ACRA
ACCOUNTING AND CORPORATE REGULATORY AUTHORITY

AUDIT PRACTICE BULLETIN NO 1 OF 2011

ENGAGEMENT QUALITY CONTROL REVIEW

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Introduction

1. The engagement quality control review process is an important aspect of a firm's controls over audit quality. It serves as a safeguard in ensuring that the audit risks have been appropriately addressed and the audit opinions issued are correct and sufficiently supported.

2. Under paragraph 35 of 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*, firms are required to establish policies and procedures requiring, for appropriate engagements, an engagement quality control review that provides an objective evaluation of the significant judgements made by the engagement team and the conclusions reached in formulating the report. SSQC 1 imposes engagement quality control review requirement on the audits of financial statements of listed entities. For the audits of financial statements of non-listed entities, SSQC 1 provides that a firm should consider the risks and public interest element in an engagement and the requirements of the laws or regulations when determining whether to subject the engagement to an engagement quality control review.

3. In practice, firms have applied the engagement quality control review requirement to engagements which are rated as high risk or subject to modified opinions and, where appropriate, first year and last year audit engagements. The requirement for engagement quality control review at the audit engagement level is provided in Singapore Standard on Auditing 220 *Quality Control for an Audit of Financial Statements* which also sets out the extent of involvement of the engagement quality control reviewer (EQCR) in the audits of financial statements for both listed and non-listed entities.

4. From the inspection of firms which audit public interest entities, ACRA's main observations in the area of engagement quality control review can be classified as follows:
   - Assignment of EQCR to engagements;
   - Independence of EQCR; and
   - Timeliness and adequacy of EQCR involvement.

5. This Audit Practice Bulletin seeks to provide guidance on, amongst other things, how firms should assign EQCR to engagements, what constitute sufficient and timely involvement of EQCR in an engagement and how the role of EQCR can be strengthened by enhancing its accountability.

Key Observations

Assignment of EQCR to engagements

6. The EQCR plays a significant role in ensuring audit quality by providing an independent evaluation of the key judgements made, particularly in high-risk areas and assessment of whether the related audit procedures and documentation support the audit conclusions reached. It follows that the intended purpose of EQCR would be better met if the role is performed by an adequately experienced partner who is technically competent and has the clout within the firm to challenge the engagement partner when needed.

7. When allocating engagements to EQCR, firms should ensure that the assigned EQCR has the appropriate capabilities, competence, authority and time to perform the required role, taking into consideration his other responsibilities including client service and management roles. Other factors such as linguistic ability and knowledge of business culture are also important consideration when assigning EQCR to overseas engagements which the firm audits.

8. Although SSQC 1 does not stipulate that the EQCR must be a partner[1] of the firm, the assignment of EQCR to a non-partner is not considered ideal as the non-partner may not have sufficient experience and competence as well as the necessary clout to discharge his role as EQCR effectively.

9. **As a best practice matter,** the assigned EQCR should not be a partner with less experience than the engagement partner. Apart from not being able to derive the most benefit from the oversight, the assignment of a less experienced partner as EQCR may also weaken the element of challenge provided by the EQCR. For the same reasons, the role of the EQCR should also not be assigned to newly promoted partners. Further, having just assumed heavier responsibilities, the newly made partners would need some time to settle down into their role as engagement partners for their own audit engagements.

[1] SSQC 1.12(e) defines EQCR as "*A partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments the engagement team made and the conclusions it reached in formulating the report.*"

10. It is also considered inappropriate for partners who have failed their practice reviews, especially those issued with an ACRA-mandated hot review order, to be assigned EQCR roles during the period when he is serving his hot review order. Appointing such partners as EQCR raises doubts on the effectiveness of the oversight role provided by these partners who are themselves in need of help to improve the quality of their audit work and should devote time to remediate the audit deficiencies noted from the practice reviews.

11. For the smaller-sized firms which have limited number of partners available as EQCR, the firms could consider seeking external help by engaging suitably qualified external parties to play the EQCR role based on the guidance given under SSQC 1.A50[2].

Independence of EQCR

12. It is important that the EQCR be regarded and seen as independent. Accordingly, it would not be appropriate for the EQCR to be named as the "backup partner" for the engagement partner for the purpose of client contact in the latter's absence. When appointing an external party as EQCR, the firm should ensure that the external party does not have direct engagement involvement in the audit and that the appointment complies with the independence requirements under the Code of Professional Conduct and Ethics for Public Accountants and Accounting Entities (the Code) set out in Fourth Schedule to the Accountants (Public Accountants) Rules.

13. The firm also needs to consider the degree to which an EQCR can be consulted on the engagement without compromising the EQCR's objectivity. ACRA has noted some cases where the engagement quality control review is being carried out by persons who are themselves involved in conducting the audit. Firms should have policies and procedures in place to provide for replacement of the EQCR should the reviewer's ability to perform an objective review become impaired.

14. ACRA has also noted instances where the public accountant (who is also the signing partner for the audits of listed companies) was heavily assisted by a non-partner. The latter carried out the role of the "working partner" and was involved in the direction and supervision of the engagement team and the review of the audit files. As the public accountant took the view that the non-partner was competent to perform the work equivalent to an engagement partner, the public accountant then took on the role of the

[2] SSQC 1.A50 states that "*Suitably qualified external persons may be contracted where sole practitioners or small firms identify engagements requiring engagement quality control reviews. Alternatively, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews*."

EQCR, whilst retaining the responsibility as the signing partner. It should be highlighted that such an arrangement raises a concern on the independence of the EQCR as well as the robustness of the EQCR review. The signing partner (who is regarded as the engagement partner[3]) and the EQCR should be separate individuals given that the roles expected of each are separate and distinct. As the EQCR is expected to independently challenge the signing partner on significant judgements made, the same individual cannot objectively perform the role of a signing partner and an EQCR at the same time. As a result, an effective engagement quality control review was not in place for the audits in question and there was non-compliance with SSQC 1.

15. Firms should be mindful that using the same EQCR on an audit engagement over a prolonged period may create a familiarity threat. In order to reduce such threat, especially in the case of listed entities, paragraph 290.154 of the Code requires the engagement partner and the individual responsible for the engagement quality control review to be rotated after serving for a pre-defined period, normally no more than seven years; and such an individual rotating after a pre-defined period, should not participate in the audit engagement until a further period of time, normally two years, has lapsed.

Timeliness and adequacy of EQCR involvement

16. The EQCR should be involved during audit planning, throughout the audit and before the issuance of the audit report. The timely involvement allows significant matters to be promptly resolved to the EQCR's satisfaction on or before the date of the report. The view that the EQCR should not be directly involved in the planning and interim stage of the audit for the purposes of ensuring his objectivity and independence during the review process is incorrect and not consistent with the requirement of SSQC 1.

17. ACRA noted instances where the timeliness of EQCR involvement was not evident either because the dates of review were not documented, the sign-off on planning memorandum was dated after the presentation of audit plan to the Audit Committee or the sign-off on completion memorandum was dated the same date as the financial statements. EQCRs are reminded to evidence their involvement through proper sign-off on the work papers and dating based on the actual dates of carrying out the reviews.

[3] Engagement partner is defined under the Code as "*The public accountant in the firm who is responsible for the particular engagement and its performance, and for the report that is issued on behalf of the firm in respect of that engagement.*" and under SSQC 1.12(c) as "*The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.*"

18. Apart from the timeliness issue, ACRA also found instances which suggested little involvement of the EQCR based on their time charged to the engagement. EQCR time should be sufficient to permit thoughtful involvement at the key decision points in the engagement. Based on the audit deficiencies noted from the detailed engagement reviews, ACRA believes that most of the main findings would not have occurred had an effective review been carried out by both the engagement partner and the EQCR.

19. Whilst the amount of time would vary according to the size and complexity of the engagements, ACRA has noted that some EQCRs have charged very little time which can range from nil to a few hours. In looking at the procedures that an EQCR would have to carry out on a listed entity audit and the estimated time expected to be spent in performing such procedures, as illustrated in Table 1 below, it would be difficult for ACRA to conclude that time spent of a few hours would have been sufficient.

Table 1: Estimated Time Spent on EQCR Activities (for illustration purpose only)

Process	**Estimated time expected to be spent**
Evaluation of significant risks identified during the engagement, including the engagement team's assessment of, and response to, the risk of fraud in accordance with SSA 240	1 to 2 hours
Review of audit planning document and audit plan to the Audit Committee	1 to 2 hours
Discussions and technical consultations	2 to 4 hours
Review of selected working papers relating to significant audit risk areas	4 to 6 hours
Review of audit completion document and final report to the Audit Committee	2 to 4 hours
Review of consolidated financial statements and Annual Report	2 to 4 hours
Evaluation of client and engagement continuance	1 to 2 hours
Total	13 to 24 hours

Conclusion

20. Given the significant role the EQCR play in achieving audit quality, firms should establish policies and carry out practices which appropriately reflect the importance of an effective engagement quality control review. Whilst the EQCR does not replace the engagement partner who remains primarily responsible and accountable for the audit, ACRA believes that the role of EQCR can be strengthened by enhancing the accountability of EQCR. This would help ensure that significant audit deficiencies are not overlooked from an ineffective EQCR review.

21. As such, ACRA would urge firms to relate EQCR accountability to partner compensation by having in place a system which rewards (or penalises) EQCR for good performance (or poor quality audit work). This will pave the way for building behaviour that will improve audit quality in the long run.

Note: Please note that the contents of the Audit Practice Bulletin are provided for the guidance of public accountants to supplement prescribed professional standards, and include criteria that ACRA considers in evaluating the work of public accountants. They are not rules of the Accounting and Corporate Regulatory Authority and are not intended to serve as a substitute for the relevant auditing standards. Public accountants must observe, maintain and apply the prescribed professional standards, methods, procedures and other requirements in carrying out the audits of financial statements.