Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

MODULE: Assurance (ASF)

EXAMINATION DATE: 14 December 2018

Section 1
General comments

December 2018 exam session was the first time Candidates used e-Exam software, with each of them recording their answers using their personal laptop (in full lockdown mode – no internet/network connectivity or hard drive access) instead of traditional pen and paper. Notwithstanding the use of laptops, all SCAQ Foundation Module examinations continue to be a restricted open-book format with Candidates being able to bring in a double-sided A4 page of personal notes for reference.

The overall performance in this ASF examination compares favourably to the previous exam in June 2018 and the quality of the answers shows improvement, particularly when discussing ethical issues. However, it appears that time management may still be impeding many Candidates. The quality of answers for Questions 1 and 2 was better than the quality of the answers provided for Questions 3 and 4 and the marks awarded reflect this observation.

Section 2
Analysis of individual questions

Question 1

Part (a) of this question required Candidates to articulate the differences between an assurance engagement and a review engagement. Most Candidates did well for this question part. However, a minority of Candidates erroneously thought that a review of financial statements is a compilation engagement.

For **Part (b)**, Candidates were required to identify deficiencies in an auditor's report on the financial statements of a private limited company.

The Candidates' performance was generally satisfactory except for the following observations:

- Some Candidates failed to see that the sample audit report provided was for a private limited company and wrongly mentioned that the Key Audit Matters section (KAM) was omitted. A KAM section is only mandatory for unmodified audit reports for listed companies. Similarly, these Candidates also mentioned the name of the audit engagement partner should be disclosed in the auditor's report. Again, this disclosure is only necessary for an auditor's report on the financial statements of a listed company.

- Some Candidates wrongly stated that the auditor should conduct the audit in accordance with Singapore Financial Reporting Standards (International)

(SFRS(I)), when the auditor should conduct the audit according to the Singapore Standards on Auditing (SSA) as issued by the Institute of Singapore Chartered Accountants (ISCA). The SSAs can be freely downloaded from: https://isca.org.sg/tkc/aa/standards/standards/ssas/

It is the financial statements prepared by management that should be in accordance with SFRS(I) (issued by the Accounting Standards Council www.asc.gov.sg). While such a mistake may have been a genuine technical error, it is far more likely due to the Candidate not thinking carefully through their answer and re-checking their work for incorrect statements.

The final part of this question (**Part (c)**) required the Candidates to identify and explain the ethical threats when deciding whether to accept an audit appointment. In the case facts given, the ethical threats mainly arose from a close friendship between the Chief Executive Officer (CEO) of a start-up company and the sole proprietor of an audit firm.

Most Candidates correctly identified the relevant ethical threats, such as familiarity threat and intimidation threat. Better Candidates went on to explain other ethical threats, such as the auditor may become too accepting of her friend's financial statements (threatening the auditor's objectivity).

However, the advice given by Candidates' to the auditor about how to respond to the friend's audit appointment request was mixed. Some Candidates correctly advised the auditor to decline the appointment. Weaker Candidates suggested another auditor from the same firm could accept the audit appointment. The case clearly stated that the audit firm was a sole proprietorship. A sole proprietorship means there is only one person in the firm that holds an audit licence, i.e. the sole proprietor. Therefore, asking another person in the firm to accept the audit appointment was not possible given the fact pattern. Future ASF Candidates are reminded of the importance of considering the facts of the case presented and to provide advice specifically tailored to the facts, not just general advice when answering a question.

Question 2

In **Part (a)**, a draft accounts receivable circularisation letter was provided and Candidates were required to identify and explain five deficiencies in the letter. Generally, Candidates' answers to this question part were satisfactory except for the following observations:

- Quite a few answers correctly identified that the circularisation should not be signed by the audit intern but then wrongly suggested that the letter should be signed by the audit senior or the audit partner. This error reflects a lack of basic knowledge that circularisation letters should be sent in the **name of the client** and thus should be **printed on the client's letterhead** and signed by the **client's management**.

- A handful of Candidates failed to point out that the replies should be sent directly to the audit firm instead of the client. The essence of external confirmation is that the reply is sent directly to the auditor to preserve the independence of the confirming third-party. When information is obtained through a direct written response from a third party, it is considered of higher quality than any information that the auditor could have obtained from the audit client's internal records.

Part (b) was a follow-on from **Part (a)** and required the Candidates to explain the assertion that could be verified if the accounts receivable circularisation replies agreed with the balances in the client's accounts receivable ledger. However, some Candidates failed to recognise that:

- Circularisation provides <u>some</u> but <u>insufficient evidence</u> on "completeness" as the debtor (the confirming party) may confirm even when the balance confirmed is understated (debtors are less likely to highlight a discrepancy when the balance is incorrect but in their favour).

- Circularisation does not provide sufficient evidence on the "accuracy, valuation and allocation" assertion because it does not provide evidence on the recoverability of the receivables amount and the necessary impairment allowance.

- Circularisation can provide evidence on the "sales cut-off assertion" because if there were sales cut-off errors, the receivables amount would be overstated (or understated) and would show up when the debtor (the confirming part) indicated a difference in the confirmation reply.

For **Part (c)**, a bank reconciliation statement was provided by the client with only one reconciling item, being an uncleared cheque deposit. The requirement was for the Candidates to describe the audit procedures to be performed on the bank reconciliation.

Whilst most answers were satisfactory, some Candidates showed a lack of understanding of bank reconciliation and the audit procedures to be performed by the auditor on the reconciliation. For example:

- Some Candidates wrote that the auditor should send a bank confirmation request letter. A bank confirmation request should be sent regardless of any bank reconciliation performed. In this instance, the correct audit procedure was to agree the figure in the bank reconciliation to the bank statement and bank confirmation reply. Stronger Candidates also stated that the bank deposit should be traced to the post year-end bank statement to ensure that it had been cleared.

- It seems that some Candidates did not understand what a cash book was and stated the audit procedure should be to agree the cash book balance to the accounting records (a cash book is part of the accounting records). A simple description of a cash book is a "book" (paper-based or digital) in which receipts and payments of money are recorded and is traditionally referred to as a book of original or primary entry. All Candidates should be well versed in common accounting terminology.

Question 3

The first part of this question (**Part (a)**) focused on assessing the credentials of a property valuation expert and the information in a valuation report provided by this expert.

A large number of Candidates did not provide satisfactory answers for sub-part (i) which related to assessing the expert's credentials. Many Candidates could not relate the audit procedures given in the case to the relevant objectives of the procedures. For example, only a handful of answers correctly stated the objective of inspecting the valuer's certification was to verify the competence of the valuer. Additionally, very few Candidates were able to provide a valid example of an "assumption" used by the valuer in the valuation of the case study property. Better answers were provided for sub-part (ii) which asked for an example of the "data" used by the valuer.

The essence of **Part (b)** was on the audit procedures to confirm that the fair value of the property had been updated in the fixed asset register correctly (**the outcome of this procedure is to ensure that the two figures match**). The answers to this requirement were not satisfactory. Quite a few Candidates included irrelevant audit procedures, such as sighting the property, which would not ensure the fixed asset register figure agreed with the fair value of the property detailed in the valuation report.

Another common error in the answers was to trace the revaluation gain to the income statement instead of to other comprehensive income. This is a technical error.

Part (c) tested Candidates' knowledge on assertions. The Candidates' performance here was generally satisfactory except for the following:

- There was confusion between the assertion "accuracy, valuation and allocation" and the assertion "accuracy". These are two different assertions. The "accuracy" assertion applies to transactions and events, not account balances (i.e. assets, liabilities and equity). For example, ensuring the loss on disposal of the old warehouse was recorded correctly is associated with the "accuracy" of the disposal transaction.

- Quite a few Candidates did not know the appropriate audit procedures to confirm that the classification of the property as a fixed asset was correct. In general, if a property is classified as a fixed asset, it is used by the company for its own business activities. In this instance, one simple audit procedure would be to do a physical inspection to confirm whether the asset was being used by the company as part of its regular business operations.

Question 4

The case provided a detailed description of the inventory system operating in the retail outlets of a jewellery company.

Part (a) required Candidates to explain if the given procedures should be considered as internal controls, and explain why in terms of the business implications and the impact on the financial statements. Generally, the answers given by the Candidates were satisfactory. However, some Candidates provided answers based on their own assumptions, i.e. using information not provided in the case. For example, some Candidates assumed the company used the inventory log book to monitor inventory status. Candidates are cautioned that answers based on assumptions not explicit in the case usually do not receive any credit. Further, at the foundation level, making unnecessary assumptions may erroneously divert your attention away from what the examiner is really asking you to do, thereby not scoring any marks at all for your answer.

For **Part (b)**, Candidates were to describe the test of controls to be performed by the auditor to confirm the internal control procedures stated in the case were operating effectively. Generally, Candidates answered this question part satisfactory. Most Candidates correctly stated "observation, reperformance of controls and sighting of signatures" as evidence of approval.

Candidates were then asked to describe the substantive procedures that an auditor will perform when attending a stock (inventory) count to confirm completeness and existence of inventories. Overall **Part (c)** was well answered, with only a small number of Candidates wrongly stating observation of the client's count as a substantive procedure when this exercise would be a test of control.

Finally, for **Part (d)**, Candidates were to suggest three methods to obtain evidence that the inventories in the retail shops were indeed real diamonds. Most Candidates correctly suggested the use of an expert. Better Candidates differentiated the use of an expert into the reliance on management's appointed expert and an auditor's expert, and these options made up two of the three methods required. The case facts stated that the diamonds came with a Certificate of Authenticity issued by a reputable diamond valuation organisation (an independent third party). The 3rd method to obtain appropriate audit evidence to confirm that the inventory items were real diamonds would be to rely on these certificates (assuming all requirements of the SSAs relating to sufficient appropriate audit evidence were met).