ACCOUNTING AND CORPORATE REGULATORY AUTHORITY

PRACTICE MONITORING PROGRAMME

12th PUBLIC REPORT 2018

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Contents

Glossary of Terms

ACRA	Accounting and Corporate Regulatory Authority
AOB	Malaysia's Audit Oversight Board
ASC	Accounting Standards Council
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

Building on the foundation to raise audit quality

1.1 ACRA issues an annual report under its Practice Monitoring Programme (PMP) that shares key findings identified by ACRA during its inspections on auditors and audit firms to help them improve audit quality. The findings in this year's report are from audit inspections (engagement and firm level) carried out by ACRA from 1 April 2017 to 31 March 2018. The report highlights areas for improvement noted by ACRA pertaining to the 6 elements of Singapore Standard on Quality Control 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* (SSQC 1). Compliance with SSQC 1 helps the audit firms to consistently achieve high quality audit for all its engagements. The key areas for improvement noted this year are:

- strengthening of linkage between audit quality and partner performance evaluation and compensation
- compliance with independence requirements by audit personnel
- improving staff retention rates and staff leverage ratios[1]
- ensuring adequate time spent by Engagement Partners and Engagement Quality Control Review (EQCR) Partners on audit engagements
- reducing lapses in archival of audit working papers
- designing robust pre-issuance and post-issuance review programs.

The system of quality controls of an audit firm is the foundation for delivering consistently high quality audits. SSQC 1 sets out the requirements for the system of quality controls for audit firms. Audit firms have demonstrated their commitment to audit quality through higher investment in their system of quality controls over the years. Several firms have increased their headcount in the quality control functions with individuals knowledgeable and experienced in accounting and auditing standards specifically tasked to assist the leadership team in overseeing, maintaining and continuously improving audit quality. Audit firms should continue to strengthen their system of quality controls in order to remediate the findings and achieve high quality audits.

[1] Staff leverage ratios comprise of staff per partner and staff per manager ratios

1.2 For the current year, we remain on track to achieve the audit quality target to reduce by 25%, the proportion of inspected audits of listed entity engagements with at least one finding. ACRA had set this target in 2016 for the six audit firms that are part of the Global Public Policy Committee (GPPC[2]) networks that perform listed company audits. The target is to be achieved over the four-year period from 2015 to 2019.

1.3 For non-listed companies, the proportion of inspected audit engagements with at least one finding decreased by 30% in 2018 as compared to prior year. This encouraging result can be attributed to some public accountants in this segment taking steps to analyse root causes and developing action plans to address the audit deficiencies. Many also attended relevant training programmes pertaining to financial reporting standards and auditing standards to stay abreast of the latest developments and changes in the auditing profession. However, within the segment of audit firms that audit non-listed companies, there is still a section of public accountants and firms that continue to have significant and for some cases, recurring findings in the inspected audit engagements.

1.4 The audit deficiencies noted during engagement inspections are mainly in relation to insufficient audit procedures performed on areas such as revenue and cut-off, valuation of trade receivables, assessment of impairment of property, plant and equipment, risk assessment and basis of modification in audit opinion. Case studies in Section 4 of this report illustrate this point. These case studies highlight deficiencies in audit procedures and documentation within the audit working papers.

1.5 Audit firms should focus on these findings and enhance their audit procedures. The report also highlights common pitfalls in key audit areas such as group audits, journal entry testing and evaluating the work of experts. Audit firms are urged to devote adequate time and resources to develop effective guidance for engagement teams and audit procedures relating to these areas.

Setting the benchmark for high audit quality

1.6 In 2015, ACRA introduced the Audit Quality Indicators (AQIs) Disclosure Framework to help further raise the quality of audits. To help audit committees better evaluate and select

[2] The six firms in the GPPC networks are BDO, Deloitte, EY, Grant Thornton, KPMG and PwC. In Singapore, as at 31 March 2018, Grant Thornton does not perform audits of listed entities.

the right auditors, the framework comprises a set of 8 quality indicators that correlate closely with audit quality. Crucial to the success of the framework is support from the Big Four[3] audit firms. The firms are encouraged to communicate their AQI data to audit committees each year when they re-appoint the incumbent auditor or appoint a new one. Encouragingly, the usage of the AQI framework is increasing. For the period 1 April 2017 to 31 March 2018, Big Four audit firms have taken the initiative to share AQI data with even more audit committees as compared to the prior year.

Stepping Up and Sustaining Audit Quality

1.7 Looking ahead, an increasingly complex business environment where rapid technological advances are disrupting many sectors and business models, will pose new challenges in raising and sustaining audit quality. Audit firms must step up and stay abreast of new developments such as changes to the accounting and auditing standards, new regulatory requirements and new technologies. They must also make the necessary investments in people, processes and technologies in order to maintain high quality audits.

1.8 One recent key change in Singapore's financial reporting landscape is the issuing of the Singapore Financial Reporting Standards (International) (SFRS(I)), Singapore's equivalent of the International Financial Reporting Standards (IFRS) by the Accounting Standards Council (ASC). Singapore-incorporated companies that have issued, or are in the process of issuing, equity or debt instruments for trading in a public market in Singapore are required to apply SFRS (I) for annual periods beginning on or after 1 January 2018 ("full IFRS convergence"). The transition to new accounting standards would require management to assess and account for any potential adjustments to comparative information and adjustments, if any, resulting from retrospective application of these standards. It is crucial that auditors review and ensure that the accounting treatment and resulting adjustments from the adoption of these standards have been appropriately recognised by the management in preparing the financial information for the companies.

1.9 In 2017, as part of larger regulatory efforts to strengthen Singapore's resilience to money laundering, terrorist financing and other illicit activities, the scope of ACRA's audit inspection was expanded to include inspecting all audit firms for compliance with enhanced mandatory requirements on implementing controls and procedures for anti-money laundering and countering the financing of terrorism. These requirements are contained in

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

the new Ethics Pronouncement 200, *Anti-Money Laundering and Countering the Financing of Terrorism-Requirements and Guidelines for Professional Accountants in Singapore* (EP 200) issued by the Institute of Singapore Chartered Accountants (ISCA) and adopted by ACRA in 2014. Audit firms should take note of the common findings identified in the EP 200 inspections which can be found in section 5 of this report, and ensure that policies, procedures and controls are in place to address money laundering and terrorist financing concerns.

1.10 Public accountants should also take note of impending changes to the Code of Professional Conduct and Ethics for Public Accountants and Accounting Entities (ACRA Code). The ACRA Code which sets out the ethical and independence standards for public accountants and public accounting entities is largely based on the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA). The changes will take effect for audits of financial statements for periods beginning on or after 15 December 2018. In Section 7 of this report, ACRA has highlighted upcoming changes to the ACRA Code that addresses the Long Association of Personnel with an Audit or Assurance Client (Revised LA provisions) based on Close-off Document issued by IESBA.

1.11 Using the same personnel on an audit or assurance engagement over a long period of time may impact an individual's objectivity and professional scepticism which are important contributors to audit quality. The Revised LA provisions aim to enhance the effectiveness of the current requirements on rotation of key audit partners on public interest entity audits and the restriction of activities during the cooling-off period.

Leveraging Data Analytics for Audit

1.12 The use of Data Analytics (DA) in audits has been included as a new focus area for ACRA's audit inspections. This is in view that more audit firms are embracing the use of data analytics in the conduct of audits. The use of DA in the audit of financial statements is still at an early stage with most audit firms still experimenting with these tools. In some cases, DA tools in a financial statement audit are applied to extract useful data and analyse patterns and deviations for the purpose of planning and performing an audit. ACRA has also observed instances where DA tools have been used by engagement teams to provide insights to audit committees and senior management and also to generate graphs and diagrams for inclusion in the audit working papers to complement existing substantive audit procedures performed in the course of the audit.

1.13 Audit firms should however note the challenges in using DA tools for audits. Engagement teams may lack the required information technology (IT) knowledge to extract source data in the required format from entities' systems. Adequate audit procedures must also be put in place to ensure the completeness and reliability of the data prior to any audit work performed thereon. The audit evidence generated from the use of DA has a much higher coverage of the financial information and is usually presented in a different format as compared to audit evidence generated using conventional audit procedures. Hence, it is extremely important that the audit firms review their current methodology and audit procedures to ensure that the primary audit evidence generated by the use of DA tools meets the requirements of *SSA 500 Audit evidence*. At the same time, audit firms should also ensure that there is adequate documentation of the audit procedures and results of evidence generated by DA tools within the audit working paper to ensure compliance with *SSA 230 Audit Documentation*.

1.14 Ultimately, auditors should take care not to over rely on DA. As useful and powerful these DA tools can be, they cannot replace an auditor's knowledge, judgement and the exercise of professional scepticism. Audit firms therefore must take heed and address the challenges in obtaining and processing relevant data, ensure adequate staff training and review audit methodologies to ensure DA tools are used judiciously in the audit of the financial statements.

International Engagements

1.15 To stay abreast of international developments in audit regulation and represent Singapore's interests, ACRA continues to be actively involved in the International Forum of Independent Audit Regulators (IFIAR) and the ASEA Audit Regulators Group (AARG). Further details of ACRA's participation in such international activities are summarised in Section 2.

Section 2: Scope of ACRA's Audit Regulatory Work

The Public Accountancy Landscape in Singapore

2.1 ACRA has regulatory oversight on about 700 audit firms and more than 1000 public accountants providing public accountancy services in Singapore.

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

Audit Inspections by the Practice Monitoring Programme (PMP)

2.3 ACRA carries out two key audit 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 Singapore Standard on Auditing (SSAs). Engagement inspections are backed by legislation. ACRA's Public Accountants Oversight Committee (PAOC[4]) is the deciding authority on the outcome of these inspections.

(b) **Firm-level Inspections**

The firm-level inspection assesses a firm's compliance with the SSQC 1. 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.

Ethics Pronouncement 200 Inspections

2.4 EP 200 was first issued by ISCA on 29 October 2014 and came into effect on 1 November 2014. It sets out Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT) requirements and guidelines for professional accountants[5]. A breach of EP 200 constitutes grounds for disciplinary action against the public accountants and accounting entities under the Accountants Act.

2.5 Since 2015, ACRA has conducted EP 200 inspections on audit firms that perform audits of listed companies. In 2017, this was extended to all audit firms. ISCA carries out the inspections of audit firms that audit non-listed companies on ACRA's behalf with oversight from ACRA. Some of the common findings resulting from EP 200 Inspections have been included in Section 5.

2.6 In December 2017, ACRA issued an Audit Practice Bulletin (APB) No.2 of 2017[6] titled Compliance with Ethics Pronouncements on Anti-Money Laundering and Countering the Financing of Terrorism that provides guidance and sets out ACRA's expectations of the audit firms' implementation of their internal policies, procedures and controls (IPPCs) to address money laundering and terrorist financing concerns.

ACRA's Calibrated Inspection Approach

2.7 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.

2.8 ACRA's inspection approach is differentiated between the two segments of public accountants and audit firms.

(a) Listed companies segment - those practising in audit firms that perform audits of listed companies

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

[5] Professional accountants refer to an individual who is a member of the Institute of Singapore Chartered Accountants (ISCA)

[6] Please refer to the link "https://www.acra.gov.sg/publications/Audit_Practice_Bulletin/" to view the Audit Practice Bulletin No.2 of 2017

2.9 As at 31 March 2018, 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 companies' segments

As at 31 March 2018	Listed companies segment	Non-listed companies segment	Total
Number of audit firms	16	682	698
Number of public accountants	348	763	1,111

2.10 In the audit of listed companies segment, the Big-Four audit firms in Singapore collectively audit about 58% of the total of about 750 companies listed on the Singapore Exchange (representing about 74% of the total market capitalisation) as of 31 December 2017.

2.11 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.

2.12 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, there is consistency in regulatory outcomes across all inspections.

Contributing towards Global Audit Regulatory Efforts

2.13 ACRA continues to actively support regional and international efforts to raise global audit quality and contribute in dialogues on global audit trends and developments. Participation in such forums also allows ACRA to benchmark its regulatory activities against other leading independent audit regulators and ensure its PMP remains robust and relevant.

2.14 On 7 April 2017 ACRA was elected to the Board of IFIAR for a four-year term. IFIAR promotes global collaboration and sharing of experience among audit regulators. IFIAR also actively engages the leadership of the six largest global audit firm networks (GPPC networks), primarily through IFIAR Global Audit Quality Working Group (GAQ WG) with the objective of improving audit quality globally.

2.15 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.

2.16 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. Focusing on the GPPC audit firms' systems for quality control and their audits of listed public interest entities[8]. IFIAR sixth annual survey which was issued on 8 March 2018 noted persistent deficiencies in the following categories:

(a) Accounting estimates, including fair value measurement;

(b) Internal control testing;

(c) Audit sampling;

(d) Group audits; and

(e) Revenue recognition.

2.17 To address these persistent deficiencies, IFIAR obtained commitment from the GPPC audit firms in March 2016, to aim for at least a 25 per cent reduction in the number of listed entity audits with inspection findings within the next four years. ACRA, with the support of the local Big-Four audit firms, has adopted a similar target for Singapore.

Regional Collaboration to Raise Audit Quality

2.18 At the regional level, ACRA is part of a group of audit regulators ("the Group") which includes Indonesia's Finance Professions Supervisory Center (PPPK[9]), Malaysia's Audit Oversight Board (AOB) and Thailand's Securities and Exchange Commission (SEC). The

[7] The Investor and Other Stakeholders Working Group is responsible for coordinating IFIAR's ongoing dialogue with investor representatives, audit committees and other stakeholders, with focus placed on improving audit quality and enhancing 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.
[9] Also known as Pusat Pembinaan Profesi Keuangan ("PPPK").

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.

2.19 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 Southeast Asia. The topics discussed at these workshops include inspection developments, findings, best practices as well as emerging topics that would have significant impact for audit firms such as changes on the restructured ethics code and highlights on the changes to the upcoming revised International Standards on Quality Control (ISQC) 1. The 6th annual inspection workshop hosted by Indonesia's PPPK in July 2018 was attended by participants from 12 jurisdictions made up of 7 Southeast Asian countries, Japan, Hong Kong, Mauritius, Pakistan and Sri Lanka. Representatives from International Ethics Standards Board for Accountants (IESBA) and International Auditing and Assurance Standard Board (IAASB) also provided updates on the changes on the restructured ethics code and proposed changes to the upcoming revised ISQC 1.

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

2.20 **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 in February 2017 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. The goal is to achieve a reduction of at least 25% in the number of listed companies' audits with inspection findings over the period from 2016 to 2020. The progress towards this goal will be monitored and measured at a national level by the respective Group members on an ongoing basis.

Section 3: Firm-level Inspection Findings

Introduction

3.1 ACRA performs a firm-level inspection to assess whether an audit firm has put in place an effective system of audit quality controls in accordance with SSQC 1. Firm-level inspections complement the engagement inspections and help to ensure that high quality standards are upheld by audit firms. 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 five of the SSQC 1 areas.

Leadership and Tone at the Top –Linkage between Quality and Partner Performance

3.3 Leadership is critical as it sets the tone at the top. When leaders of the firm set audit quality as one of their key priorities and demonstrate their commitment, this has a profound influence on the behaviour and work ethics of staff. A firm's leadership must 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. ACRA commends firms which have moved from a 'seniority-based only' partner compensation system to a performance-based system which links quality to partner compensation. For some firms, the partner appraisal system takes into consideration various sub-components within 'Quality' such as regulatory compliance, results of internal and external reviews and quality of audit work.

3.4 However, more can be done to further strengthen this linkage between quality and partner performance and compensation. Firms could consider implementing a clearer and higher differential in compensation for partners with different ratings for Audit Quality. ACRA encourages all the firms to do more to establish a clearer audit quality rating and compensation framework and place greater emphasis on audit quality in the determination of the partner's overall performance.

Compliance with Independence Requirements

3.5 SSQC 1.21 states that the firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel maintain independence where required by relevant ethical requirements. Such policies assist to identify and address circumstances and relationships that may create threats to independence of personnel involved in the audit engagements and uphold the firm's independence and objectivity that supports trust in the audit opinion. Therefore, it is extremely important that firms have a robust system to check compliance of independence requirements by the audit personnel, especially partners. This should be coupled with consequential outcome for non-compliance, including severe financial penalties to act as deterrent for independence violations by the audit personnel, especially partners.

3.6 ACRA has observed that despite internal monitoring and sanction systems implemented by firms to check compliance of independence requirements by the partners, there was a high proportion of independence violations particularly by partner's spouses. These independence violations mainly pertain to a breach of firm's policy on untimely and inaccurate update of investment portfolio maintained by the senior audit personnel's spouses. While these violations did not breach the Accountants (Public Accountants) Rules (the "Code"), they were in breach of the firm's policies. Firms should re-emphasise to the partners the importance of communicating the independence requirements to their immediate family members to curb such cases of non-compliance. Further, ACRA also noted increasing trend of non-compliances pertaining to firm's independence policy by direct admit partners, particularly on the reporting of financial interests. Firms should take note and act promptly to reduce independence violations.

Human Resources – Staff Turnover Rate

3.7 Whilst some turnover in any organisation is expected, audit quality is likely to be significantly affected by excessively high turnover rates in an audit firm and made worse via inadequate or non-timely involvement of the senior audit personnel. Besides the loss of knowledge and experience, the audit firm may face difficulties in re-hiring auditors with similar levels of experience and competency. Hence, it is important for the firms to pay sufficient attention to human resource management areas such as staff training, staff engagement and communication, effective staff appraisal, greater transparency on career progression so as to attract and retain audit professionals. ACRA has noted that several firms have experienced significantly higher overall staff turnover during the current period of inspection compared to prior period. Further analysis of the overall staff turnover rate indicates that this was mainly due to increased attrition of audit seniors. The firms have attributed the spike in seniors' turnover to sector reorganisation of the audit practice, changes to audit technology and better prospects in the outside market. Notwithstanding, people are the biggest asset for the audit profession. No system or process can substitute for the proper exercise of an auditor's professional judgement and scepticism when performing audit engagements. The firms should therefore place as a priority, initiatives to improve the staff retention rates, particularly at the senior level.

Human Resources – Staff leverage ratios

3.8 The desired outcome of engagement partner and engagement manager involvement in the audit engagement is the effective supervision of the engagement. If the engagement partner and engagement manager's involvement on the audit engagement is untimely and insufficient, they will not be able to effectively supervise the audit staff. ACRA noted that staff/partner ratio among some firms continues to be notably high. This is an indication that inadequate time might be spent by partners on the audit engagements. This may result in higher workload and also dissatisfaction among the various engagement team members resulting in higher staff turnover rates. Firms should promptly act on this area to ensure adequate level of supervision by experienced members of the team as there are close linkages between their involvement in engagements and the resultant quality of audit work.

Engagement Performance – Time Spent by Engagement Partners and EQCR Partners on audit engagements

3.9 The timely involvement of partners and managers on an audit engagement is extremely important from the perspective of audit quality. Audit quality is likely to increase with higher levels of involvement by senior audit members as they have the requisite knowledge and experience to identify and resolve audit issues.

3.10 The hours spent by engagement partner relative to total engagement hours are used as an indicator of the extent of involvement of the partner. For the engagements reviewed, ACRA noted a declining trend in the engagement partner involvement in engagements. The audit firms should devote higher efforts in striving for engagement partners being more involved and engaged in the audit process.

3.11 Based on our inspections, we noted that the EQCR partners have been increasingly involved in the engagements. This is evidenced by the increased proportion of engagements inspected with higher EQCR hours in the current year as compared to prior year. However, in view of the findings identified by ACRA during its inspection, ACRA continues to urge engagement partners and EQCR partners to be adequately involved in the audit.

Engagement Performance – Time Spent by Partners on Audits of Financial Institutions ("FI")

3.12 In last year's PMP report, ACRA had highlighted 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. However, based on the inspections conducted in the year ended 31 March 2018, ACRA noted inadequate involvement of Partners in the FI engagements and high concentration of FI engagements with same year-end held by partners.

3.13 The low engagement partner and EQCR partner hours are indicative that they may not be spending adequate time on the engagement. Whilst ACRA is cognizant that due to the size and nature of FI engagements, consideration should be given to absolute time spent by engagement partners, 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 urges the firms to review and set benchmarks for audits of engagements in the FI segment and also monitor these benchmarks to ensure there is sufficient review and supervision by the senior audit personnel.

Engagement Performance – lapses in archival of audit working papers

3.14 SSQC1.45 requires the firms to establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the auditors' reports have been issued. An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of auditor's report.

3.15 ACRA has noted several cases of repeated late archival of audit working papers by the same engagement partners. In one firm, one engagement was archived more than 2 years late. In another firm, there was an increase in the number of late archival of PIE audit engagements as compared to prior year.

3.16 ACRA observed certain good practices implemented by firms to address the issue of lapses in archival of auditing papers such as stepping up their internal control mechanisms to include more frequent review of archival statistics and sampling of audit engagements to ascertain whether the working papers have been assembled and archived and providing adequate training to staff on the importance of timely archival of audit working papers. In addition, some of the firms even introduced a firm-wide policy of shorter archival time (less than 60 days) for all engagements. Some firms are also using their audit software to send automated email reminders to the engagement team to archive the audit working papers.

3.17 For audit firms auditing the non-listed companies segment, ACRA has also noted instances of engagement files not being properly archived whereby in some cases the audit working papers filed in external files are not the updated version or the working papers are missing and wrongly filed in prior year audit working paper files.

3.18 There were also instances where engagement teams did not document the audit evidence obtained during the course of the audit on a timely basis. Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of audit and facilitates effective review and evaluation of the audit evidence obtained and conclusions reached before the auditors' report is finalized.

3.19 Arising from the above, ACRA urges firms to ensure there are processes and controls in place to ensure timely and proper audit documentation and archival of engagement files so as to preserve the integrity and confidentiality of audit working papers. The partners should be held accountable for timely archival of the engagement files and any archival lapses especially repeated lapses should be severely dealt with by the firm. Further, in cases where the firm maintains its audit working papers in external files, more effort should be made by engagement team to ensure that all updated and latest audit working papers are duly filed and archived within the time limit.

Monitoring – Robustness of Pre-issuance and Post-issuance review programs

3.20 SSQC1.48 states that the firm shall establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate and operating effectively. ACRA noted that certain engagements selected for inspection by ACRA were also scoped in for the firm's pre-issuance and post-issuance review. ACRA believes that the findings arising from ACRA's review relate to risk areas that would have pre-existed when pre-issuance and post-issuance reviews were performed, indicating that the firm's internal reviews may not be robust. Lack of robustness in internal reviews by the firms may compromise the effectiveness of these reviews. ACRA recommends the firms to develop a robust framework for such internal reviews so as to ensure that these are effective in meeting the ultimate objective of audit quality. Firms should also consider whether they have appropriate arrangements to assess the internal quality reviews' contribution to audit quality, to ensure that lessons are learnt and that these quality reviews can contribute to improvement in audit quality.

Section 4: Engagement Inspection Findings

Introduction

4.1 This year's report focuses on the following topics where findings were observed in the most recent inspection cycle:

(a) Group Audits

(b) Journal entry testing

(c) Evaluating the work of experts

(d) Audit opinion (Case study 1)

(e) Revenue recognition (Case Study 2)

(f) Valuation of trade receivables (Case Study 3)

(g) Assessment of impairment of property, plant and equipment (Case Study 4)

(h) Risk assessment (Case Study 5)

Some of engagement inspection findings are presented in the form of scenario-based case studies which mirror some of the recurring observations and scenarios that ACRA inspectors have come across during the inspections. The aim is to enable public accountants to better relate to and understand how such findings could have been avoided.

4.2 The case studies are presented in the following format:

(a) Background information,

(b) Work performed by the engagement team,

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

(d) Finding.

(a) Group Audits

4.3 *SSA 600 - Special Considerations - Audits of Group Financial Statements (Including the Work of Component Auditors)* states that the group auditor is responsible for the overall direction and supervision of the group audit and should therefore demonstrate sufficient involvement in the work of component auditors, particularly in the significant risks of material misstatement at the group financial statement level.

4.4 ACRA has observed audit engagements, especially in non-listed companies segment, where the public accountant did not send group audit instructions or any other communication to component auditors and instead placed reliance on audited financial statements of the components for purposes of opining on the consolidated financial statements. There were also instances wherein the group auditor did not perform adequate work such as review of audit documentation of the component auditor including the documentation that would be relevant to the significant risks, hold discussions with the component auditor on significant risk areas, etc. so as to evaluate whether sufficient appropriate audit evidence has been obtained by the component auditor to address the risk of material misstatement. These findings are not new and were flagged out by ACRA in previous years' inspections. Another recurring deficiency arising from the group audit engagement as noted in ACRA inspection pertains to incorrect or no materiality established for the group and component auditors.

4.5 There could be several explanations for these recurrent findings. One would be insufficient knowledge and understanding of the public accountants with regard to the requirements of SSA 600. ACRA noted engagements where group auditor performed inadequate or insufficient work to evaluate if the component auditor has obtained sufficient appropriate audit evidence especially for areas identified as significant risk by the group engagement team. Another reason for findings in group audits is the lack of challenge by the group engagement team on the adequacy of component auditor's work, particularly, in relation to estimates and judgemental areas.

4.6 Public accountants should seek to have a comprehensive understanding of the requirements of SSA 600. In addition, the group auditor should also seek an in-depth understanding of the group and its structure including the components and their environments and business operations. Such understanding will help the public accountant to identify the significant components and scope of reporting required from each of these components for group audit.

4.7 Public accountants are also encouraged to learn from the best practices for group audits adopted by some audit firms such as:

- Templates and guidance on group audits: To facilitate documentation of group engagement team's considerations and overall assessment of component auditor's work.
- Enhance reporting requirements by component auditors: To obtain component auditor's "significant matter" summaries of audit procedures performed and findings on significant risks.
- Detailed review of component auditor's audit work performed and evidence gathered: Detailed documentation of the nature, timing and extent of audit procedures performed, instead of boilerplate review memorandum.
- Visit by group engagement team to significant overseas components: To obtain greater understanding of the component's business processes and risks.
- Secondment of group engagement team's member to component audit team: To provide greater understanding of the component audits by group engagement team.

With more companies expanding their international footprint, it is common for Singapore-incorporated group companies to hold equity stakes in foreign entities, be it subsidiaries, associates or joint arrangements. Hence, it is extremely important for public accountants to be fully aware of the requirements of SSA 600 such as proper planning of group audits, identification of significant components, identification of scope of component auditors work and setting up of appropriate group and component materiality levels, timely involvement and communication with the component auditors and that audit evidence obtained and retained are sufficient and appropriate.

(b) Journal entry testing

4.8 *SSA 240 – The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* requires an auditor to design and perform audit procedures to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements, irrespective of the auditor's assessment of the risks of management override of controls in an entity. In designing and performing audit procedures for such tests, the auditor needs to select journal entries and other adjustments made at the end of a reporting period and also consider the need to test journal entries and other adjustments throughout the period.

4.9 An important starting point in this test is to identify the population of journal entries and other adjustments to reduce the possibility that the auditor omits journal entries and other adjustments from being selected for testing. Once the auditor has identified the population, the completeness assessment of this population must be performed prior to selecting journal entries and other adjustments for testing. ACRA noted through its inspections that inadequate and ineffective audit procedures are being performed by auditors to assess the completeness of journal entries. There were instances where the audit firms used manual audit procedures to test the completeness of journal entries whereby they selected sample of journal entries for testing from manual journal voucher files and verified the posting in the accounting system. However, no audit procedures were performed by engagement team to ascertain whether there were any inappropriate or unauthorised journal entries posted or adjustments made to general ledger but not filed in manual journal voucher files (i.e. completeness of journal manual voucher files).

4.10 The auditor's testing of journal entries and other adjustments can be effective only if the auditor is assured of access to a complete set journal entries and other adjustments made during the period. Various audit procedures can be employed by the auditor to assess the completeness of the population of journal entries and other adjustments such as:

- Perform a roll forward: Obtain the general ledger for the period, agree opening balances to prior year audited closing balances, sort activity by account, roll forward selected general ledger accounts for the period and agree with ending trial balance. Further, reconcile the ending trial balance from the roll forward with the financial statements to ensure that all journal entries and other adjustments are reflected in the financial statements.

- Use Computer Assisted Audit Techniques (CAATs)

4.11 Auditors should adopt audit procedures to assess the completeness of journal entries having regard to the complexity and volume of journal entries posted by the entity. In case of an entity with high volume of journal entries and other adjustments, it may be more effective to analyse and test completeness of journal entries electronically. CAATs can provide an effective means for considering the entire population of journal entries and addressing fraudulent financial reporting risks. The audit firms need to provide adequate guidance for engagement teams to ascertain the most effective audit procedure to assess the completeness of journal entries and other adjustments when assessing management override of controls so that the engagement team is able to duly address the risk of fraud in an entity.

(c) Evaluating the work of experts

4.12 *SSA 620 Using the Work of an Auditor's Expert* defines 'auditor's expert' as an individual or organisation possessing expertise in a field other than accounting or auditing and whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence. A Management's expert is defined as an individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements. Experts might be engaged by management or auditors in several areas such as valuation of land and buildings, plant and machinery, jewellery, estimation of oil reserves, gas reserves and actuarial calculation of liabilities associated with insurance contracts, employee benefit plans, etc.

4.13 *SSA 620 Using the Work of an Auditor's Expert* requires the public accountant to determine whether to use the work of an auditor's expert, evaluate the competence, capabilities and objectivity of the auditor's expert and obtain sufficient understanding of the field of expertise of the auditor's expert so as to be able to evaluate the adequacy of that work for purposes of opining on whether the financial statements are fairly stated. Further, in determining the nature, timing and extent of audit procedures to be performed by the auditor with regard to the matter for which the auditor's expert is engaged, the auditor needs to consider:

- the nature of the matter
- risk of material misstatement in the matter
- significance of the expert's work in the context of the audit
- auditor's knowledge of and experience with previous work performed by that expert
- whether the expert is subject to the auditor's firm's quality control policies and procedures

4.14 ACRA noted instances where the public accountant placed reliance on the work of the auditor's expert and included limited details in the memo (filed in the audit working papers) as to the nature, timing and extent of the procedures performed by auditor's expert. The public accountant then quoted SSA 620.A13 and shared that the firm's methodology entitled the audit team to rely on the firm's system of quality control (being a network firm). Hence, the audit team accepted that no further work is required on the part of the audit team (such as reviewing the source working papers of the auditor's expert). However, SSA 620 clearly states that the auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert. Accordingly, whilst due consideration should be given to the fact that the expert is subject to auditor's firm's quality control policies and procedures, the public accountant should need to perform adequate audit procedures to obtain sufficient understanding of the work performed by the expert including evaluation of the source data, methods, assumptions used by the expert in that work. Such details together with the auditor's conclusion on the expert's work should form part of the audit working papers so as to support the auditor's opinion on the financial statements as a whole.

4.15 ACRA also noted instances of inadequate work being performed by public accountants to evaluate the work done by management's expert. In addition to assessing the competence, capability and objectivity of the management's expert, the public accountants must also obtain an understanding of the work done by the expert and also evaluate the appropriateness of the expert's work as audit evidence for the relevant assertion. Management's experts are most commonly used in valuation of land and buildings, leasehold properties, property, plant and equipment, etc. The valuation methods/techniques adopted by the experts require them to make several assumptions in order to arrive at the valuation. The public accountant should independently assess and corroborate the reasonableness of such assumptions and also validate the source data used in the valuation method/technique adopted by the expert. Adequate documentation should be included in the audit working papers detailing the understanding and evaluation of the work of management's expert and also auditor's overall conclusion on the appropriateness and relevance of that work for purposes of the audit.

Section 5: EP 200 Inspection Findings

As highlighted in Section 2 above, since 2015, ACRA has carried out EP 200 inspections on audit firms that perform audits of listed companies. In 2017, EP 200 was extended to all audit firms. In this section, ACRA will share some of the common findings noted during EP 200 inspections through the use of case studies.

Illustrative Audit Firm A

Background Information

Firm A is a sole-proprietor audit firm. The firm had no new clients and approximately 25 existing clients for the period under review. The firm has two staff.

Implementation of EP 200 requirements

The firm's IPPCs were incomplete and did not cover all the areas set out in ACRA's APB No.2 of 2017.

Inspection Findings

Firm's IPPCs

The firm's IPPCs did not cover the following areas relating to:

a) Suspicious Transaction Reporting (STR)

- How to identify suspicious transactions;
- Information required to be in the STR; and
- When to report and file STR

b) Customer due diligence (CDD)

The following procedures were not performed:

- Conducting on-going monitoring of business relationships with its existing clients
- Enhanced CDD procedures for higher risk clients

c) Ongoing training

There was no documented on-going training programme for the firm's staff and corresponding monitoring procedures but there was evidence to show that all levels of professional staff had undergone such training in the last 24 months.

Illustrative Audit Firm B

Background Information

Firm B is a two-partners audit firm. The firm derives approximately 50% of its fees from statutory audits and had approximately 90 new clients and 120 existing clients for the period under review. The firm's clients are mainly investment holding companies, consultancy services companies and small charitable organisations. The firm has six staff (including four part-time staff).

As the firm has limited resources, it has a policy not to accept the following categories of clients:

a) Listed companies;

b) Multinational companies;

c) Large charities;

d) Large non-profit organisations; and

e) Companies linked with politically exposed persons ("PEPs").

Implementation of EP 200 requirements

The firm IPPCs covers areas such as STR, CDD, records keeping, reporting procedures, ongoing training, compliance management, hiring and independent audit function.

Firm's Acceptance and Continuance Procedures

The firm will send the Client Information Forms to both its new and existing clients for their completion in order to obtain information about the following:

a) Client;

b) Beneficial owners of the client;

c) Person acting on behalf of the client;

d) Connected parties of the client; and

e) PEPs, if any.

The firm will also request for photocopies of certified true copies of National Registration Identity Cards (NRICs) (for Singapore citizen or Singapore Permanent Resident) and passports (for foreigners) to verify the individuals' details such as full name, identify card/passport number, nationality, date of birth and residential address.

Upon receiving the Client Information Forms signed off by the client or person acting on behalf of the client, the firm will assess whether it should establish, maintain, decline or terminate the business relationship with the client. The firm's assessment is documented in the AML/CFT Risk Assessment Form.

The firm does not use any advanced screening tools but uses *"Google"* as a screening tool to perform background checks. The firm will also perform screening against the Monetary Authority of Singapore (MAS)/Ministry of Home Affairs (MHA) sanction lists.

Training

The firm has established an on-going training programme and represented that EP 200 training have been provided to all staff.

Inspection Findings

Training

The inspector could not ascertain if EP 200 training have been provided to all staff as represented by the firm as the firm was unable to provide corroborative evidence such as training attendance records and training materials.

Acceptance and Continuance Procedures

Based on the samples selected for client acceptance and client continuance testing, the inspectors noted exceptions in the following areas:

(a) **No identification of the beneficial owners of the client**

- For one of the client acceptance samples, the ultimate parent company i.e. a corporate shareholder was identified as the client's beneficial owner. There was no identification of the natural person(s) who ultimately owns or controls the client.

- For one of the client continuance samples, the Client Information Form on beneficial owner was not completed by the client and the firm documented that "*there was no beneficial* *owner for the client*". It was not evident that work had been performed to identify the beneficial owner.

(b) **No verification of the identity of beneficial owners**

- In three of the client acceptance samples and one of the client continuance samples, the firm did not verify the identity of beneficial owners declared by the clients using reasonable measures such as researching publicly available information on the beneficial owner.

(c) **Inadequate screening**

- In all the client acceptance and client continuance samples, the firm represented that it had screened the clients, connected parties and beneficial owners against MAS/MHA sanction lists. However, the firm was unable provide any evidence of the screening performed such as print screen copies of the search results.

- In four of the client acceptance samples, the firm only retained the first page of the Google search results which contained name matches to the client being screened. The firm represented the name matches were false positives but was unable to provide evidence to demonstrate that a detailed search had been performed in concluding so.

Illustrative Audit Firm C

Background Information

Firm C is a ten-partners audit firm. The firm derives the majority of its fees from statutory audits and had approximately 190 new clients for the period under review. The firm's clients span across a broad range of industries such as manufacturing, trading and distribution, financial markets, healthcare, shipping, leisure, education, information technology, food and beverage and logistics. The firm has 100 staff.

Implementation of EP 200 requirements

The firm implemented its IPPCs from 1 May 2015 and the IPPCs cover areas such as STR, CDD, records keeping, reporting procedures, ongoing training, compliance management, hiring and independent audit function.

Firm's Acceptance and Continuance Procedures

In accordance with the firm's quality control policy, Client Acceptance and Continuance Forms are required to be completed by the engagement team for all clients. The engagement team will also send the Client Information Form to both their new and existing clients for their completion in order to obtain information on the following:

a) Client;

b) Beneficial owners of the client;

c) Person acting on behalf of the client;

d) Connected parties of the client; and

e) PEPs, if any.

The engagement team will also request for photocopies of certified true copies of NRICs (for Singapore citizen or Singapore Permanent Resident) and passports (for foreigners) to verify individuals' details such as full name, identify card/passport number, nationality, date of birth and residential address.

Other documents required to be obtained by the engagement team include:

a) Background check of the client (including group structure), ACRA BizFile check and a memo setting out the engagement team's understanding of the client's business activities;

b) Latest audited financial statements; and

c) Latest management accounts.

All the above information is submitted to the engagement partner who will decide whether the firm should establish, maintain, decline or terminate the business relationship with the client. The decisions are documented in the Client Acceptance and Continuance Forms and signed off by the engagement partner.

<u>Inspection Findings</u>

Acceptance and Continuance Procedures

Based on the samples selected for client acceptance and client continuance testing, the inspectors noted exceptions in the following areas:

<u>(a) No identification of the beneficial owners of the clients</u>

- For one of the client acceptance samples, the customer due diligence performed was for the senior family member of the ultimate holding corporation's shareholder instead of the shareholder himself. There was no documentation how the person of which the customer due diligence procedures were carried out on, were deemed to be the beneficial owner of the clients.

(b) Money laundering and terrorist financing risks not addressed

- In one of the client acceptance samples, 5 out of 6 directors are foreign directors and some of these directors reside in countries ranked as high risk and other monitored countries as defined by The Financial Action Task Force. Despite the above, it was not evident that the firm had considered the money laundering and terrorist financing risks vis-à-vis:

    i. The operational risks where the usage of funds are decided by executive members who are also the directors
    ii. The country risks where funds received were remitted to different countries

Section 6: Sector Driven Initiatives to Improve Audit Quality

Introduction

6.1 Making high quality audits a hallmark of our financial and business sectors is a collective responsibility. ACRA works closely with ISCA, the national accountancy body of Singapore to raise the quality of audits in Singapore. This section details some of the sector driven initiatives led by ISCA for the past year.

Improve processes and ensuring consistency in work

6.2 ISCA continues to provide support to small and medium-sized public accounting entities ("SMPs") to help improve their processes, and thereby create an environment that is best suited for quality audits to be carried out on a consistent basis.

- Automating the Audit Workflow - ISCA collaborated with a global audit and analytics solution firm to automate the audit workflow via an audit software which is customized according to the ISCA Audit Manual for Standalone Entities.

- ISCA Small and Medium-sized Practices Learning Roadmap (ISCA SMP LRM)- The ISCA SMP LRM is designed to help audit professionals, with different levels of experience, better understand the different skills they require to carry out their respective roles and responsibilities in a proper manner.

6.3 ISCA also regularly issues technical publications aimed at providing guidance to public accountants, enhancing their technical knowledge and sharing of best practices. Examples of such publications are:

- ISCA Audit Manual for Group Entities

- Technical publication: Cybersecurity Risk Considerations in a Financial Statements Audit (Published on 1 June 2018)

- Technical publication: Frequently Asked Questions (FAQs) on Enhanced Auditor Reporting (1st published in November 2017 and updated in June 2018)

- Technical publication: FAQs on Auditor’s Report on Financial Statements Prepared in Accordance with Singapore Financial Reporting Standards (International) (Published in April 2018)

Section 7: Revisions to the ACRA Code of Professional Conduct and Ethics for Public Accountants and Accounting Entities (ACRA Code): Long Association of Personnel with an Audit or Assurance Client

7.1 ACRA is making changes to the ACRA Code addressing the Long Association of Personnel with an Audit or Assurance Client ("Revised LA provisions") based on the pronouncement issued by the International Ethics Standards Board for Accountants ("IESBA"). The Revised LA provisions aim to enhance the effectiveness of the current requirements on rotation of Key Audit Partners (KAPs) on public interest entities ("PIE") audits and the restriction of activities during the cooling-off period, to address the threats to the auditors' independence created by long association.

7.2 Subject to the transition provision set out at 7.9 below, the Revised LA provisions will be effective for audits of financial statements for periods beginning on or after 15 December 2018 and for other assurance engagements from 15 December 2018.

7.3 The purpose of this section[10] is to share what the key provisions are, so that public accountants can assess the impact on their current practices and make the necessary changes before the provisions become effective.

7.4 The key provisions and changes to the extant ACRA Code (where applicable) are as follows:

A. <u>Rotation Requirements for KAPs on PIE Audits</u>

7.5 Under the current ACRA code, the time-on and cooling-off periods for all KAPs on PIE audits are 7 years and 2 years respectively.

7.6 SSQC 1.A14[11] which applies to *all* audit firms states that national requirements may establish shorter rotation periods. For audits of companies listed on the Singapore Exchange Limited (SGX), Rule 713 of the extant Singapore Exchange Securities Trading Limited (SGX-ST)

[10] This section includes extracts from "Close-Off: Changes to the Code Addressing the Long Association of Personnel with an Audit or Assurance Client" and "Staff Questions and Answers – Long Association of Personnel with an Audit Client" of the IESBA, published by the International Federation of Accountants (IFAC) in January 2017 and May 2017 respectively and are used with permission of IFAC. All rights reserved.

[11] Para A14 of the Singapore Standard on Quality Control (SSQC) 1: *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* states that "*The ACRA Code recognizes that the familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the ACRA Code requires the rotation of the key audit partner after a pre-defined period, normally no more than seven years, and provides related standards and guidance.* ***National requirements may establish shorter rotation periods.***" (emphasis added)

Listing Manual provides that the audit partner[12] must not be in charge of more than 5 consecutive audits for a full financial year and the audit partner may return after 2 years. Similarly, for audits of large charities and institutions of a public character (IPCs), the Charities Regulations require the auditor[13] to be changed at least once every 5 years whether to another auditor from the same auditing firm or company or to another auditor from a different auditing firm or company. Public accountants on audits of SGX listed companies or large charities and IPCs are to comply with the stricter of the rotation requirements prescribed in the ACRA Code and the SGX-ST Listing Manual or the Charities Regulations.

7.7 Under the Revised LA provisions, the time-on period for all KAPs on PIE audits will remain unchanged at 7 years. The cooling-off period will be increased to 5 years for the engagement partner ("EP") to ensure an effective fresh look by the incoming partner and to 3 years for the engagement quality control review partner ("EQCR") as the EQCR role has more significance compared to other KAP. The cooling-off period for other KAP will remain at 2 years.

7.8 SGX has agreed to harmonize the time-on and cooling-off requirements in Singapore and to have one single point of reference for the requirements. In this regard, SGX has started the process to amend the listing rules to refer to the relevant ACRA Code for the requirements. For audits of large charities and IPCs, EPs will have to comply with the stricter of the requirements under the current Charities Regulations and the ACRA Code and be subject to 5-year time-on and the eventual 5-year cooling-off requirements, when the Revised LA provisions in the ACRA Code come into effect.

Transition to New Provisions

7.9 IESBA included a transitional provision to facilitate an eventual changeover to the cooling-off period of 5 consecutive years for EP in those jurisdictions that have established a cooling-off period of less than 5 years. For these jurisdictions, the EP's cooling-off period may be reduced to the higher of that period or 3 years for audits of financial statements for periods beginning prior to 15 December 2023. As Singapore has an established cooling-off period of 2 years currently, the applicable cooling-off period for EPs on PIE audits will be 3 years during the transitional period.

[12] Audit partner refers to the Engagement Partner

[13] Auditor refers to the Engagement Partner.

Illustration on the Application of the Transitional Provisions

7.10 As mentioned at para 7.2 above, the Revised LA provisions are effective for audits of financial statements for periods beginning on or after 15 December 2018 (i.e. effectively beginning with calendar year 2019 audits). Based on the transitional provision, EPs will be subject to 3-year cooling-off requirement during the transitional period. Below are the 5 scenarios to illustrate the application of the transitional provision[14]. The scenarios assume that the current auditor rotation requirement of 5/2 time-on/cooling off in the SGX Listing Rules would be replaced by the transitional provision of 7/3 time-on/cooling off.

Scenario 1

7.11 The EP for the audit of a SGX listed company served for 5 cumulative years in that role with the completion of the calendar year 2016 audit and did not participate in the 2017 and 2018 audits. As the individual has served the time-on limit of 5 cumulative years with the 2016 audit and cooled off for 2 consecutive years in 2017 and 2018, he or she may return to the audit engagement for a new 7-year term beginning with the calendar year 2019 audit under the new provisions.

8 The table below illustrates the situation where "X" represents a year in which the individual was not a KAP on the audit:

2016 (Year 5)	2017	2018	2019 (Year 1)	2020 (Year 2)	2021 (Year 3)	2022 (Year 4)	2023 (Year 5)	2024 (Year 6)	2025 (Year 7)
EP	X	X	KAP	KAP	KAP	KAP	KAP	KAP	KAP

Effective Date

End of Transitional Period

Scenario 2

8.1 The individual for the audit of a PIE served as an EQCR or Other KAP[15] for 7 cumulative years in that role with the completion of the calendar year 2018 audit. As the individual has served the time-on limit of 7 cumulative years with the 2018 audit, he or she is required under

[14] Please note that the illustrations on the application of the transitional provision are provided for the guidance of public accountant to supplement prescribed ACRA Code. They are not rules of the ACRA and are not intended to serve as a substitute for the ACRA Code.

[15] KAP other than an EP or EQCR.

the new provisions to cool off for 3 consecutive years in the case of an EQCR or 2 years for Other KAP, before he or she may return to the audit engagement for a new 7-year term.

The tables below illustrate the situations:

2016 (Year 5)	**2017 (Year 6)**	**2018 (Year 7)**	**2019**	**2020**	**2021**	**2022 (Year 1)**	**2023 (Year 2)**	**2024 (Year 3)**	**2025 (Year 4)**
EQCR	EQCR	EQCR	X	X	X	KAP	KAP	KAP	KAP

Effective Date

7 years KAP to 2028

2016 (Year 5)	**2017 (Year 6)**	**2018 (Year 7)**	**2019**	**2020**	**2021 (Year 1)**	**2022 (Year 2)**	**2023 (Year 3)**	**2024 (Year 4)**	**2025 (Year 5)**
Other KAP	Other KAP	Other KAP	X	X	KAP	KAP	KAP	KAP	KAP

Effective Date

7 years KAP to 2027

Scenario 3

8.2 The EP for the audit of a SGX listed company completed his or her 5 cumulative years with the calendar year 2017 audit and commenced cooling off from the 2018 audit as required by the old provisions. As the EP had not completed a 2-year cooling-off period under the old provisions by the time the new provisions become effective, the EP has two options as follows:

<u>Option 1</u>

8.3 The EP can continue to cool-off for another 2 consecutive years to reach the cumulative 3 years cooling-off period before he or she may return to the audit engagement for a new 7-year term.

The table below illustrates the situation:

2016 (Year 4)	2017 (Year 5)	2018	2019	2020	2021 (Year 1)	2022 (Year 2)	2023 (Year 3)	2024 (Year 4)	2025 (Year 5)
EP	EP	X	X	X	KAP	KAP	KAP	KAP	KAP

7 years KAP to FY27

Effective Date

End of Transitional Period

<u>Option 2</u>

8.4 The EP can serve for a further two years on the 2019 and 2020 audits, making for a total cumulative 7 years under the new provisions. He or she will then be required to cool off for 3 consecutive years before he or she may return to the audit engagement for a new 7-year term.

The table below illustrates the situation:

2016 (Year 4)	2017 (Year 5)	2018	2019 (Year 6)	2020 (Year 7)	2021	2022	2023	2024 (Year 1)	2025 (Year 2)
EP	EP	X	EP	EP	X	X	X	KAP	KAP

7 years KAP to 2030

Effective Date

End of Transitional Period

Scenario 4

8.5 The EP for the audit of a SGX listed company served for 5 cumulative years in that role up to 2018 audit, before the new provisions come into effect.

There are two options the EP can consider:

<u>Option 1</u>

8.6 The individual can serve as an EP for an additional 2 years (i.e. for the 2019 and 2020 audits) to reach the cumulative 7-year time-on period under the new provisions. Thereafter, the individual is required to cool off for 3 consecutive years from the 2021 audit before he or she may return to the audit engagement for a new 7-year term.

The table below illustrates the situation:

2016 (Year 3)	2017 (Year 4)	2018 (Year 5)	2019 (Year 6)	2020 (Year 7)	2021	2022	2023	2024 (Year 1)	2025 (Year 2)
EP	EP	EP	EP	EP	X	X	X	KAP	KAP

7 years KAP to 2030

Effective Date

End of Transitional Period

<u>Option 2</u>

8.7 Alternatively, the individual can be rotated off the engagement for 3 consecutive years under the new provisions, starting with the 2019 audit, and come back to the engagement in any KAP role for a new 7-year time term with the 2022 audit.

The table below illustrates the situation:

2016 (Year 3)	2017 (Year 4)	2018 (Year 5)	2019	2020	2021	2022 (Year 1)	2023 (Year 2)	2024 (Year 3)	2025 (Year 4)
EP	EP	EP	X	X	X	KAP	KAP	KAP	KAP

7 years KAP to 2028

Effective Date

End of Transitional Period

Scenario 5

8.8 The EP for the audit of a PIE (other than a large charity and IPC) served for 7 cumulative years in that role with the completion of the calendar year 2021 audit and commenced cooling off as required under the new provisions. The individual would have completed 2 years of cooling-off by the 2023 audit which is the last financial year for which the transitional provision applies. In this scenario, the EP is required to cool off for an additional 1 year (i.e. for the 2024 audit) to reach the 3 consecutive years of cooling-off before he or she may come back to the engagement in any KAP role for a new 7-year term with the 2025 audit. As long as the transitional provision is in effect, the length of the cooling-off period will depend on when it begins under the new provisions.

The table below illustrates the situation:

2016 (Year 2)	2017 (Year 3)	2018 (Year 4)	2019 (Year 5)	2020 (Year 6)	2021 (Year 7)	2022	2023	2024	2025 (Year 1)
EP	EP	EP	EP	EP	EP	X	X	X	KAP

Effective Date

End of Transitional Period

7 years KAP to 2031

B. Service in a combination of KAP roles during 7-year time-on period

8.9 Given the differing cooling-off period for the EP, EQCR and other KAP, new provisions are added to clarify the applicable cooling-off period where an individual has served in a combination of KAP roles during the 7-year time-on period.

8.10 The applicable cooling-off period is as follows:

If, during the 7-year time-on period, the individual has acted as:	**Cooling-off period (years)** [16]
EP for 4 or more years	5
EQCR for 4 or more years	3
Combination of EP and EQCR for 4 or more years, of which:	
• EP for 3 or more years	5
• Any other combinations	3
All other combinations	2

C. Obtaining the Concurrence of Those Charged with Governance ("TCWG")

8.11 The current ACRA Code provides that in rare cases due to unforeseen circumstances outside the firm's control (e.g. serious illness of the intended EP), a KAP may be permitted an additional year on the audit team beyond the 7-year time-on period. This provision is strengthened to allow the KAP to serve an additional year on the new condition that the concurrence of TCWG be obtained. The firm is required to discuss with TCWG the reasons

[16] The transitional provision allows the EP's cooling-off period to be reduced to 3 years for audits of financial statements for period beginning prior to 15 December 2023.

why the planned rotation cannot take place and the need for any safeguards to reduce any threat created.

D. <u>Restriction on Activities During Cooling-off Period</u>

8.12 The current ACRA Code provides that during the cooling-off period, the former KAP should not:

(a) Be a member of the engagement team or act as the EQCR; or

(b) Provide consultation to the engagement team or the client.

The Revised LA provisions clarify that the former KAP is permitted to have discussions with the engagement team provided that they are limited to work undertaken or conclusions reached in the last year of the former KAP's time-on period where such information remains relevant to the audit.

8.13 However, additional restrictions are placed on a former KAP during the cooling-off period, prohibiting the former KAP from:

(a) Overseeing the firm's relationship with the audit client; or
(b) Undertaking any other role, including provision of non-assurance services, that would result in:
   (i) having frequent interaction with senior management or TCWG; or
   (ii) exerting direct influence on the outcome of the audit engagement.

<u>Conclusion</u>

8.14 ACRA would like to remind all public accountants and accounting entities of the need to strictly observe the requirements of the ACRA Code as any non-compliance could subject the public accountants and accounting entities concerned to disciplinary proceedings under Part IV of the Accountants Act.

APPENDIX 1: CASE STUDIES

Note:

(a) ACRA would like to stress that the below case studies **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.

ILLUSTRATIVE AUDITED ENTITY 1

BACKGROUND INFORMATION:

Company A is engaged in the business of trading of metals and chemical materials. Majority of its customers and suppliers are local. It has a warehouse in Singapore for purposes of stocking its inventory.

OTHER INFORMATION ON COMPANY A WAS AS FOLLOWS:

- Financial year end: 31 December 2017
- Audit opinion: Qualified (An "except for" qualified audit opinion was expressed on the financial statements for the financial year ended 31 December 2017)
- Overall materiality was determined to be $600,000.

CASE STUDY 1

AUDIT OPINION

Case Facts:

An "except for" qualified audit opinion was expressed by the public accountant on the financial statements of the Company A for the financial year ended 31 December 2017 as below. The public accountant had reviewed the audit working papers of the predecessor auditor and had obtained sufficient appropriate evidence on the opening balances.

"Basis for Qualified Opinion
Inventories
We were not engaged as auditors of the Company until after 31 December 2017, and therefore, did not observe the counting of physical inventories at the end of the year. We are unable to satisfy ourselves by other auditing procedures concerning the existence of inventories held at 31 December 2017, which is stated in the statement of financial position at $500,000.

Other receivables
Included in the other receivables as at 31 December 2017 comprise an advance amounting to $2,500,000 paid to supplier for purchase of goods. We were unable to obtain sufficient appropriate audit evidence to assess the recoverability of the advances to supplier. Hence, we are unable to determine the effect of any adjustment that may be required in relation to the recoverability of advances to supplier.

Qualified Opinion
In our opinion, except for the matters mentioned in the Basis for Qualified Opinion paragraphs, the financial statements are properly drawn up in accordance with the provisions of the Act and Singapore Financial Reporting Standards so as to give a true and fair view of the state of affairs of the company as at 31 December 2017 and the results, changes in equity and cash flows of the company for the financial year then ended."

WORK PERFORMED BY THE ENGAGEMENT TEAM

Inventories:

The inventories balance as at year-end comprise of only 2 categories of inventory items. The engagement team had verified the supplier invoices, contracts and warehouse receipts for both the categories. In addition, the engagement team verified the subsequent sale of these two categories of inventory items after the year-end.

Other receivables:

The engagement team verified the purchase contract with the supplier and evidence of payment of deposit to supplier. The engagement team further documented that based on its discussion with the client management, the purchase contract was subsequently cancelled and the deposit was refundable by the supplier to the Company within 9 months from the end of the current financial year. Further, the engagement team sent out the confirmation request to the supplier but did not get a response from the supplier.

WORK NOT PERFORMED BY THE ENGAGEMENT TEAM

Inventories:

Despite the alternative audit procedures performed by the engagement team to ascertain the existence of inventories balance as at year-end, it was not clear how did the public accountant assess and conclude that there was a limitation on scope of the audit to support the qualified audit opinion expressed on the existence of inventories as at year-end.

Other receivables:

The engagement team did not disclose sufficient information within the “Basis for Qualified Opinion” to enable users of the financial statements to understand the transaction and reason for public accountant’s inability to obtain sufficient appropriate audit evidence on recoverability of the advances to supplier. Details of transaction such as subsequent cancellation of the purchase contract, non-repayment of the refund from the supplier up to the date of signing of financial statements and management’s inability to furnish any documentary evidence to support the recoverability was not included within the “Basis for Qualified Opinion” paragraph and hence the disclosure did not meet the requirements of para 20 of SSA 705 *Modifications to the Opinion in the Independent Auditor’s Report*.

Finding:

Given that the engagement team had performed alternative procedures on existence of inventories as at year-end, it is unclear how did the public accountant conclude that there was limitation on scope of audit. Further, in the absence of adequate details of transaction pertaining to the advances to supplier within the “Basis for Qualified Opinion”, the requirements of SSA 705 were not met.

ILLUSTRATIVE AUDITED ENTITY 2

BACKGROUND INFORMATION:

Company B, the holding company, is engaged in the business of selling ship spare parts and providing repair services for spare parts whose warranty period had expired.

Company B has a wholly owned subsidiary, Subsidiary S1, whose principal activity is that of vessel owner and charterer of vessels to oil field companies.

Both Company B and Subsidiary S1 were incorporated in Singapore and audited by the same public accountant. Company B did not prepare consolidated financial statements as it met the criteria for exemption from presenting consolidated financial statements.

OTHER INFORMATION ON COMPANY B AND SUBSIDIARY S1 WAS AS FOLLOWS:

- Financial year end: 31 December 2017
- Audit opinion: Unqualified
- Overall materiality for Company B and Subsidiary S1 was determined to be $300,000 and $1.9 million respectively.

CASE STUDY 2

REVENUE RECOGNITION

Case Facts (Please see Illustrative audited entity 2 for background information on Company B):
Company B's revenue for the financial year ended 31 December 2017 amounted to $33,000,000 comprising of $23,000,000 from sale of spare parts and $10,000,000 of repair service revenue.

WORK PERFORMED BY THE ENGAGEMENT TEAM

Testing of sales transactions

For testing of accuracy of sales, the engagement team selected 25 samples of sales transactions and vouched to sales invoices and supporting delivery documents.

Sales cut-off

For testing the sales cut-off, the engagement team tested selected last 7 sales invoices and supporting delivery documents before year-end and first 7 sales invoices and supporting delivery documents after year-end.

The engagement team noted that the revenue was correctly recognised and no cut-off issues were noted.

WORK NOT PERFORMED BY THE ENGAGEMENT TEAM

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

Testing of sales transactions

All the samples selected for testing of sales transactions were pertaining to spare parts sales. Considering that spare part sales and repair service revenue were non-homogeneous revenue components with different revenue recognition criteria, it was not clear how the public accountant had assessed that the testing of two components as a whole was appropriate, an approach which inadvertently resulted in the entire repair service revenue component being omitted from the testing of sales transactions.

Sales cut-off

The delivery time for spare sales ought to have been considered in designing the sales cut-off audit procedures. For example, if the average delivery time to deliver goods to the customers by the Company is 2 weeks, then the minimum targeted period of testing to address sales cut-off should be 2 weeks instead of just last 7 and first 7 sales transactions before and after year-end respectively.

Finding:

The public accountant had not performed sufficient and appropriate work to address the accuracy, and cut-off of revenue recognised during the financial year.

CASE STUDY 3:

VALUATION OF TRADE RECEIVABLES

Case Facts (Please see Illustrative audited entity 2 for background information on Company B):

As at 31 December 2017, trade receivables of Company B amounted to $5 million. There have been no major changes in the customer base for Company B in the current year. Further, the proportion of trade receivable balances in the respective aging categories as at year-end has been consistent with prior years. Company B had recognised provision for doubtful debts amounting to $300,000 as at 31 December 2017 for trade receivables balances due for more than 60 days. Credit period offered to customers by Company B was in the range of 30 to 60 days. As at year end, Company B's trade receivables amounting to $3 million were past due more than 60 days.

WORK PERFORMED BY THE ENGAGEMENT TEAM

The engagement team sent 15 debtors' confirmations to customers with material trade receivable balance as at year-end. The engagement team received responses from 10 customers who confirmed the trade receivables balance with no discrepancies. Out of these 10 debtors' confirmations obtained from the customers, 7 debtors' confirmation were from customers with trade receivables balance past due more than 60 days totalling $2.2 million. In order to address the valuation of the remaining trade receivables balance past due for more than 60 days, engagement team verified sales invoices and acknowledged delivery order for 2 customers with trade receivables balance past due more than 60 days amounting to $400,000 as there were no subsequent receipts from these two customers.

The engagement team then concluded that based on work done and discussion with management, they had concurred with management that no further provision for doubtful debts was necessary as at year-end.

WORK NOT PERFORMED BY THE ENGAGEMENT TEAM

Receipt of debtor's confirmation from customers and verification of sales invoices and acknowledged deliver order only address "existence" assertion of trade receivables as at year-end. In the absence of work done to verify subsequent receipts from customers, the "valuation" assertion of trade receivables is not addressed. Hence, it is not evident from the work done as to how did the engagement team conclude that provision for doubtful debts amounting to $300,000 is adequate as at year-end.

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 trade receivables balance past due more than 60 days.

Upon inquiry, the public accountant represented that the Company had continued business relationship with these customers. Nevertheless, sole reliance on the Company's continued business relationship with customers would not be considered sufficient audit evidence obtained to concur with management's representation that the provision for doubtful debts is adequate as at year-end.

CASE STUDY 4

ASSESSMENT OF IMPAIRMENT OF PROPERTY, PLANT AND EQUIPMENT

Case Facts (Please see Illustrative audited entity 2 for background information on Subsidiary S1):

As at 31 December 2017, the carrying amount of the Subsidiary S1's vessels recognised as Property, plant and equipment amounted to $61 million. The public accountant concurred with management that there were indicators of impairment of property, plant and equipment owing to depressed market conditions in the oil and gas industry.

Management had disclosed in its Annual Report "Prices for new contracts are likely to drop from present levels due to depressing market conditions and severe competition in the industry and hence group expects fewer charter contracts at lower rates."

WORK PERFORMED BY THE ENGAGEMENT TEAM

The engagement team obtained Discounted cash flow (DCF) workings prepared by management to support that no provision for impairment of property, plant and equipment (PPE) was required as at year-end. The engagement team reviewed the following key assumptions used in the DCF:

Key assumptions used in DCF	
(a) DCF projection period	15 to 30 years
(b) Residual value of PPE	20% of cost of vessel
(c) Revenue growth rate	Charter rates based on last contracted rates in past 2 years; flat charter rate over DCF period
(d) Discount rate	5%

<u>DCF projection period:</u>

Useful life of vessels is 15 to 20 years. Engagement team assessed DCF projection period of 15 – 30 years to be reasonable based on remaining useful life of vessels. 2 vessels with planned modification had extended projection period of 25 and 30 years respectively.

Residual Value:

The engagement team compared the range of residual value of vessels estimated by S1 (of $1.2 million to $6.6 million) against sale prices obtained from external websites (of $3.9 million to $9.7 million). In addition, engagement team compared the 20% estimate used by S1 against the industry range of residual values (of 5% to 20%) published by an external party.

Revenue growth rate:

The engagement team documented that the charter rates used in DCF are based on contracted rates in the past 2 years instead of historical rates which were generally lower due to the economic downturn.

Discount rate:

The engagement team compared the discount rate of 5% used by management in the DCF with Weighted Average Cost of Capital (WACC) of 3.5% obtained from an external website that provides data on WACC for listed entities.

WORK NOT PERFORMED BY THE ENGAGEMENT TEAM

DCF projection period:

The DCF projection period for 2 vessels were longer than the remaining useful life of the vessels due to planned modifications to enhance the performance of the vessel. It was not evident how the public accountant assessed the DCF projection period for the vessels to be reasonable despite it being longer than the remaining useful life of the vessels.

Residual Value:

It was not evident how the public accountant had adequately challenged management's basis of 20% of cost of PPE as residual value given that selling prices of the property, plant and equipment of similar age and capacity obtained by the public accountant from external sources were spread over a very wide range and also considering that management has used the upper end range of residual value published by an external party.

Revenue growth rate:

Management had disclosed in its Annual Report "Prices for new contracts are likely to drop from present levels due to depressing market conditions and severe competition in the industry and hence group expects fewer charter contracts at lower rates."

It was not evident if the public accountant challenged management on the use of charter rates contracted in past 2 years in the DCF in view of the above statement in the Annual Report.

Discount rate:

The assessment performed by the public accountant on the discount rate did not consider market assessment of the time value of money and the specific risks associated with the PPE's estimated cash flows. WACC of 3.5% obtained from external website was based on cost of debt of 1.8% whereas Entity's effective interest rate on borrowings was 6% p.a. Entity's actual interest rate should have been considered in arriving at WACC.

Finding:

It was not evident how the public accountant had concluded that the key assumptions used in the DCF workings were reasonable. Accordingly, it was unclear how the public accountant had evaluated and concurred with management that no impairment allowance was required for the PPE despite the indicators of impairment.

ILLUSTRATIVE AUDITED ENTITY 3

BACKGROUND INFORMATION:

Company C's principal activities are those related to sale of computer spare parts and other IT related products. Company's registered office and principal place of business is Singapore. Company's immediate and ultimate holding corporations are incorporated in Country X.

OTHER INFORMATION ON COMPANY C WAS AS FOLLOWS:

Financial year end: 31 December 2017

Audit opinion: Unqualified

Case Study 5:

RISK ASSESSMENT

Case Facts:

Company C purchased products from overseas suppliers for sale to its customers in Country Y (country identified with heightened risk of money laundering). No physical inventories were kept in Singapore. The Company did not have a bank account and all payments to overseas suppliers and receipts from debtors were managed through immediate holding corporation's bank account. The Company's accounts were maintained by an outsourced accountant in Country X.

WORK PERFORMED BY THE ENGAGEMENT TEAM

The engagement team documented in the audit working papers titled "Audit Risk Summary" that the general risk of the Company was assessed to be low. In the audit working paper titled "Risk Response Summary", it was documented that all financial statement line items were assessed to be low risk and described to be straightforward areas with no problems expected.

In the audit working paper titled "Review of design and implementation of internal controls", the public accountant identified only controls in "trade receivables" as internal controls relevant to the audit.

WORK NOT PERFORMED BY THE ENGAGEMENT TEAM

The public accountant did not perform an appropriate risk assessment and understanding of the Company's operations and its environment in accordance with the requirements of *SSA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*, so as to identify and assess the potential risks of material misstatement and to correspondingly design and implement responses to such identified risks. This is especially when the following anomalies were noted for the engagement:

- the Company did not have a physical office in Singapore
- the Company did not have a bank account and used its holding corporation's bank account in Country X
- all supporting documents were kept in Country X
- the Company's customers were in Country Y (Country identified with heightened risk of money laundering)

Finding:

Despite there being risk indicators present in relation to the Company's operations and operating environment, it was not evident that the public accountant had made an appropriate risk assessment and understanding of the Company and its environment to identify and assess the potential risks of material misstatement and to correspondingly design and implement responses to such identified risks.