



# ACRA's Observations from its firm-level and engagement inspections

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# Agenda

1. Scope of Practice Monitoring Programme
2. Firm-level Inspection findings
3. Engagement Inspection findings
4. Key Observations
5. Key Messages



# **Scope of Practice Monitoring Programme**

# Scope of Practice Monitoring Programme

Firm-level Inspections	Engagement Inspections
▪ Inspect audit firms' quality controls	▪ Inspect audit engagements performed by public accountants (PAs)
▪ Applies to firms that audit listed companies	▪ Applies to PAs who audit: <ul style="list-style-type: none"><li>- Listed companies</li><li>- Non-listed companies</li></ul>
▪ Assessed based on <b>Singapore Standard of Quality Control (SSQC) 1</b>	▪ Assessed based on <b>Singapore Standards of Auditing (SSAs)</b>
▪ <b>Advisory</b> basis	▪ <b>Mandatory</b> under Accountants Act



# Firm-level Inspections

# Firm's Quality Control

## - Six elements of SSQC 1

Tough situations call for tough measures – impact partners financially and on amounts that matter.

Client acceptance and continuance is an ongoing process, and continued association with a client must be accompanied with continued review and update.

Audit quality is doing the right thing when no one is looking.



Compliance with ethical requirements is non-negotiable.

Sufficient professional strength with relevant skills and experience are imperative to deliver quality audits.

It takes less time to do things right than to explain why you did it wrong.

# Leadership : Linkage between Quality and Partner Performance

**Firms should place greater emphasis on audit quality in the determination of the partner's overall performance rating and compensation**



- Further strengthen linkage between quality and partner performance and compensation
- Clearer and higher differential in compensation for partners with different rating for audit quality



# Compliance with Independence requirements

Firms should have robust system to check compliance of independence requirements coupled with severe financial penalties for non-compliance



## Partner C

- Inaccurate update of investment portfolio by partner's spouse
- Untimely update of investment portfolio by partner

### Observation:

The audit firm might not be able to identify and **address independence issues on a timely basis.**

# Human Resources

**Firms to continue with initiatives to improve the staff retention rates**



## Observation:

- Firms to continue their efforts to strengthen human resources through various initiatives such as :
  - Staff training
  - Staff engagement and communication
  - Effective staff appraisal
  - Greater transparency of career progression

# Human Resources

**Firms to ensure adequate levels of supervision by experienced members of the team**



## **Observation:**

- Timely and sufficient involvement of partner and manager is a must
- Effective supervision of audit staff is critical for audit quality
- Inadequate time spent by partner and managers on audit engagements may result in higher workload and dissatisfaction among team members resulting in higher staff turnover rates

# Engagement Performance

Firms should ensure adequate and timely involvement of engagement partners and managers on audit engagements to achieve high quality audit

<b>Firm A:</b>	<b>EP %</b>	<b>EP + EM %</b>
Engagement 1	Less than 5%	Less than 20%
Engagement 2	Less than 5%	Less than 20%
Engagement 3	Less than 5 %	Less than 20%
Engagement 4	Between 5 to 10%	More than 20%

**Observation:**  
Timely involvement and close supervision of engagement partners and managers is important for audit quality. Partners and managers may not be spending **sufficient time** on the audit engagements resulting in poor audit quality.

# Engagement Performance

Firms should ensure adequate involvement of partners on audits of Financial Institutions (“FI”) to achieve high quality audit



## Partner D

### Portfolio:

- **Engagement partner** – 38 FI engagements with December year-end
- **EQCR partner** - 12 FI engagements with December year-end

### Observation:

Partner D may not be able to spend **sufficient time** on his engagements due to **high number of FI engagements** and **concentration** of deadlines.

# Engagement Performance

**Firms should have proper processes and controls to ensure timely and proper audit documentation and archival of engagement files**



## Archival lapses:

### Findings:

- Files archived beyond 60 days
- Missing working papers in archived manual files
- Updated version of working papers not filed in archived manual files

### Observation:

- Non-compliance with SSQC 1 para 45
- Examples of measures implemented by firms :
  - Frequent review of archival statistics
  - Sampling of audit engagements to ascertain if the working papers have been assembled and archived
  - Training to staff on importance of timely archival of audit working papers.
  - Introduced a firm-wide policy of shorter archival time (less than 60 days) for all engagements.
  - Use of audit software to send automated email reminders to the engagement team to archive the audit working papers.

# Monitoring

Firms should ensure robust pre-issuance and post-issuance review programs

## Firm B's 2017 pre-issuance review:

- Focus on significant matters and other focus areas
- No significant findings noted

VS

## ACRA's 2017 inspection:

- Focus on significant risk areas
- Reportable findings noted in engagements that were also subject to pre-issuance review

### Observation:

Firm's pre-issuance review program is **not sufficiently robust** to identify audit findings



# Engagement Inspections



# Agenda

1. Non-Case Study
  - Group Audits
  - Journal entry testing
  - Evaluating the work of experts
2. Illustrative Audited Entity 1
  - Case Study 1 : Audit Opinion
3. Illustrative Audited Entity 2
  - Case Study 2 : Revenue Recognition
  - Case Study 3 : Valuation of Trade Receivables
  - Case Study 4 : Assessment of impairment of Property, Plant and Equipment
4. Illustrative Audited Entity 3
  - Case Study 5 : Risk Assessment

# Group Audits

## SSA 600 – Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)

### Recurring Findings:

- No group audit instructions or any other communication with component auditors
- Inadequate work performed by group engagement team to evaluate whether sufficient appropriate audit evidence obtained by component auditor
- Incorrect or no materiality established by group engagement team for group and component auditors

### Good Practices adopted by some audit firms:

- Templates and guidance on group audits
- Enhance reporting requirements by component auditors
- Detailed review and documentation of component auditor's audit work papers and evidence gathered
- Visit by group engagement team to significant overseas components
- Secondment of group engagement team's member to component audit team to facilitate communication between the teams on matters such as reporting requirements

# Journal Entry Testing



**SSA 240** requires an auditor to design and perform audit procedures to test the appropriateness of journal entries in the general ledger and other adjustments made in the preparation of the financial statements.

## Findings:

- Ineffective audit procedures performed to assess the completeness of journal entries

## Observation:

- Completeness assessment of journal entries and other adjustments population must be performed prior to selecting samples for testing
- Various audit procedures can be employed by auditor to assess the completeness of population such as:
  - Perform a roll forward
  - Use Computer Assisted Audit Techniques
- Audit firms to provide adequate guidance for engagement teams to ascertain the most effective audit procedure to assess the completeness of journal entries and other adjustments

# Evaluating the work of experts

## Auditor's expert - Findings

- Limited details in the memo (filed in audit working papers) as to nature, timing and extent of the procedures performed by auditor's expert
- Auditor's expert subject to the firm's methodology and hence the engagement team conclude no further work is required on part of the audit team (such as reviewing the source data, methods, assumptions applied by the auditor's expert)

## Management's expert – Findings

- Inadequate work done to assess the competence, capability and objectivity of management's expert
- Inadequate or no work done to independently assess and corroborate the reasonableness of assumptions used by management's expert in their work
- Inadequate or no work done to validate the source data used

# Illustrative Audited Entity 1

## Principal activities of Company A

- Trading of metals and chemical materials
- Majority of customers and suppliers are local

## Other information on Company A

- Financial year-end : 31 Dec 2017
- Audit opinion : Except for Qualified Opinion <sup>1</sup>
- Overall materiality : \$600,000

<sup>1</sup>Extracted from Audit opinion “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.*

# Case Study 1 : Audit Opinion

## Case Facts:

- The public accountant was appointed as auditor of the Company A after 31 December 2017
- The public accountant had reviewed the audit working papers of the predecessor auditor and obtained sufficient appropriate evidence on the opening balances.

## Work Performed

- Inventories – Verified supplier invoices, contracts and warehouse receipts and subsequent sale of the two categories of inventory items.
- Other receivables – Verified purchase contract and evidence of payment of deposit to supplier. Documented that based on discussion with client, purchase contract was subsequently cancelled and deposit was refundable by supplier within 9 months from end of FY.



## What should have been done

- Inventories : In view of alternative audit procedures performed, PA should have considered whether there was indeed a limitation of scope **[SSA 705.7 (b)]**
- Other receivables : PA should have considered to include a description of matter giving rise to the modification **(SSA 705.20)**

# Illustrative Audited Entity 2

**Company B**  
(Holding company)

## Principal activities of Company B

- Selling ship spare parts and providing repair services for spare parts whose warranty period had expired

**Subsidiary S1**  
(100% owned subsidiary)

## Principal activities of Subsidiary S1

- Vessel owner & charterer to oil field companies

## Other information on Company B and S1:

- Financial year-end : 31 Dec 2017
- Group audit opinion : Unqualified
- Overall materiality : Company B - \$300,000; Subsidiary S1 - \$1,900,000

# Case Study 2 : Revenue Recognition



## Case Facts:

- Company B did not prepare consolidated financial statements as it met the criteria for exemption from preparing consolidated financial statements.
- Company B's revenue amounted to \$33m comprising of \$23m from sale of spare parts and \$10m of repair service revenue.

## Work Performed

- Vouched to 25 samples of sales invoices and supporting delivery documents (such as duly acknowledged delivery order and/or service report) to verify **accuracy** of entire sales population
- Vouched to last 7 and first 7 sales invoices and supporting delivery documents before and after year-end respectively to verify sales **cut-off**.



## What should have been done

- PA should have assessed if the testing of two different revenue streams as one homogeneous population was appropriate.
- PA should have considered the delivery time for spare sales in designing the sales cut-off audit procedures.



# Case Study 3 : Valuation of trade receivables



## Case Facts:



- Company B's trade receivables amounted to \$5m as at year-end.
- Credit period offered to customers is 30 to 60 days.
- Trade receivables amounting to \$3m past due for more than 60 days.
- No change in customer base and proportion of trade receivable balance in respective aging categories.
- Provision for doubtful debts amounted to \$300,000 as at year-end for trade receivable balances due for more than 60 days.

# Case Study 3 : Valuation of trade receivables (cont'd)

## Work Performed

- Obtained 7 debtors confirmations from customers with trade receivables balance past due more than 60 days totaling \$2,200,000.
- Verified sales invoices and acknowledged delivery orders for 2 trade receivables balance past due more than 60 days amounting to \$400,000 as no subsequent receipts from these customers.



## What should have been done

Receipt of debtors confirmation from customers and verification of sales invoices and acknowledged delivery order only address existence assertion of trade receivables.

- PA should have performed work e.g. verify subsequent receipts from customers to address the valuation of trade receivables.

# Case Study 4 : Assessment of Impairment of Property, Plant and Equipment



## Case Facts:

Subsidiary S1	31 Dec 2017
Carrying amount of vessels recognised as PPE	\$61m
<b>Key assumptions used in DCF</b>	
DCF Projection Period	15 to 30 years
Residual Value of PPE	20% of cost of vessel
Revenue Growth Rate	Charter rate based on last contracted rates in past 2 years; flat charter rate over DCF period
Discount Rate	5%

### Indicator of Impairment



Depressed market conditions in the oil and gas industry

As disclosed in 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.”

# Case Study 4 : Assessment of Impairment of Property, Plant and Equipment (cont'd)

## Work Performed

Key assumptions used in DCF	
DCF Projection Period	Useful life of vessels is 15 to 20 years; 2 vessels with planned modification had extended projection period of 25 and 30 years respectively
Residual Value of PPE (\$1.2m to \$6.6m)	Compared against sales prices from external websites; Compared 20% estimate against range of residual values (5% to 20% - \$3.9m to \$9.7m) published by external party
Revenue Growth Rate	Agreed to charter rate based on last contracted rates in past 2 years
Discount Rate	Compared with WACC of 3.5% obtained from an external website

# Case Study 4 : Assessment of Impairment of Property, Plant and Equipment (cont'd)



## What should have been done

Public Accountant should have challenged the management on the:

- DCF projection period being longer than the useful life of the vessels
- use of 20% estimate for residual value as compared to the very wide range of residual value estimates published by external party
- use of charter rates contracted in past 2 years in view of depressing market conditions
- use of 5% discount rate as it did not consider market assessment of time value of money and specific risk associated with PPE's estimated cash flows.

# Illustrative Audited Entity 3

## Principal activities of Company C

- Sale of computer spare parts and other IT related products

## Other information on Company C

- Financial year-end : 31 Dec 2017
- Audit opinion : Unqualified
- Registered office and principal place of business is Singapore
- Immediate and Ultimate holding corporation incorporated in Country X

# Case Study : Risk Assessment



## Case Facts:

- **Purchases from overseas suppliers**
- **Sale to customers in Country Y (country identified with heightened risk of money laundering)**
- **No physical inventories in Singapore**
- **No bank account maintained by Company C**
- **Payments and receipts managed through immediate holding corporation's bank account**
- **Management accounts prepared by outsourced accountant in Country X**

# Case Study : Risk Assessment (cont'd)

## Work Performed

- Documented in working papers that general risk of Company is assessed to be low.
- Identified only controls in “trade receivables” as internal controls relevant to the audit.



## What should have been done

- Perform appropriate risk assessment and understanding of Company’s operations and its environment in accordance with SSA 315 to identify and assess potential risks of material misstatement in view of anomalies (*no physical office in Singapore, no bank account and supporting documents kept in Country X, sales to customers in Country Y*), noted for the Company.



# Key Observations

- **Increase** in usage of **data analytics** tools by PIE firms
- **Continued increase in sharing of AQI data** by Big Four audit firms as compared to prior year.
- Firms **expanding** their **headcount in quality control** functions with individuals who are knowledgeable and experienced in accounting and auditing standards.
- Recurring audit deficiencies mainly arising from **inadequate audit procedures** and **evidence**.
- Further **strengthening** of system of **internal control** by audit firms required to ensure compliance with **SSQC 1**.

# Key Messages

**Adequate  
audit  
procedures  
and evidence**

**Strengthen system of  
internal control to ensure  
compliance with SSQC 1**

**Firms to review  
current methodology  
and audit procedures  
to encompass the DA  
tools**

**Stay abreast of  
changes to auditing  
and accounting  
standards**

**Adherence to  
Revised LA  
provisions**

**Ensure  
compliance  
with EP 200**

# Thank You



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