

ACRA's 10th Public Report

A Decade-Long Journey in Enhancing Audit Quality

**Singapore Accountancy Convention
25 August 2016**

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ACRA**



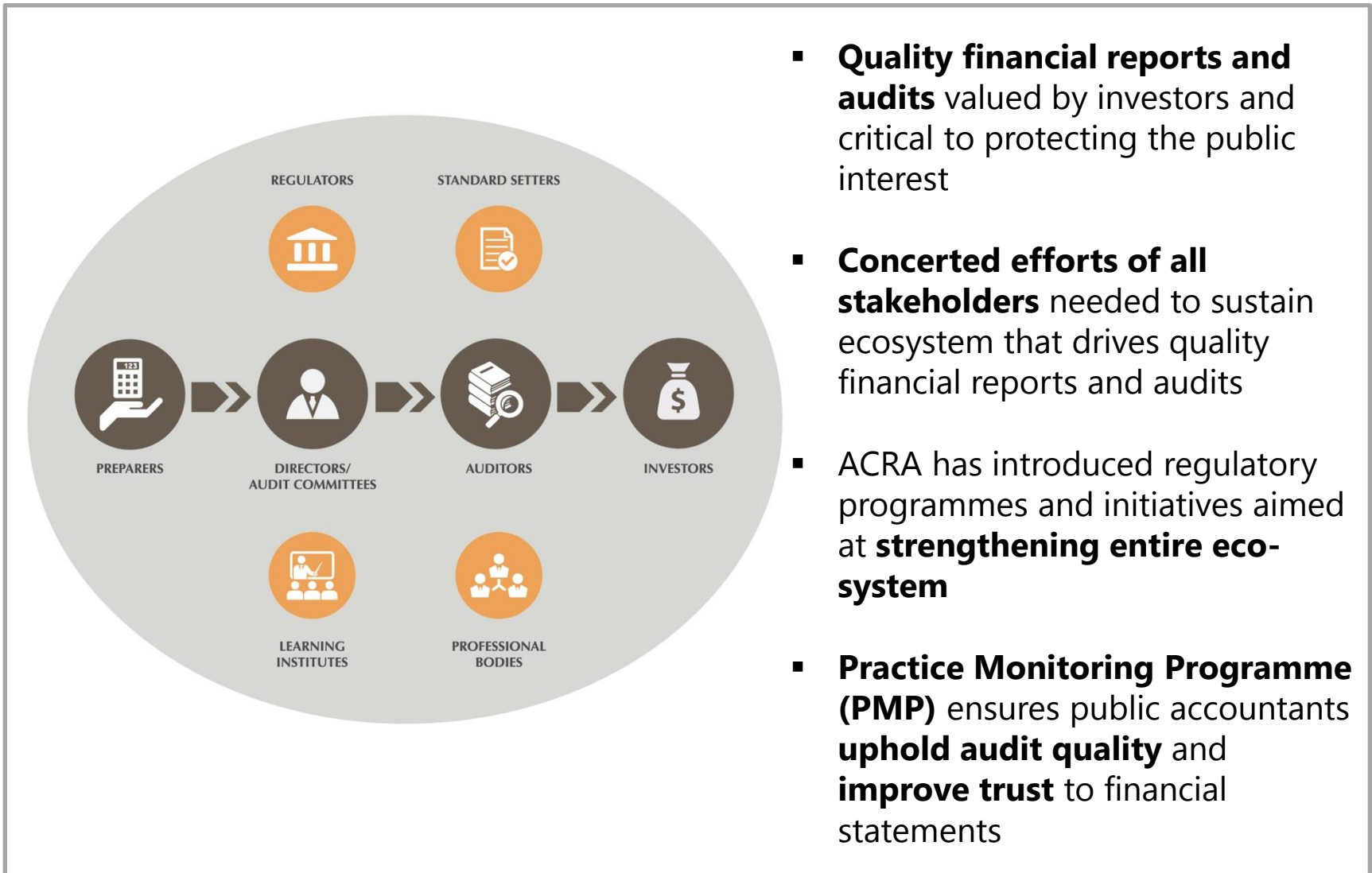
Agenda

- 1. A Decade-Long Journey in Enhancing Audit Quality**
 - Strengthening the Financial Reporting Eco-System
- 2. Firm-Level Inspections**
 - Key Findings and Improvements
- 3. Engagement Inspections**
 - Four Key Themes of Inspection Findings
 - Importance of Risk Assessment and Audit Documentation
- 4. New Initiatives to Improve Audit Quality**
 - Adoption of IFIAR's Audit Quality Initiative in Singapore
 - Extension of ACRA's Publication Regime on Inspection Outcomes
 - Introduction of ACRA's Six Targets of Audit Quality Indicators
- 5. Upcoming Developments and Future Focus**
 - New Standards and Regulations
- 6. Key Messages and Conclusion**

A Decade-Long Journey in Enhancing Audit Quality

Enhancing Audit Quality

- Strengthening the Financial Reporting Eco-system



Enhancing Audit Quality

- Non-regulatory initiatives to strengthen eco-system



WHO IS ACCOUNTABLE



Issued **Audit Practice Bulletins** and **remedial elements to PMP orders**

2009

Issued **Guidance to ACs** on the evaluation of auditors using the E-A-S-E indicators of audit quality

2010

Commissioned research pieces¹ to discuss the responsibility of financial reporting by preparers, directors and ACs and the knock-on effects on audit quality

2013 and 2014

Introduced the **AQI Disclosure Framework** to facilitate a meaningful dialogue between ACs and auditors on audit quality during appointments

2015

Commissioned Investors Perception Study to affirm the value that investors place on quality financial reports and audits

2016

¹ Survey of preparers and audit adjustment study were conducted in 2013 and 2014 respectively to highlight to preparers, directors and Audit Committees on their roles and the need to take ownership of the quality of financial reporting.

Firm-Level Inspections

Firm-Level Inspections

- Registrations and Inspections

Firm Registrations

30% growth in registered firms since 2007; **689** as at 31 March 2016

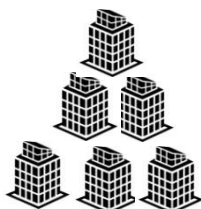
16 firms in the **listed companies segment**

673 firms in the **non-listed companies segment**

Firm-Level Inspections from 2007 to 2016



Listed companies segment



Non-listed companies segment

- Completed **3 cycles of inspections** from 2007 to 2014
- 9 firms were inspected in 2016 (2015: 10 firms)
- Inspections now on **advisory basis**, pending legislation

- Inspections now on engagements due to small size of practice
- Firm-level inspections will **commence upon legislation**

Firm-Level Inspections

- Key Findings in the Past Decade

Firms in the Listed Companies segment progressed at uneven pace



Right Tone at the Top

And emphasis on quality drives the pace of remediation and improvements in strengthening firm-level quality controls



Human Resources and Involvement

Poor staff retention and low involvement of partners in supervision and resolution of issues can significantly reduce audit quality



Continuous Monitoring

Lack of monitoring mechanisms over the six SSQC1 quality controls to ensure its continued effectiveness

Firm-Level Inspections


- Leadership and Tone At The Top

Linkage between audit quality and overall partner's performance



**Partner's overall
performance rating**

Big-Four firms

- **Clear linkage** to partner's performance
- Multiple and balanced factors included in determining "**Audit Quality**" such as:
 - Results of internal and external quality reviews
 - Results of independence testing
 - Effectiveness as an EQCR partner 
 - Retention rates of directly supervised staff

Non Big-Four firms

- **Weak or no linkage**
- For example, if there are no ratings for internal quality reviews, there cannot be clear linkage between audit quality and partner's performance

Firm-Level Inspections

- Leadership and Tone At The Top

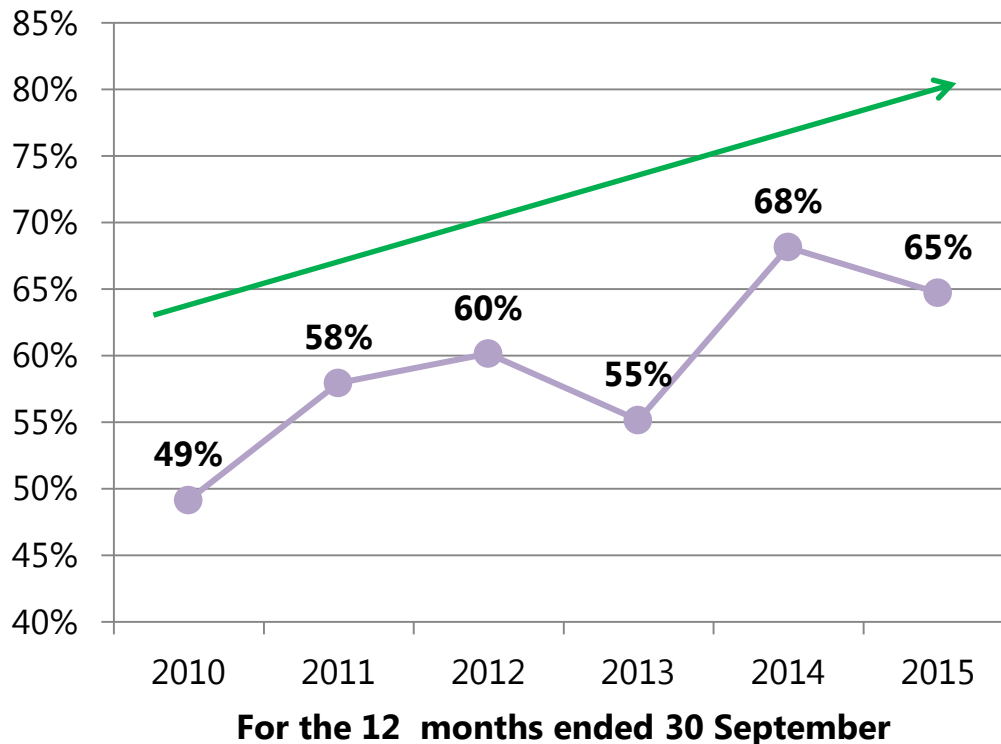
Increased Resources in Quality Control Functions



Firm-Level Inspections

- Human Resources: Average Staff Retention Rate

- **High correlation** between staff retention and audit quality
- High staff retention ensures **retention of knowledge and experience** of the audited entity
- **Increases ability** to identify and resolve auditing issues



General upward trend in average staff retention rates

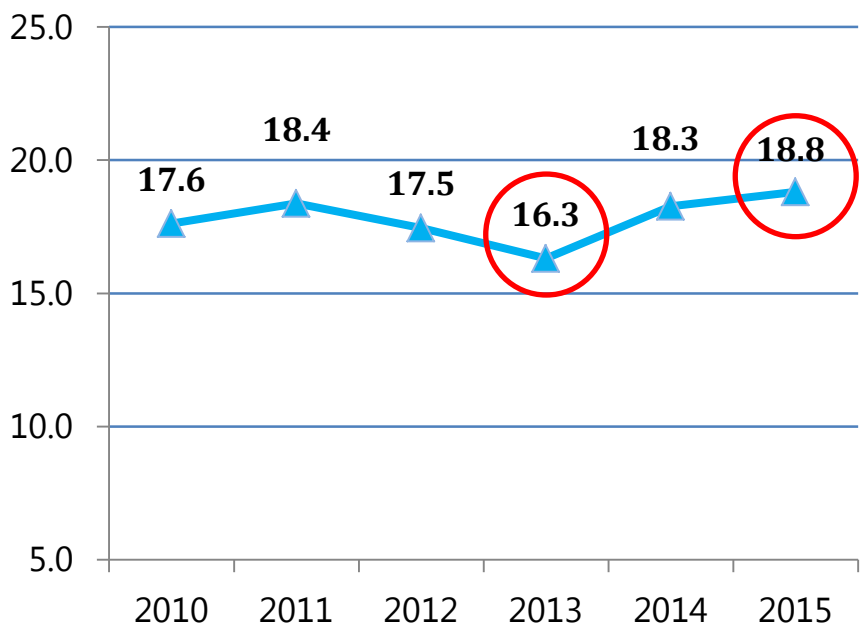
Firm-Level Inspections

- Human Resources: Staff leverage ratios



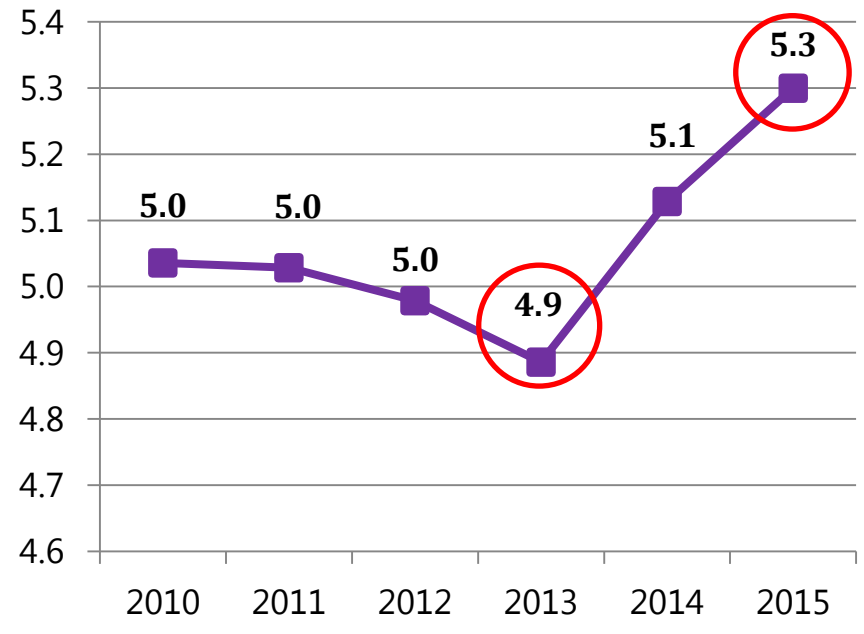
- Lower staff leverage enables **more time to supervise junior audit staff** thereby increasing audit quality
- While relatively stable, leverage ratios **can be further decreased to ensure adequate supervision** of staff

Average staff per partner ratios



For the 12 months ended 30 September

Average staff per manager ratios



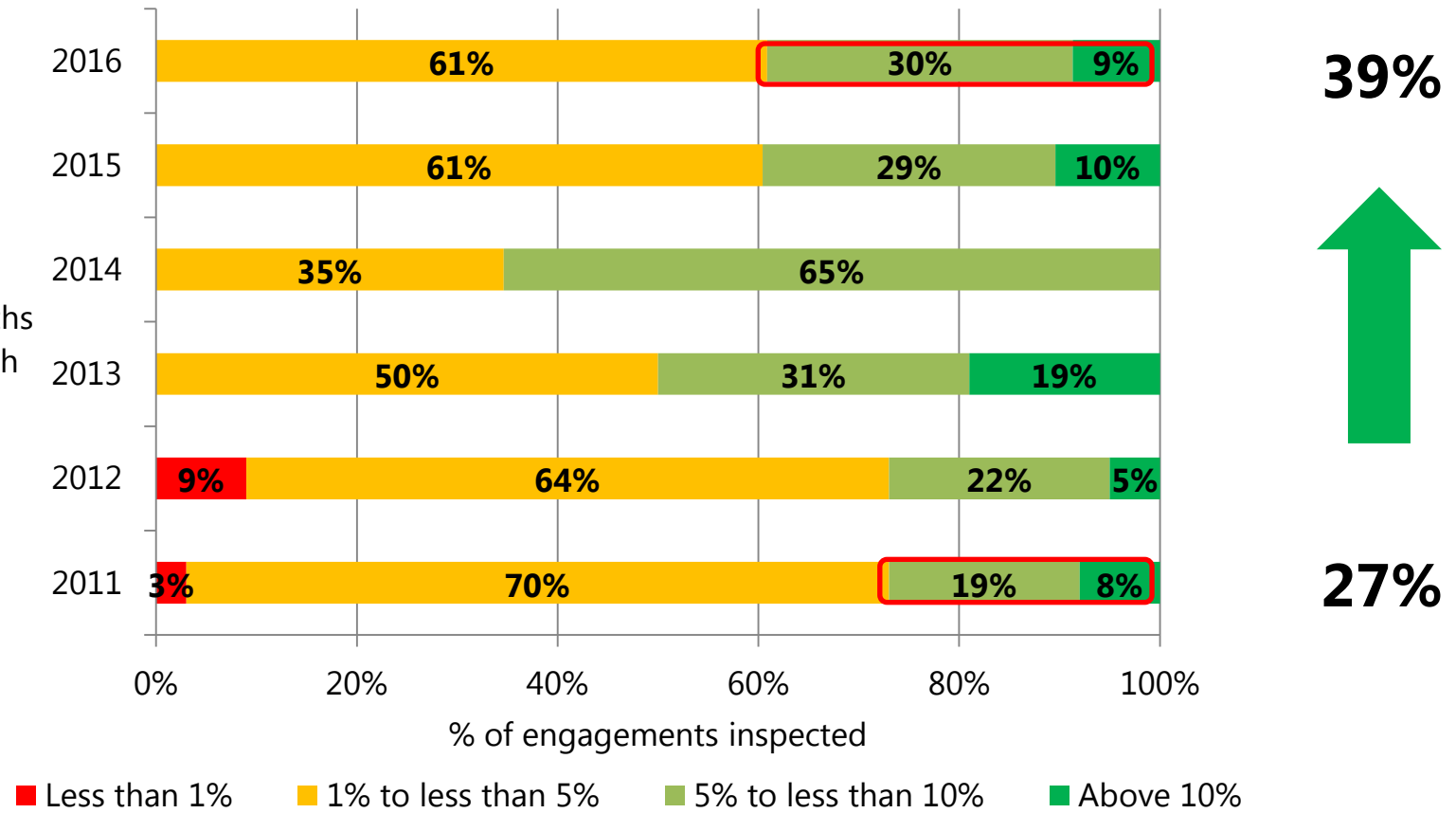
For the 12 months ended 30 September

Firm-Level Inspections

- Extent of Engagement Partner Involvement

- Higher time spent by partners ensures **adequate supervision and resolution of auditing issues** thereby increasing audit quality
- Proportion of inspected engagements with partner time spent of >5% of total audit hours has been increasing

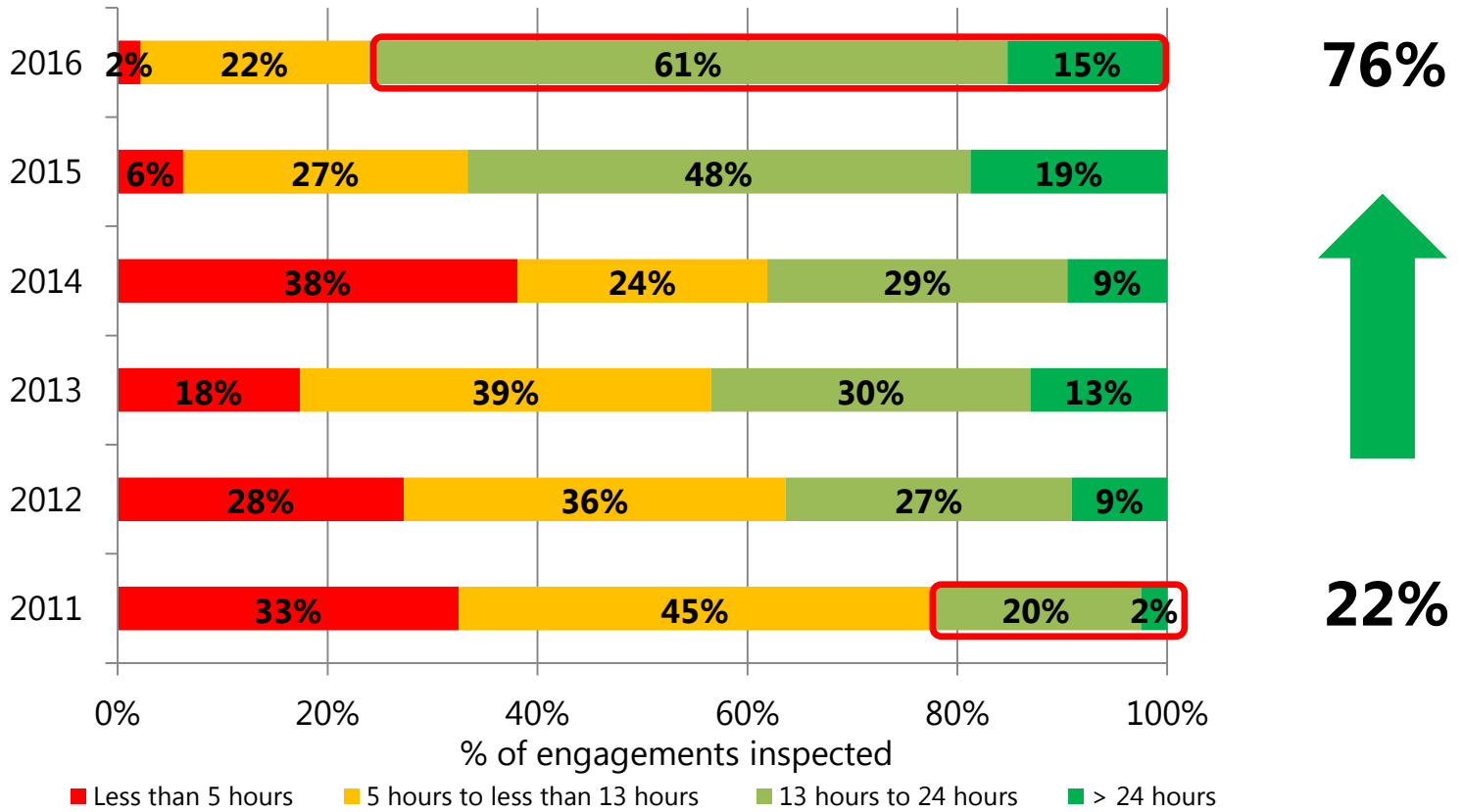
For the 12 months ended 31 March



Firm-Level Inspections

- Extent of EQCR Partner Involvement

- Adequate time spent by EQCR ensures **robust and independent review of audit issues** thereby increasing audit quality
- Proportion of inspected engagements with EQCR partner time spent of >13 hours² has been increasing



² A time spent of at least 13 hours is expected based on the review activities performed by EQCR partner.

Firm-level Inspections

- Two Categories of Findings on Monitoring Mechanisms

Category 1

or

Category 2

- ✓ Design of policies and procedures
- ✓ Quality controls operating effectively
- ✗ **Inappropriate and ineffective follow-up actions** to address lapses

- ✓ Design of policies and procedures
- ✗ **Controls no longer operating effectively** to address its intended objectives

Example: **Follow-up actions on lapses were ineffective** to drive behavioural changes on the discipline of timely archival of files

Example: **Ineffective frequency of testing** to enable timely detection of non-compliance with relative fee sizes between audit and non-audit services

Engagement Inspections

Engagement Inspections

- Public Accountants Registered and Inspected

No. of PAs
Registered

36% growth since 2007, **1,076** registered PAs as at 31 March 2016

338 in the **listed companies segment**

738 in the **non-listed companies segment**

No. of Inspections³
from 2007 to 2016

223 PAs in the **listed companies segment**

953 PAs in the **non-listed companies segment**

Inspected **13 industries** over the past 10 years

³ Inspections to-date do not represent unique inspections and may include revisit inspections of the same PA.

Engagement Inspections

- Key Findings Over the Past Decade

2007 > 2008 > 2009 > 2010 > 2011 > 2012 > 2013 > 2014 > 2015 > 2016

- Previously a cover-to-cover inspection
- Focused on significant risks with effect from 2014

Listed companies segment

- **Improvement noted** in audit quality⁴
- Basic audit procedures were previously not performed (i.e. 2007) but are now performed satisfactorily
- Findings noted in the past 2 years are in more complex areas

Non-listed companies segment

- **No improvement** noted⁵
- Basic audit procedures previously not performed (i.e. 2007) are now performed but still **inadequate** resulting in finding(s) raised

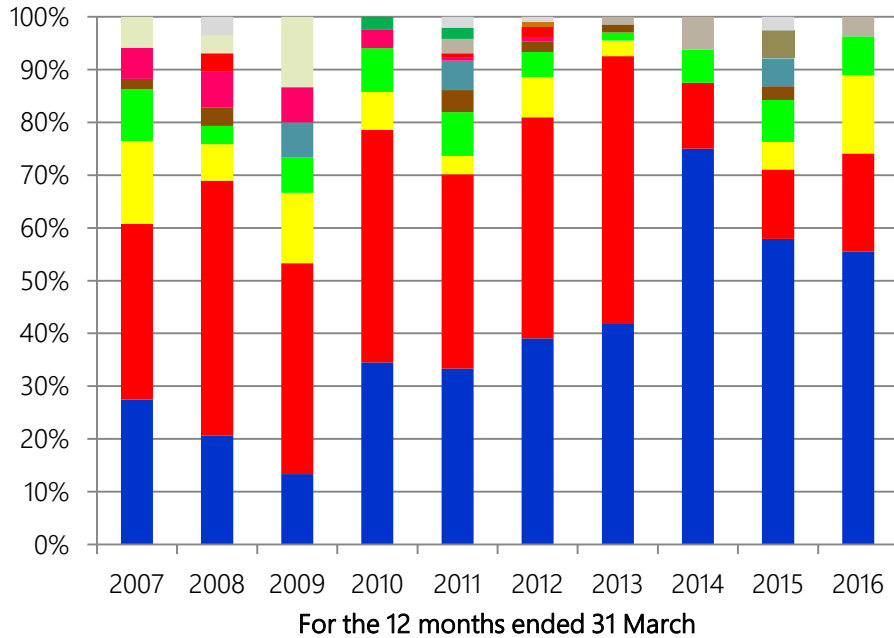
⁴ Measured by the percentage of inspected audit engagements with at least one finding. This percentage had reduced by 27% in 2016 as compared to 2015.

⁵ Based on the same measure over the same period as the listed companies segment.

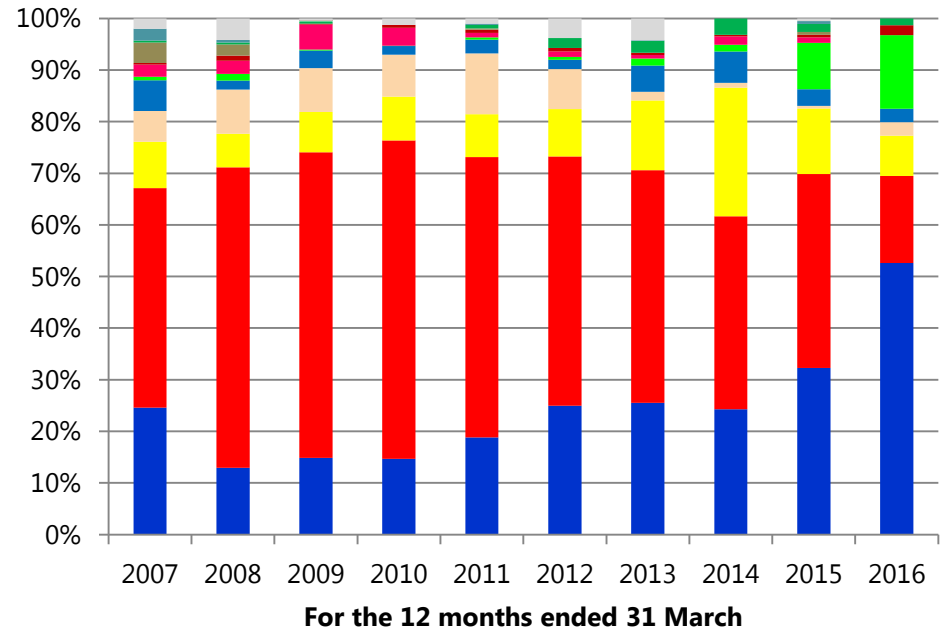
Engagement Inspections

- 10-year Inspection Findings by Common Themes

Listed companies segment



Non-listed companies segment



- 10-year trends of inspection findings can be categorised into **13 themes**
- Top 4 themes contribute to **over 80%** of the 10-year inspection findings



- Accounting estimates, including fair value measurement
- Audit evidence
- Revenue
- Group audits

Engagement Inspections

- Theme One

Accounting Estimates, Including Fair Value Measurement

- Findings more prevalent in the **listed companies segment** due to the size and complexity of engagements

**Direct testing
by engagement
team**

**Reliance on
management's
experts**

Finding: Failure to

- Challenge management's assumptions used; and
- Assess accuracy of data used

Finding: Failure to

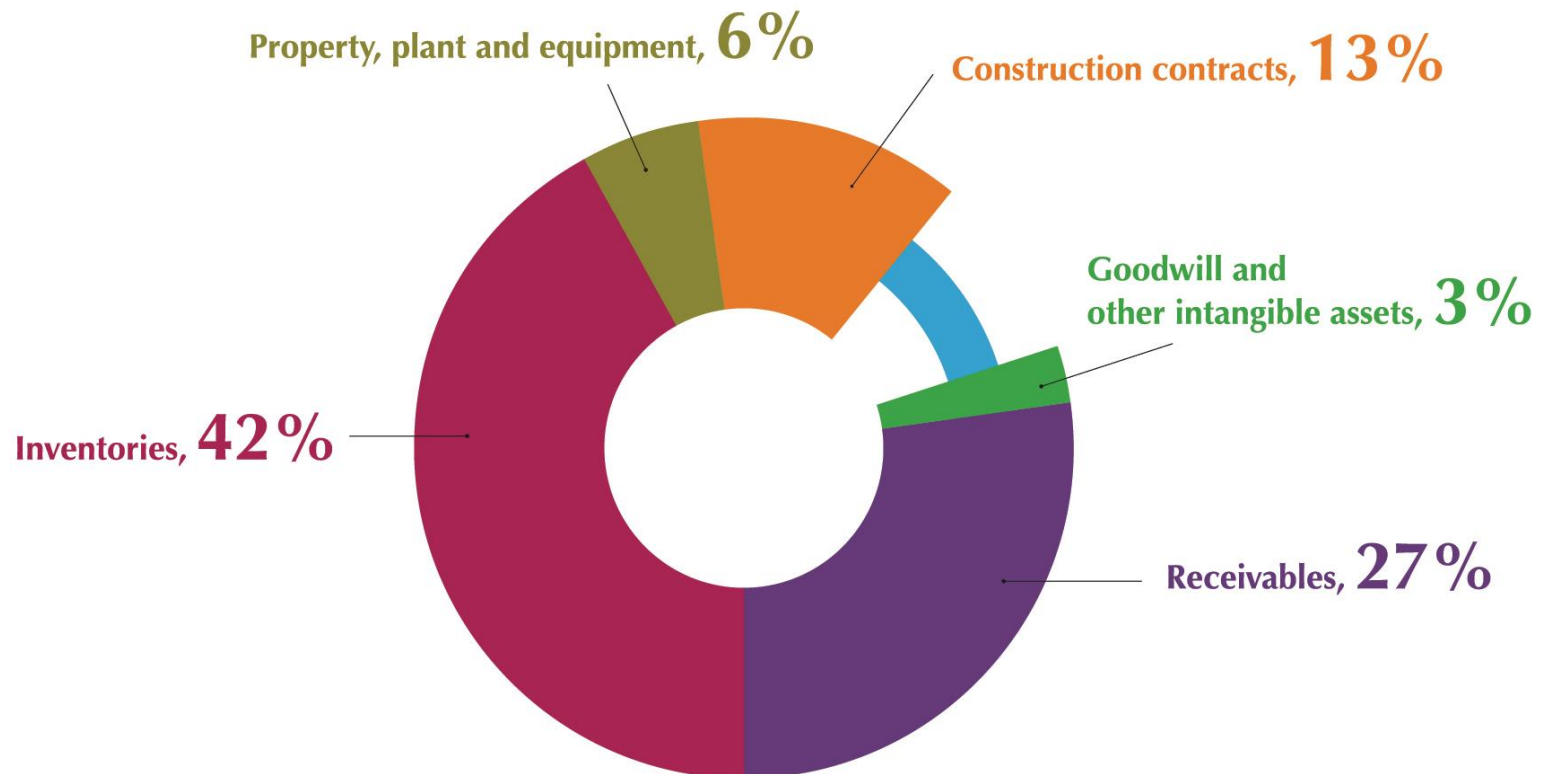
- Assess the competency and objectivity of expert; and
- Evaluate the expert's work as audit evidence

Engagement Inspections

- Theme One

Accounting Estimates, Including Fair Value Measurement

- Prevalent in the following top five financial statement line items
- These collectively contributed to **approximately 90%** of inspection findings in this theme (see next slide for details)



Engagement Inspections

- Theme One

Accounting Estimates, Including Fair Value Measurement⁶

Goodwill, other intangible assets and PPE

- Mainly relate to auditing **discounted cash flow models (DCF)**
- Failed to test reasonableness of inputs, variables and assumptions used by management

Inventories

- Failed to **independently challenge reasonableness of inventories obsolescence**
- Testing confined to **re-computation of management's inventories obsolescence provision**

Receivables

- No work performed to test subsequent receipts from customers

Construction contracts

- Reliance placed on management's experts on **stage of completion** of contracts
- No testing on budgeted costs of projects, provisions for foreseeable losses and liquidated damages

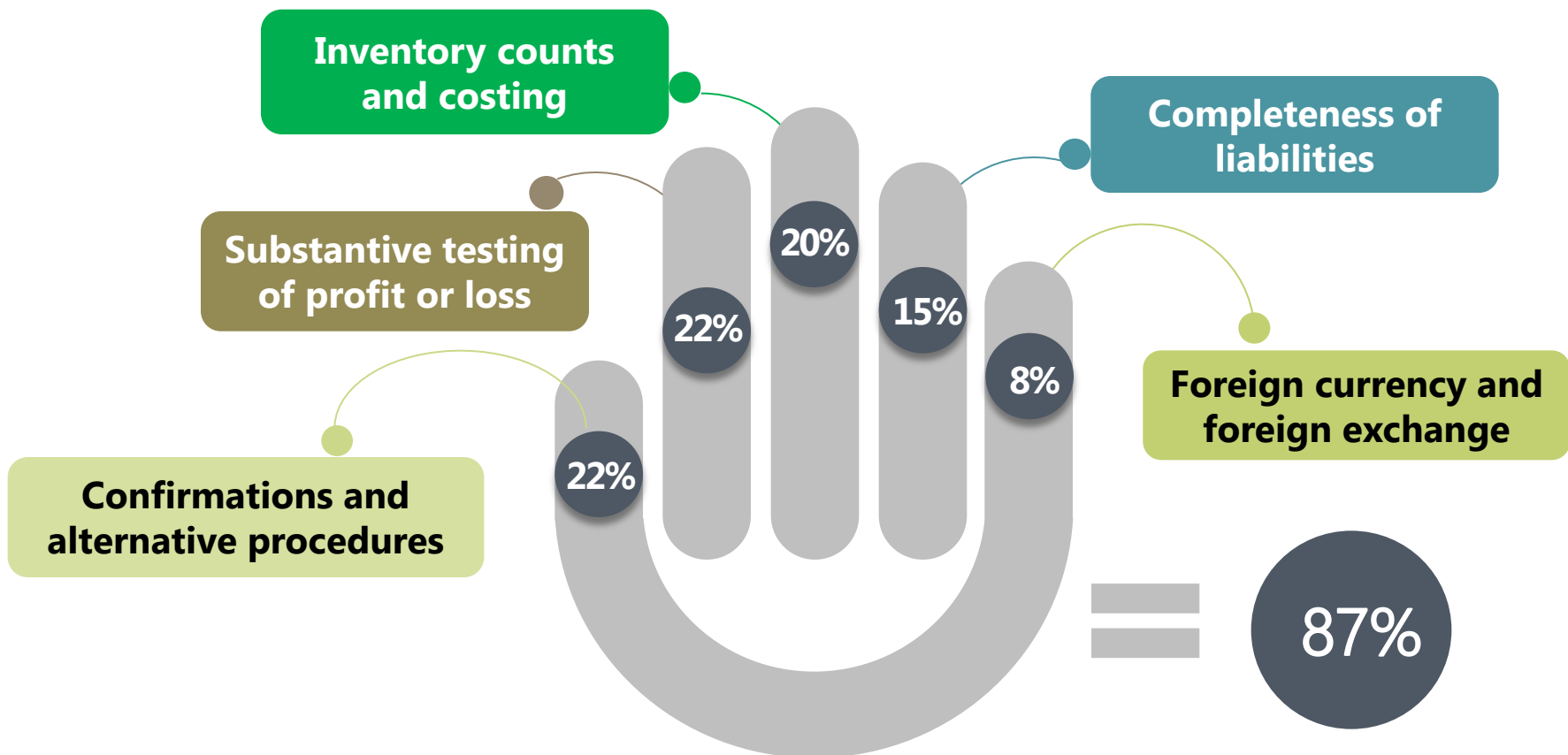
⁶ For further details of the inspection findings, please refer to the 2016 PMP Public Report.

Engagement Inspections

- Theme Two

Audit Evidence – top five categories contributed to 87% of inspection findings

- “Catch-all” theme of inspection finding - comprised of failure to obtain audit evidence on existence, completeness and non-valuation related assertions



Engagement Inspections

- Theme Two

Audit Evidence – common inspection findings in the five categories⁷



External confirmations

- Failure to circularise confirmations and maintain control
- Insufficient or no alternative procedures performed
- Testing of reconciling items not performed



Inventory counts and costing

- Failure to test inventory movements between date of inventory count and year-end date
- Failure to reconcile differences between inventory count and accounting records



Completeness of liabilities

- Insufficient work to test unpaid supplier's invoices
- Inadequate scope when performing search for unrecorded liabilities

⁷ For further details of the inspection findings, please refer to the 2016 PMP Public Report.

Engagement Inspections

- Theme Two

Audit Evidence – common inspection findings in the five categories⁸



Substantive testing of profit or loss items

- Failure to test material expenses in the profit or loss
- Inappropriate testing of purchases cut off (e.g. vouching to post year-end payments to test purchases cut-off)



Functional currency and foreign exchange

Failure to assess:

- the appropriateness of the Company's functional currency, and/or
- the company's translation of foreign currency balances and transactions

⁸ For further details of the inspection findings, please refer to the 2016 PMP Public Report.

Engagement Inspections

- Theme Three

Revenue – nature of inspection findings⁹

Past deficiencies, mainly “vouching” in nature, e.g.:

- Did not consider **terms of trade**;
- Did not trace sales transactions to **source documents**; and
- Misconception that analytical reviews **are the same** as substantive analytical procedures



Present deficiencies:

- Did not **understand the terms of the contracts** with customers; and
- Did not **assess and respond to the presumed fraud risk**



5 step approach required by IFRS 15 *Revenue from Contracts with Customers* (effective 2018)

- Q1:** Identify the contract(s)
- Q2:** Assess if there are separate performance obligation(s)?
- Q3:** Determine the transaction price
- Q4:** Allocate transaction price to each performance obligation
- Q5:** Determine the revenue recognition policy



⁹ For further details of the inspection findings, please refer to the 2016 PMP Public Report.

Engagement Inspections

- Theme Four

Group Audits – extent of audit evidence in the group audit working papers

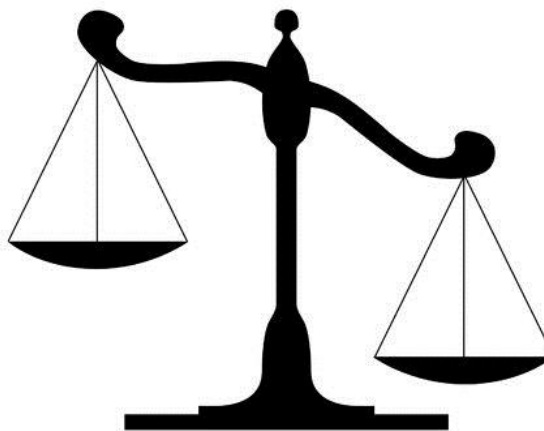
Failure to demonstrate the involvement as a group engagement partner:

- Did not assess the adequacy of the component auditors' work
 - E.g. reliance placed on component auditors' opinion and checklists submitted with no further understanding or challenge to the audit work performed
- Did not review the audit working papers of significant components

1

If the Reporting Deliverables from the component auditor(s) was a checklist with **no explanation of the nature, timing and extent of audit work performed**

Illustration:



2

Group audit working papers should be **supplemented with detailed documentation** of the nature, timing and extent of component auditors' audit procedures, including conclusion on its sufficiency and appropriateness

Achieving High Quality Audits

- Robustness of Risk Assessment

Audit process and risk assessment



- Did the engagement team perform a **robust risk assessment at the planning of the audit**? For example:
 - Did the business strategy or contract terms change from prior year?
 - How did economic conditions affect the business and its pricing?
- Risk assessment and audit plan should be **updated continually throughout the audit process**

What ACRA noted:

1

31%

of engagements in the listed companies segment **where ACRA had elevated risks from "normal" to "significant"**, had inspection findings noted

2

High proportion of engagements in the non-listed companies segment **did not have significant risks identified**



SSA 315.25 may not be complied with

Achieving High Quality Audits

- Audit Documentation

1



Paper files



**Audit Working Papers
(Awps)**



2



**Electronic audit
software**

Objective of SSA 230 “Audit Documentation” is to ensure there is:

- Sufficient and appropriate record of the basis of the auditor’s report; and
- Evidence that the audit was planned and performed in accordance with SSAs and applicable legal and regulatory requirements.

Common deficiencies in Audit Documentation:

- Not sufficiently detailed for an experienced person not involved in the audit, to understand the **nature, timing and extent** of audit procedures performed. Thus, the experienced person may not arrive at the same conclusion
- **Not updated** for changes during the audit, thus does not support audit opinion
- **Omission to archive** pertinent documents and communication as audit evidence

New Initiatives to Improve Audit Quality

New Initiatives to Improve Audit Quality

- Complementary Suite of Regulatory and Non-Regulatory Initiatives



Engagement-level:

- **Initiative #1** – 25% reduction in the percentage of inspected audit engagements with at least one finding
 - ▶ part of IFIAR's global initiative to improve audit quality
 - ▶ applies only to listed company audits performed by Singapore firms that are part of GPPC networks¹⁰
- **Initiative #2** – Extension of ACRA's Publication Regime on inspection outcomes



Firm-level:

- ACRA sets targets for six Audit Quality Indicators (AQIs)
 - ▶ to guide ACs on the level of AQIs that indicate quality
 - ▶ to spur firms to strive towards meeting those targets

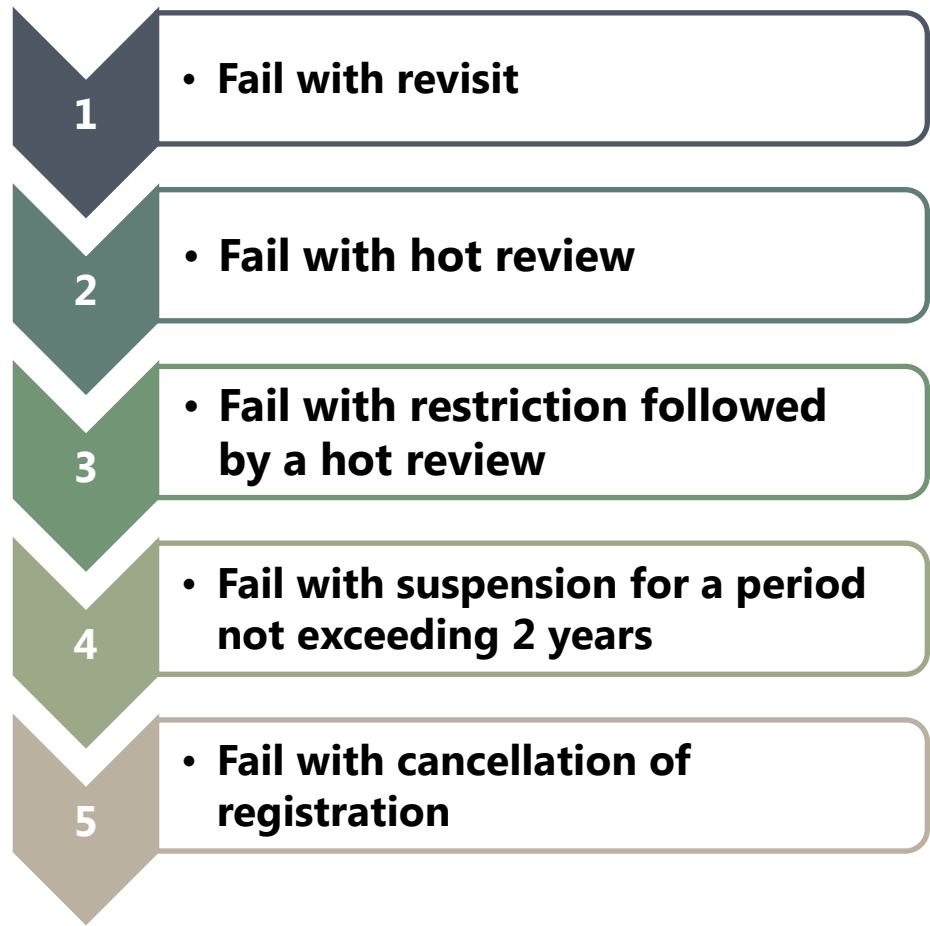
¹⁰ The Singapore audit firms that are part of the GPPC networks are BDO, Deloitte, EY, Grant Thornton, KPMG and PwC. However, as at 31 March 2016, Grant Thornton does not perform any audits of Singapore listed companies.

New Initiatives to Improve Audit Quality

- Extension of Publication on Inspection Outcomes

Publication aims to level the playing field for those who uphold audit quality

Range of PMP Fail outcomes:



Applies to revisits¹⁰ only

Names of PAs with **hot review, or restriction followed by a hot review** outcome for inspections commencing **on or after 1 April 2017** will be published on ACRA's website until the PA passes the next inspection

Names of PAs published on ACRA's website since 2007

¹⁰ This implies that the public accountant has failed to pass at least two successive PMP inspections (the latter being a revisit) and receives a hot review or restriction followed by a hot review outcome.

New Initiatives to Improve Audit Quality

- Publication applied only to failure of revisit inspections

Fail with a hot review or
restriction followed by a hot review outcome

Initial Visit

- **Not subject to publication regime**
- ACRA believes **time and opportunity** should be given to these PAs to remediate their findings
- PMP focuses on **quality assurance** and is not **punitive** in nature

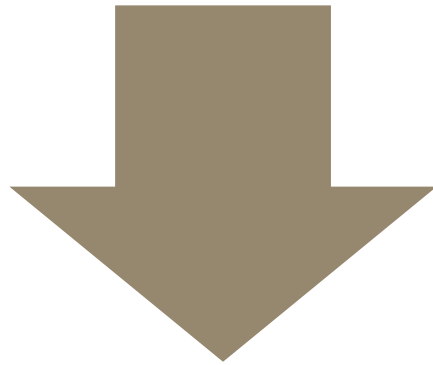
Revisit

- Initiative to **strengthen the deterrence effect**
- **Motivation** to develop sound remediation plans and initiatives
- **Protect public interest** for stakeholders to make informed decisions on auditor appointments

New Initiatives to Improve Audit Quality

- ACRA Sets Targets for AQIs at Both Firm and Engagement Level

Targets Initially Set for 6 AQIs that are Closely Correlated to Audit Quality
(further targets to be considered in the future)



Firm-Level Targets

- 1) Staff retention rate
- 2) Staff leverage ratio
- 3) Maximum number of listed companies' audits with the same financial year-end

Engagement-Level Targets

- 1) Engagement partner hours
- 2) Engagement partner and manager(s) hours
- 3) EQCR partner hours



New Initiatives to Improve Audit Quality

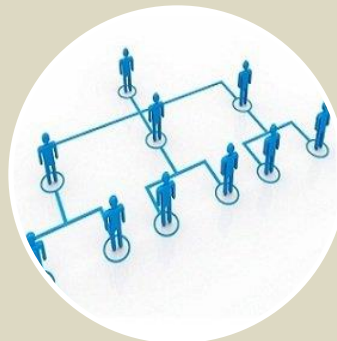
- ACRA Sets Targets for 3 Firm-Level AQIs



Like It
Or Not
I'm Here
To Stay

Staff retention
rates

75% to
80%



Staff per partner
ratio

< 15

Staff per
manager ratio

< 5



Number of listed
companies' audits
with the same
financial year-end

5

New Initiatives to Improve Audit Quality

- ACRA's Targets Reinforced for 3 Engagement-Level AQIs

Time Spent by:



EQCR partner

At least

13
hours

in an engagement



Engagement partner

At least **5% to 10%** of total engagement hours for engagements with normal and higher risk ratings respectively



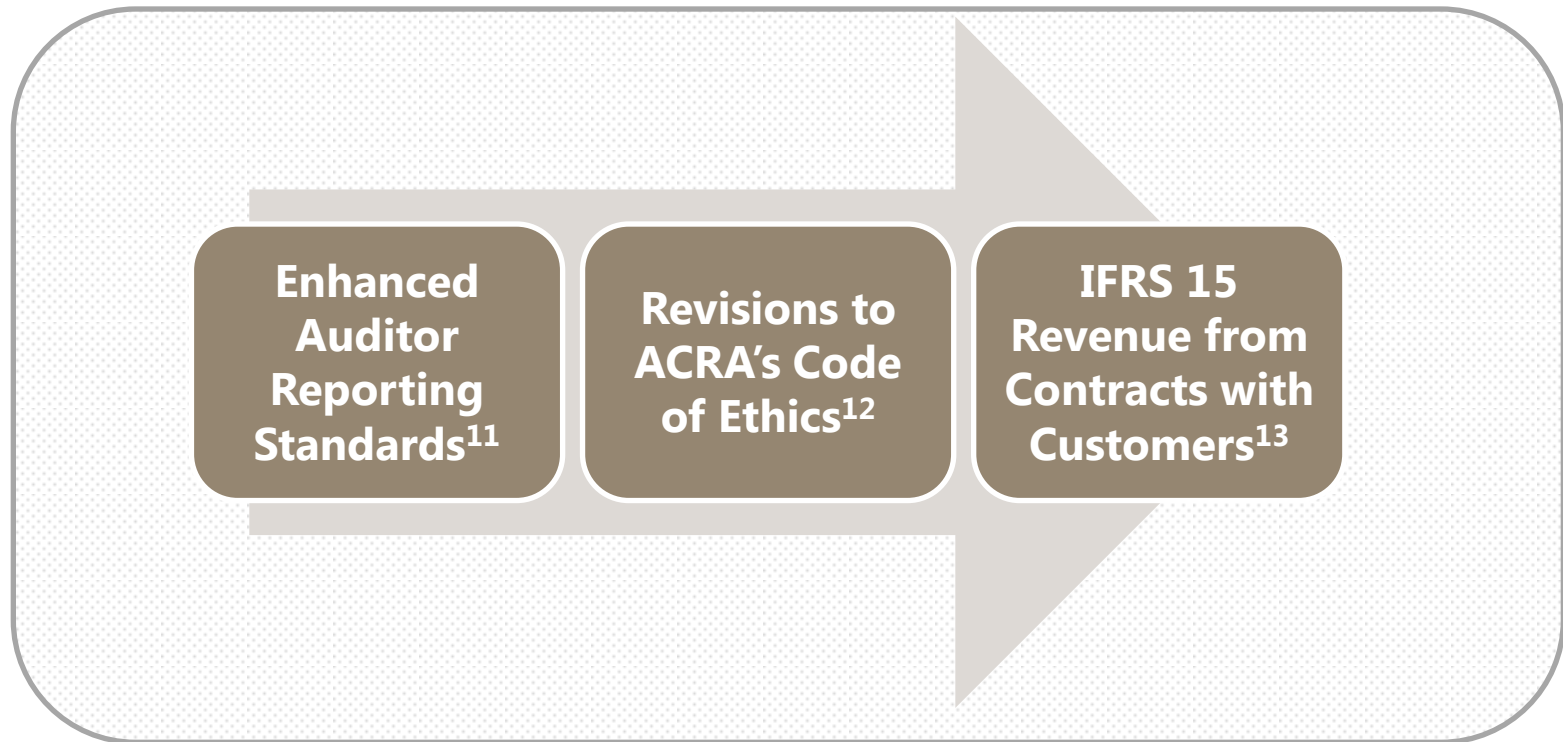
Engagement partner and manager(s)

Collectively at least **20%** of total engagement hours

Upcoming Developments and Future Focus

Upcoming Developments and Future Focus

- New Standards and Regulations



Public Accountants urged to stay abreast and prepared for future changes

¹¹ Effective for audits beginning on or after 15 December 2016.

¹² Expected to be effective for period beginning on or after 1 January 2017. Revision relates to (i) removal of "emergency situation" provision; (ii) clarification of "management's responsibility" and (iii) definition of "routine and mechanical".

¹³ Replaces FRS 11 and FRS 18, and is effective on or after 1 January 2018.

Key Messages and Conclusion

Key Messages and Conclusion



- **More effective remediation of root causes** needed to drive marked improvements in audit quality
- **Listed company segment** will face higher expectations on regulatory targets and AQIs
- Regulatory measures may be raised if **non-listed company segment** continues to show no improvements



- Profession should take heed of the **common themes** of inspection findings and ensure **robust risk assessment** and **adequate audit documentation**



- Looking ahead into the next decade, the professional must continue to **uphold audit quality** and **stay abreast**

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