Chartered Accountant
SINGAPORE

SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Assurance (AS)

EXAMINATION DATE: 10 June 2019

Section 1
General comments

The overall Candidates' performance was similar as compared to the previous exam in December 2018.

Candidates generally performed the best for Question 4 and did poorly for Question 3. Candidates did not perform well on questions relating to Ethics Pronouncements (EP) 100 *Code of Professional Conduct and Ethics* and EP 200 *Anti-Money Laundering and Countering the Financing of Terrorism – Requirements and Guidelines for Professional Accountants in Singapore*.

Candidates' performance for Question 2 and 3 was of moderate standard.

Section 2
Analysis of individual questions

Question 1

Part (a) required Candidates to discuss the risk of material misstatements in relation to the accounting for sales return of medical equipment sold to consumers.

A detailed narrative description of the business processes and accounting in relation to sales return was provided in the case.

A common mistake made by Candidates was the discussion on the risk of the damaged or defective returned not being written down to net realisable value (NRV). This is not an acceptable answer because of following two reasons:

- The requirement asked for the risk of material misstatement relating to the accounting of sales return. This is a specific requirement on the accounting for sales return and not on inventory valuation.

- Furthermore, the case stated clearly that the conditions for sales return to be accepted are only if:

    - Return is within 10-days from date of sale;
    - Equipment must be in original packaging

It was indicated in the case that the reason for sales return is due to defective goods. Indeed, if customers have removed the packaging, sale return will not be accepted.

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Most Candidates correctly stated the principle of accounting for sales return as required by SRFS(I) 15 *Revenue from Contracts with Customers*. For example, revenue should not be recognised for the cash collected in relation to expected sales return. Instead, a contract liability (refund liability) should be recognised. Thus, the associated risk of non-recognition of the refund liability and the overstatement of the revenue. However, some Candidates failed to use the specific information provided in the case to evaluate whether this risk of material misstatement is significant or not. The case stated that any sales return within the financial year is reversed from revenue and was thus not recognised as revenue. For sales returned within 10 days after year end, Express Medical (EM) Pte Ltd used the actual sales return to reverse the revenue recognised. Thus, the business process and accounting procedure support the revenue recognition policy. The risk of recognising sales return as revenue is thus low.

Some Candidates are not updated with the new SRFS(I) 15 and Candidate were using the principle in the old FRS 18 *Revenue* in their answers.

The learning points include:

- Read the case carefully and use relevant information in preparing the answer
- Be updated on the financial and auditing standards

Part (b) required Candidates to describe the audit procedures to confirm the completeness of accounting for sales return. Most Candidates correctly stated the direction of tracing from the source documents, i.e. sales return vouchers, to the ledger to confirm the completeness of accounting for sales return. A small number of Candidates described the tracing of cash returned from the bank statement to the ledger. These Candidates did not read the case carefully. This is because the case clearly stated that refund is made in cash and thus individual cash refund will not be recorded in the bank statement.

Part (c) required Candidates to discuss the risk of material misstatement in the recognition and/or disclosure of registration fee revenue, enrolment fee revenue and course fee revenue in relation to the 26-week course offered by EM.

The case stated that the registration fee is non-refundable and both the entity and the customer have unilateral right not to proceed with the course without compensating to the other party. As such, the registration fee is not the consideration for the exchange of any goods or services. Thus, the registration fee does not come within the scope of SFRS (I) 15 *Revenue from Contracts with Customers* and should not be accounted as revenue under this accounting standard. Most Candidates did not know of this particular principle in SFRS (I) 15, thus Candidates did not provide the correct answer.

Most Candidates correctly identified enrolment fee as unearned income because performance obligation has not been satisfied. However, the enrolment fee and the

course fee should be recognised as revenue over time as customers who attended the course simultaneously received and consumed the benefits provided by EM's performance as EM conducts the course over 26 weeks. Some Candidates wrongly concluded the revenue should only be recognised when the course is completed.

Part (d) relates to a contingent asset arising from a legal claim by EM against its supplier. Most Candidates correctly stated that contingent asset should not have been recognised as other receivables and should only be disclosed in the note. Some Candidates supported their conclusion that the legal claim is a contingent asset as the supplier will be defending the claim rigorously. This would earn Candidates more marks.

Question 2

This question is about Hightension Pte Ltd (HPL) which faced significant doubt on its going concern in FY 2018. This led to the auditor's report on FY 2018 being qualified for inadequate disclosure of the material going concern uncertainty. The severe cash flow problem was resolved in FY 2019 when the company secured an investment from a white investor. The investment was in the form of a bond subscription. Because of the cash injection via the bond issue, HPL called off its programme of selling a manufacturing plant and job redundancy.

Part (a)(i) required Candidates to explain the risk of material misstatements in relation to bond issue. Generally, Candidates' performance was less than satisfactory. The case provided details of the bond, including the principal amount of $200 million and a payment of premium of $40 million on redemption date. Many Candidates failed to recognise the premium of $40 million is in substance a finance cost. Thus, the effective interest rate of the bond is higher than its nominal rate. Some Candidates even interpreted the $40m as discount. The general principle in SFRS (I) 9 *Financial Instruments* [para 4.2.1] is to classify financial liabilities as subsequently measured at amortised cost. Because of the premium, the effective interest rate of the bond is higher than its nominal rate. Many Candidates failed to identify the risk of understatement of finance cost due to the use of nominal rate in the amortisation.

Part (a)(ii) required Candidates to state the source documents in relation to the bond issue that auditor can use as audit evidence. This is relatively straightforward if Candidates are familiar with bond payable accounting. Many Candidates correctly stated the bond subscription agreement as one of the source documents. However, many Candidates did not refer to the amortisation schedule and the effective interest rate worksheet as necessary source documents. The lack of understanding of bond accounting contributed to the lack of understanding of what source documents are expected to be available.

Part (b) is related to the calling off of the redundancy programme. The provision for redundancy recognised in FY 2018 became unnecessary in the financial statements for FY 2019. The provision should be reversed and the risk of material misstatement is the provision for redundancy is not reversed. Quite a number of Candidates failed

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to see this point and went to discuss about inadequate or inaccurate provision as the main risk of misstatement. It is important that Candidates read the details of the case carefully, including the dates of the transactions. The transactions could be prior year events, current year transactions or subsequent events.

Part (c) relates to the cancellation of the plan to sell the manufacturing plant which was classified as non-current assets held for sale in the FY 2018 financial statements. As such, the manufacturing plant should be reclassified as property, plant and equipment. Many Candidates correctly identified the risk due to the lack of reclassification of the manufacturing plant. However, many Candidates did not go on to discuss the risk of material misstatement in relation to the measurement of the manufacturing plant due to its reclassification.

Part (d) required Candidates to discuss how the prior year's qualified opinion, due to lack of disclosure of going concern, would impact on current year's auditor's report. Many Candidates did not know the guidance stipulated in SSA 710 *Comparative Information – Corresponding Figures and Comparative Financial Statements* for such situation. As the problem is satisfactorily resolved in current year (i.e. there is no longer significant going concern uncertainty), the issue does not need to be referred to in current year's auditor's report. Some Candidates suggested to issue a qualified opinion and some Candidates suggested adding an emphasis of matter paragraph to refer to the issue. Both suggestions were inappropriate. Emphasis of matter is added to refer to a fundamentally important financial statement matter that is correctly presented and disclosed in the financial statements. As HPL did not disclose the going concern problem in prior year's financial statements, it is unlikely HPL will disclose the resolution of the going concern issue in current year's financial statements. Thus, adding an emphasis of matter is not possible here.

Question 3

The question is about an audit partner who left his former audit firm and joined another audit firm. Some of his audit clients whilst he was with his former firm wished to continue to appoint him as the audit engagement partner. One of such a client was a listed company which this audit partner has served as audit engagement partner for seven years.

Part (a) required Candidates to discuss the ethical issues if the partner continue as the audit engagement partner or act as client service partner for this listed client. Most Candidates were able to discuss the familiarity threat and self-interest threat involved. Some Candidates were not updated with the Code of Professional Conduct and Ethics (thereafter referred to as The Code) and they did not realise that acting as client service partner is prohibited during the cooling off period.

Another ethical issue in the question involved an audit client requesting the external auditor to provide internal audit service. Many Candidates were able to state the principles in The Code on self-review threat and the threat of auditor assuming management responsibility. However, not many Candidates used the information in the question to evaluate the significance of the threats. A major factor that increased

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the self-review threat was the client proposed the external auditor to be fully responsible for the internal audit function. This required the external auditor to assume management responsibility. Consequently, the threats are so significant that, according to The Code, no safeguard is sufficient to reduce the threats to an acceptable level. Not discussing the significance of the threat caused Candidates to lose precious marks.

Part (c) is about a suspicious money laundering transaction. **Part (c)(i)** required Candidates to identify the criminal proceeds in the case. To identify criminal proceeds, Candidates should first identify the crime in the case, which was using bribery to secure customer contracts. Bribery is a crime. The money generated by offering bribery is not the bribe but the gain from the customer contracts. Many Candidates did not answer this question well.

Part (c)(ii) required Candidates to identify the stage of money laundering the firm might be in. Many Candidates correctly concluded that the firm was at the layering stage and provided good definition of layering stage. However, Candidates did not provide adequate explanation on why it was the layering stage.

Part (c)(iii) required Candidates to state the immediate steps the audit engagement team should take when it has reasonable ground to suspect a money laundering transaction. Quite a few Candidates correctly pointed out the need to inform the firm's senior partner or money laundering reporting officer about their suspicion. Fewer Candidates stated the next step to take which is to continue with the audit without tipping off. Some Candidates wrongly suggested for the resignation as auditor or raising the issue with management or those charged with corporate governance.

Part (c)(iv) required Candidates to explore the conflict which the auditor will face in relation to the reporting of the suspicious money laundering transaction. SSA 240, SSA 250 and SSA 260 all requires auditor to have adequate communication with those charged with governance about the issues encountered during audit, including fraud and non-compliance with law. However, anti-money laundering legislation required auditor to file confidential suspicious transaction reports with the authority and then take actions to avoid tipping off. Very few Candidates to discuss the conflict adequately.

Question 4

Question 4 is about a new audit client that acquired 90% of the share capital of a new subsidiary. **Part (a)(i)** required Candidates to describe the audit procedures in relation to the business combination. As the investee was accounted for as a subsidiary, the audit procedures should aim to cover the objectives such as investment cost, acquisition date, whether control exists, percentage of ownership, fair value of non-controlling interest, fair value of identifiable assets acquired and liabilities assumed on acquisition date. Most Candidates were able to describe relevant audit procedures in relation to the above objectives. However, some Candidates answers were too general, lacked details and provided audit objectives instead of audit procedures. For example, "The agreement should be obtained to

extract necessary information required to ascertain the accuracy of the recognition of subsidiary." Candidates should explain what "agreement" should be obtained, what kind of information is considered "necessary information" and how auditor will "ascertain the accuracy of the recognition of subsidiary". Candidates' answers lacked basic details to be awarded marks.

Part (a)(ii) required Candidates to identify the misstatements in the consolidation schedule prepared by the group accountant. Generally, Candidates' performance was satisfactory. Some Candidates did not use the information from the case and some Candidates were not familiar with consolidation. The answers provided by the Candidates were either too general or not relevant. For example, a Candidate's answer provided was "The inventory does not seem to be recognised at the lower of cost or net realisable value." This answer was not awarded any mark because of two reasons. Firstly, writing down of inventories to net realisable value should be done in the company's individual financial statements and not in the consolidated financial statements. Secondly, the case did not refer to any inventory valuation issue that needs to be addressed in the consolidation schedule.

Part (b) is about the implication on audit opinion and auditor's report in the case that the company did not prepare consolidated financial statements. **Part (b)(i)** assumed that the parent company met the criteria to be exempted from preparing consolidated financial statements. Thus, non-consolidation of financial statements is not in breach of the accounting standards. However, the parent company did not disclose the reason for not preparing consolidated financial statements. Inadequate disclosure of material information is a material misstatement that would lead to a modified opinion. In this case, the nature of non-disclosure is material but not pervasive. Therefore, the appropriate modified opinion is a qualified opinion. Some Candidates did not identify the inadequate disclosure as a misstatement. Some Candidates wrongly concluded that it is a limitation of scope. Some Candidates wrongly suggested to add an Emphasis of Matter (EOM) to draw attention to the fact that the company did not disclose the reason for not preparing the consolidated financial statements. Candidates continued to use EOM wrongly. EOM is only added to highlight a fundamentally important accounting matter that is correctly accounted for and disclosed. EOM cannot be used as a substitute for modified opinion.

Part (b)(ii) assumed that the company did not meet the exemption criteria and thus is required to prepare consolidated financial statements. Therefore, non-consolidation of financial statements has breached the accounting standards. Most Candidates correctly arrived at issuing an adverse opinion due to material and pervasive misstatements. Some Candidates discussed that the opinion will depend on whether the misstatements are material. These Candidates did not use the information in the case which was given that the subsidiary's assets were 14.95% of the group assets (before consolidation adjustment) and the subsidiary is a financially significant component of the consolidated financial statements. Such general answer did not score a pass mark.

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