SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

MODULE: Assurance (ASF)

EXAMINATION DATE: 10 June 2021

Section 1
General comments

While most candidates completed the examination on time, the overall performance has deteriorated as compared to the December 2020 examinations. Possible contributing factors to decline in average pass rate are:

(i) Not using the information in the case and using self-developed assumptions as a basis for writing answers.

(ii) Poor knowledge in relation to EP 200 and, in particular, the customer due diligence in relation to politically exposed persons.

(iii) Poor understanding of auditor's report, particularly the use of Emphasis of Matter paragraph.

(iv) Poor understanding of the linkage between assertions and associated direction of misstatements, i.e. overstatement or understatement.

(v) Not reading the requirements and providing answers that are not relevant.

Section 2
Analysis of individual questions

Question 1

Question 1 was one of the worst performing questions of the entire paper. Many questions did not manage to pass part (b) and (c).

Auditors were required to consider the entity's internal controls in preventing or detecting and correcting material misstatements. **Part (a)** tested Candidates' ability to identify control deficiencies and link the control deficiencies to assertions.
Most Candidates were able to identify the weekly handing of source documents for purchases from the project managers to the accounting department as source of risk of misstatements, i.e. delay and incomplete handover. Thus, the two related assertions were cutoff and completeness.

Some Candidates suggested that the issue was with the occurrence assertion by stating that the project managers did not verify supplies delivered by the suppliers. However, this was based on assumption. Candidates should have used the information provided in the case, instead of writing answers based on assumptions, particularly when facts in the case were clearly there for use in answers.

The next requirement in **part (a)** was asking Candidates which accounts might be overstated or understated as a result of the control deficiencies. The quality of the Candidates' answers for this question part was not satisfactory. Some Candidates stated that both understatement and overstatement of inventories and payables could happen due to the cutoff issue. Whilst cutoff issue generally could lead to overstatement or understatement, the main risk in this case was understatement. Some Candidates got the incorrect account affected. They had stated that the risk could lead to understatement of leased assets. However, in the case, it was stated that the company applied the exemption in SFRS(I) – 16: Leases and recognised lease expenses. This showed that Candidates did not read the case carefully or did not understand the lease recognition exemption.

Part (b) required Candidates to describe the audit procedures to perform to address the risk of material misstatements identified in **Part (a).** The answers were generally correct but lacking in details. Some suggested using 3 days as cutoff for cutoff test. The case stated that the handing over of documents from project managers to accounting happened on every Friday. Thus, the exposure to cutoff delay should be 7 days. Again, this reflected that the information in the case was either not read carefully or not used.

Part (c) tested the Candidates' knowledge and application of the auditor opinion and auditor's report. Candidates' performance for this question was less than satisfactory. Most Candidates correctly identified the issue as misstatement arising from unrecorded liability to pay the legal penalty. Most also correctly evaluated and concluded that the misstatement was immaterial as it was below the materiality for the financial statements as a whole and below the performance materiality. However, not all Candidates that correctly identified the issue decided on the correct audit opinion.

Whilst the appropriate audit opinion for financial statements that contained immaterial misstatements was that of an unmodified opinion, some of the Candidates suggested adding an Emphasis of Matter (EOM) to highlight the unrecorded penalty payable. This was an incorrect use of the EOM section. EOM was added in the auditor's report to highlight an accounting matter that is of fundamental importance to users' understanding of the financial statements. Furthermore, this accounting matter must be correctly accounted for. The unrecorded penalty payable should **NOT** be included in EOM because:

- It was immaterial – an immaterial transaction could not be of fundamental importance;
- It was not correctly accounted for as it was not recorded and resulted in understatement of expense and liability.

Some Candidates did not understand the use of materiality for the financial statements and the use of performance materiality. They should compare the misstatements with the materiality figures to determine if the misstatements exceed materiality [in which case, the misstatements would be deemed as material] instead of computing the misstatements as a percentage of materiality.

Candidates were also required to explain why other types of audit opinion were not appropriate. Whilst most gave the correct answers, marks scored on average were not high because of the lack of details in the answers. For example, many Candidates correctly identified the disclaimer of opinion would not be an appropriate opinion in this case but no explanation was offered on why it was not appropriate.

Question 2

Part (a) tested Candidates' knowledge on the difference between management responsibility and auditor's responsibility. There was **a** material contingent liability that was not disclosed at all in the financial statements. Candidates were asked to evaluate if it was appropriate for the auditor to add a disclosure in the notes to the financial statements.

Preparation of the true and fair financial statements in accordance with accounting standards is the responsibility of management. Thus, it is management responsibility to add the necessary the disclosure. It is not auditor's responsibility to add the disclosure in the notes to the financial statements. Many Candidates wrote the correct answers but they did not provide sufficient details of explanation which caused some marks to be lost.

Candidates were further required to explain if it was appropriate for auditor to add a disclosure note in the audit report to help the company disclose the error. This requirement was also less well answered as most Candidates did not manage to give appropriate explanations. Most Candidates stated that the auditor could help by issuing a qualified opinion and add the disclosure on the contingent liability in the Basis for Qualified Opinion section but this was justifying a qualified audit opinion and not helping the entity to disclose what they should have disclosed in the financial statements.

In **part (b),** five internal control procedures were provided in the case. Candidates were asked to explain the business objectives of each control procedure and describe the test of control auditor would perform to verify whether these controls were operating effectively. Candidates' answers were generally satisfactory. However, some Candidates did not understand that business objectives were the business benefits to the company and instead repeated the control procedure as the business objective. For example, the first control procedure was to ensure that the company bought from suppliers that sold acceptable quality products at competitive pricing but some Candidates stated that the business objective was to buy products from approved suppliers.

Part (c) where Candidates had to identify and explain assertions that were addressed as well as not addressed by one of the controls listed in the question, was reasonably well-answered.

In **part (d),** the question indicated that Candidates did not need to provide definition of audit risk and the components of audit risk. However, many still provided the definitions and components. This wasted precious examination time yet it did not score them any additional marks. To keep the audit risk low, auditor increases test of details to reduce detection risk. Some Candidates wrongly wrote that high control risk would lead to high detection risk.

Question 3

Question 3 focused on ethical issues. **Part (a)** was about an offer from the audit client to pay higher audit fee if the firm successfully helped the audit client to resolve the tax dispute with the tax authority. Generally, Candidates correctly identified the issue as an advocacy threat arising from a contingent fee arrangement. Some Candidates clearly were not aware of contingent fee and wrote answers that were irrelevant.

Part (b) required Candidates to discuss ethical issue relating to providing accounting service to audit clients. Many Candidates correctly identified self-review threat as the ethical issue. However, few Candidates considered whether the accounting service was of routine and mechanical in nature.

Part (c) focused on the ethical issue arising from the audit firm representing the audit client to resolve tax dispute with the tax authority. Some Candidates were unable to identify advocacy threat arising from promoting audit client's position. This showed that Candidates had insufficient knowledge of the ethical scenarios affecting auditor's independence in the EP 100 ethics pronouncement.

Part (d) tested Candidates' knowledge on EP 200 relating to anti-money laundering and terrorist financing. Some Candidates correctly identified that the director-cum-shareholder was an immediate family member of a politically exposed person (in this case, a former prime minister of a foreign country). which also made him a politically exposed person. EP 200 required audit firms to perform know-your-client procedure prior to acceptance of new clients. The fact that the former prime minister was arrested for corruption pointed to heightened risk of money laundering. This was a very important factor that could make the firm reject acceptance of this new client. However, many Candidates failed to discuss this factor.

Part (e) required Candidates to consider the fact that the company's financial statements were never audited before, as factor decision in accepting the audit appointment. The main issue was higher risk of material misstatements in the opening balances. Less than half the candidates identified the issue well while some stated that the audit firm had to allocate more resources and time to audit the opening balances.

Lastly, **part (f)** tested on the Candidates' knowledge on the content of auditor's report and auditor's responsibility. It required Candidates to consider the appropriateness to include a statement in the auditor's report that the audit firm was responsible for the preparation of the financial statements. This was clearly inappropriate as management was responsible for the preparation of financial statements. The outsourcing of bookkeeping and compilation of financial statement to the audit firm did not transfer that responsibility to the audit firm. Less than half of the Candidates correctly identified the issue.

Question 4

Question 4 covers the performance of an audit and it is disappointing that most candidates performed badly for this question.

In **part (a)**, six test of details relating to sales invoices were provided. Candidates were required to state the assertion to be tested and the misstatements that could be detected, i.e. overstatement of sales or understatement of sales or both.

Generally, Candidates' answers were not satisfactory. Some did not get the assertions right and while they were right, they were wrong with the misstatements. For example, incomplete recording was an issue relating to completeness assertion that led to understatement. Some wrongly linked this to overstatement.

Part (b) required Candidates to describe two tests of details that could be performed to confirm that the cutoff of sales transactions was correct. Many Candidates did not read the case which stated "Lobo is also concerned that there is no test of details to confirm the cutoff assertion in the audit programme. He heard that there are two types of cutoff procedures to be performed." Thus, this requirement was awarding marks for two different types of cutoff procedures.

Part (c) described the detection of proceeds on disposal delivery vans wrongly recorded as revenue. Many Candidates correctly identified the assertion of classification as the main issue, however the explanation given was lacking. Less than half of the Candidates correctly identified the overstatement of revenue and the understatement of other income.

In **part (d)**, Candidates were required to describe that further audit procedures need to be performed as a result of detecting profit on disposal of van wrongly recorded as revenue from the sample test of details of revenue. The question tested the Candidates' ability to discern that as the accounting system routinely posted sales invoices to the revenue account, any proceeds from disposal fixed assets would be recorded as revenue. Thus, the misstatement was not an anomaly. In accordance with SSA 530, auditor should consider increasing the sample test and extend the test of details due to higher risk of misstatement being identified or asked the management to identify all fixed disposal proceeds that had been recorded as revenue and make an appropriate adjustment. Most Candidates did not answer this question well.

Part (e) required Candidates to suggest improvement in controls to ensure that the proceeds from disposal of fixed assets would not be recorded as revenue. Most Candidates were not able to suggest relevant improvements.