

- require **complex accounting estimates or judgement**;
- are significant or unusual; or
- are **affected by significant economic, industry or accounting developments**.

In addition, certain core areas are still inspected such as fraud risk, materiality and related-party transactions.

4.22 As a result of this change, ACRA will be able to utilise its resources to **cover more engagements and the risk areas identified in greater depth**. This would also enable ACRA to more effectively detect pervasive issues of concern across the profession.

Reporting on Significant Findings only

4.23 Another key enhancement made is in the area of reporting, whereby the scope of findings to be included in the formal inspection report has been redefined. A **reportable finding is now defined** as "a finding in a significant risk area arising from either a deficiency in audit procedure[13] or inappropriate professional judgment[14]". This is in principle similar to the classification of "main findings" under the previous regime.

4.24 The change in scope aligns with the methodology shift from a cover-to-cover approach to inspection on significant risk areas only. This also implies that **less severe findings** such as minor deficiencies in non-significant risk areas that are unlikely to have bearing on the inspection outcome would be **excluded from the report**, though these may still be verbally communicated to the public accountant.

13 The deficiency may stem from inadequate work done or non-performance of necessary audit procedures.

14 It has to be obvious to a reasonable auditor that the public accountants' application of professional judgment is fundamentally flawed.

4.25 This approach facilitates a more efficient evaluation process as it helps the decision making authorities focus on findings that will affect the inspection outcome on the public accountant. By doing so, the public accountant is also **directed to important and priority areas** for remediation.

4.26 In addition, a draft report will now be provided to the public accountant prior to its finalisation, thus allowing the opportunity for the public accountant to confirm the factual accuracy of the case details and the audit work performed. This approach aims to **enhance transparency** over the reporting process and **minimise disagreement over facts or introduction of new evidence** subsequent to the issuance of the report. It must however be emphasised that this process is not meant to re-open discussions arising from differences in opinions and judgement between the engagement team and the PMP inspector.

4.27 ACRA **will continue to fine-tune the inspection approach and methodology, where necessary** and keep itself abreast of local and international developments, as well as feedback from the profession to ensure that its regulatory practices keep pace with the fast changing landscape. The profession should also prepare for the proposed amendments to the Accountants Act which are expected to be enacted by late 2015/early 2016. A summary of key amendments to the Accountants Act is discussed in **Section 5** of this report.

5 Initiatives to Help the Profession and Upcoming Developments

- **The profession can reach out to accountancy professional bodies to help them remediate and improve audit quality.**
- **ACRA is evolving its audit oversight to emphasise on firm-level controls that can sustain audit quality and hence will be amending the Accountants Act.**

Initiatives by Accountancy Professional Bodies

5.1 The accountancy professional bodies in Singapore play a crucial role in shaping the development of the profession. Working closely with ACRA on broad regulatory concerns as well as detailed areas of finding identified from the PMP, the **accountancy professional bodies are pro-active** in identifying initiatives that can be carried out to raise awareness of audit quality and financial reporting issues. Some of the notable initiatives by the accountancy professional bodies to uplift the standards of audit quality are outlined below.

ISCA

5.2 Besides conducting seminars and workshops to enhance the accounting knowledge and technical capabilities of public accountants, ISCA provides support to small and medium-sized public accounting entities ("SMPs") to help strengthen their systems and audit processes via the following:

- **SSQC 1 Guidance and Implementation Support**

  To help SMPs in the implementation of SSQC 1, ISCA has rolled out the following initiatives:
  - the issuance of comprehensive practice guides, articles, and pre and post SSQC 1 implementation workshops;
  - conducting an inaugural survey in 2013 to understand the state of SSQC 1 implementation amongst the SMPs, their needs and challenges; and
  - the launch of the Collaborative Industry Project ("CIP") Process Manual, which is co-funded by SPRING Singapore under the CIP scheme. The initiative aims to assist SMPs in establishing and maintaining a system of quality control in their respective practices. Under this initiative, SMPs can implement SSQC 1 without incurring significant financial costs as they can leverage on government funding of up to 70% of the total consultancy and training costs.

- **The Quality Assurance Review Programme ("QARP")**
  The QARP is a voluntary programme that aims to help participating public accountants improve their audit practices. The programme involves review of engagement files conducted by a Quality Assurance Advisor, with feedback for improvements provided on audit and documentation procedures.

CPA Australia

5.3 CPA Australia has the following on-going initiatives to help its members improve their work and further enhance their technical skills:

- **Singapore Accountancy Alliance**
  CPA Australia's Singapore Accountancy Alliance ("SAA") is an initiative formed in 2013 for SMP practitioners. The alliance **shares resources for training and has started a series of regular monthly talks** on topics relating to audit, tax, trade finance and staff communication. Membership of the SAA is currently restricted to CPA Australia members.

- **Quality Assurance Review Mentor Program**
  CPA Australia provides a mentor service for its members in public practice through its Quality Assurance Review Mentor Program. The program offers public practitioners a constructive and educational opportunity for members requiring guidance for their PMP review. This service, provided by experienced practitioners, is based on CPA Australia's highly-successful Quality Assurance Review Program in Australia.

ACCA

5.4 ACCA continues to hold regular "Practitioners' Clinics" for public accountants. These clinics discuss the latest technical and business issues relevant to the SMPs, including the latest PMP findings issued by ACRA. These clinics also provide a platform for public accountants **to network and share auditing practices** with others in the profession.

5.5 ACCA also conducts a Global Forum for Audit and Assurance. This Forum serves to provide input into audit standards setting and aims to help identify, evaluate and champion the value of audit, as well as new and alternative forms of assurance which bring value to investors, businesses and the public.

Upcoming Developments

5.6 An update of ACRA's governing legislation, the Accountants Act (the "Act") and its subsidiary legislation, the Accountants (Public Accountants) Rules is currently in progress. The Act establishes the framework for registration and oversight of public accountants. The proposed amendments aim to update the Act to be in line with local and international developments in audit regulation and to improve ACRA's effectiveness in promoting audit quality and protecting public interest.

5.7 ACRA consulted the profession and key stakeholders on the main proposals in 2011, in two consultation papers and in focus groups. In 2012, the revised proposals were issued for public consultation. The main amendments proposed are summarised below.

Enhancing Practical Experience Requirements for Registration as Public Accountant

5.8 The proposed amendments seek to raise the practical experience requirements for registration as a public accountant by focusing on a public accountant's core responsibilities. Specifically, emphasis will be placed on an individual's audit management experience instead of general audit experience in meeting the requirements to register as a public accountant.

5.9 These revised requirements would define and make the expectations about a public accountant's responsibilities clearer and act as a safeguard to ensure that all applicants are prepared for this responsibility. The key requirements proposed are as follows:

- **Period of experience**

  Applicants must have 2,500 hours of qualifying audit experience (QAE), gained after the applicant has completed their professional accountancy training, as follows:

  i) Members of ISCA will need to have gained the 2,500 hours after qualifying as a full member, which normally takes one to three years of post-qualification experience (i.e. such as after gaining an accountancy degree). Non-ISCA members must demonstrate that they had completed an equivalent amount of post-qualification experience before accumulating their 2,500 hours.

  ii) From 1 January 2019, all applicants to be a public accountant will need to have completed the Singapore Qualification Programme (Singapore QP) or a recognised equivalent professional qualification. Applicants who gain the Singapore QP or a recognised equivalent professional qualification after 1 January 2019 will need to have gained their 2,500 hours of QAE after they have completed the qualification.

The QAE must be gained within five years of the application.

- **Nature of experience**
  QAE is work in an audit management, audit quality review or a senior audit technical role, and applicants should have performed the Key Audit Functions (KAF) of planning, leading the engagement, and forming and reporting conclusions and opinions.

- **Supervision of experience**
  The applicants, and one or more Audit Principal(s) (AP), must declare that the applicant has completed the 2,500 hours of QAE, and has independently and competently performed the KAF under the supervision of the AP. An AP must have been a public accountant for at least five years and have not failed an audit inspection with hot review or more serious sanctions under the Practice Monitoring Programme (PMP)[15].

- **Location of experience**
  At least 1,250 hours (approximately one year) of QAE must be gained in Singapore, i.e. foreign experience of up to one year will be recognised. This is the same as the current requirement of one year of Singapore experience, and will be subject to similar criteria (such as being gained under auditing standards that are equivalent to that of Singapore).

5.10 These proposed amendments will be taken up in the Accountants (Public Accountants) Rules, a subsidiary legislation of the Act and will be effective from 1 February 2015.

Enhancing ACRA's audit supervisory framework

5.11 The amendments in this respect seek to better equip ACRA with a suite of supervision measures to more effectively and efficiently monitor audit quality. These measures include:

- **Introduction of Statutory Firm-Level Inspections**
  Firm-level controls are critical in sustaining consistent delivery of quality audits. Hence, the sufficiency and robustness of firm-level controls are evaluated and monitored by international audit oversight regulators. On the home front, ACRA has been performing firm-level reviews since 2007 on an advisory basis and will soon introduce statutory powers to require firms to remediate weaknesses in quality controls and the ability to make public disclosure and to impose sanctions when remedial actions are not satisfactory.

15 In a hot review, a public accountant must have a certain number of audits reviewed by another public accountant before signing them. To receive a hot review order, a public accountant would generally have severely failed a first inspection or failed two consecutive inspections.

- **Greater Transparency and Clarity in Communicating PMP Inspection Findings and Outcomes**

  The detailed engagement inspections carried out under the PMP will continue to be ACRA's key regulatory tool to monitor the audit work of public accountants. One of the proposals mooted is for the PMP to move away from a binary pass / fail model of assessing the results of detailed engagement inspections to one that allows for a more variegated outcome. The essence of the change is to create greater differentiation in outcomes, particularly for those with more serious consequences and to tailor appropriate remediation expectations in accordance to these outcomes. A variegated approach also aims to remove the stigma of negativity associated with a binary pass/fail model.

  Following the proposed amendments, the revised Act will also allow ACRA to communicate inspection findings, in instances of severe deficiencies (e.g. restatements or changes to audit opinions), to those charged with governance, such as audit committees of listed entities whose audits were inspected. Transparency channels will be further bolstered by proposed measures to allow information on inspection findings to be shared with other regulators and to a lesser extent, the ability to communicate information on inspection activities (e.g. date of last inspection) to enable those interested in audit quality to directly inquire on the outcome or findings with the firm or public accountant.

5.12 A final round of public consultation on the revised Act will be issued towards the end of 2014. Public accountants and interested stakeholders are encouraged to participate actively in the public consultation by submitting their views on the proposed amendments. The amended Act is expected to be enacted by late 2015 /early 2016.

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