

**AUDIT PRACTICE BULLETIN NO. 3 OF 2012**

**QUALITY CONTROL FOR FIRMS THAT PERFORM AUDITS AND REVIEWS OF  
FINANCIAL STATEMENTS, AND OTHER ASSURANCE AND RELATED  
SERVICES ENGAGEMENTS (PART 3)**

***HUMAN RESOURCES***

**3 DECEMBER 2012**

1. Part 3<sup>1</sup> of the series of Audit Practice Bulletins (APB) on 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*<sup>2</sup> discusses ACRA's inspection observations on the fourth element of SSQC 1 – Human Resources.
2. In Singapore, the profession continues to face challenges in attracting and retaining accounting trained talent. Hence, it becomes more important for firms to establish quality controls pertaining to human resources to sustain the consistent delivery of quality audits.
3. The completion of an audit is dependent on professional staff who have the necessary skills and experience to exercise professional scepticism and to make professional judgment when executing audit procedures. Therefore, the level of professional competency and experience of the professional staff in a firm affects the quality of audits performed.
4. SSQC 1.29 states that firms shall establish policies and procedures designed to provide them with reasonable assurance that they have sufficient personnel with the competence, capabilities, and commitment to ethical principles necessary to (a) perform engagements in accordance with professional standards and applicable legal and regulatory requirements; and (b) enable the firms or engagement partners to issue reports that are appropriate in the circumstances.

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<sup>1</sup> Parts 1 and 2 were published on 13 August 2012 and 18 September 2012 respectively and are available for download at: <http://www.acra.gov.sg/Publications/Audit+Practice+Bulletins.htm>.

<sup>2</sup> SSQC 1, which is issued by the Institute of Certified Public Accountants of Singapore (ICPAS), is based on the equivalent of the International Standard on Quality Control 1 issued by the International Federation of Accountants, with amendments as were considered appropriate for local adoption. SSQC 1 is available for download at: <http://www.icpasca.org.sg/wp-content/uploads/2010/06/SSQC-1-R.pdf>.

5. Based on inspections of firms that audit public interest entities (PIE), ACRA noted that most firms have made concerted efforts to strengthen their human resources through various initiatives aimed at attracting and retaining audit professionals. However, the quantitative indicators such as staff turnover rates, staff leverage ratios and average years of experience, do not appear to support the firm's ability to ensure consistent execution and sustainability of audit quality. Firms are urged to continue to keep a close watch in this area.

## **Key Observations**

### **(a) Recruitment**

6. SSQC 1.A24 states that effective recruitment processes and procedures help firms select individuals of integrity who have the capacity to develop the competence and capabilities necessary to perform the firms' work and possess the appropriate characteristics to enable them to perform competently.
7. In an increasingly competitive market space for accounting trained professionals, firms, particularly the smaller-sized ones, are facing challenges in attracting suitable qualified staff. Smaller-sized firms can reverse the trend and put up a strong value proposition<sup>3</sup> as their flatter organisation structure will allow (a) closer mentoring and counselling by public accountants; (b) good work to be recognised instantaneously; (c) relatively shorter path to partnership admission as compared to bigger-sized firms; and (d) close-knitted teams, amongst other advantages of working in a smaller-sized firm.
8. ACRA noted that similar to Big-Four firms, some mid-tier firms are offering scholarships and internships programs to accountancy undergraduates in various universities as well as polytechnics. Smaller-sized firms can emulate such practices as a means to increase their visibility and attract staff to their firms. Firms can also consider tapping on the Singapore Qualification Programme (SQP)<sup>4</sup> which is expected to be launched in June 2013. Under the SQP framework, a minimum 3 years of practical experience would have to be obtained via employment-cum-training contracts with an

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<sup>3</sup> Certain contents of this APB are extracted from the survey conducted by ACRA and the Association of Chartered Certified Accountants (ACCA) titled *Talent Attraction and Retention in Larger Accounting Firms* issued in August 2012.

<sup>4</sup> The SQP provides a pathway for qualification and recognition for individuals from all disciplines who aspire to be Professional Accountants. The successful completion of the SQP by an individual will lead to the conferment of a Singapore-branded professional accountancy designation that is globally recognised and internationally portable.

Accredited Training Organisation (ATO)<sup>5</sup>. Being an ATO will enable the firm to broaden its recruitment base and attract candidates interested in the SQP to join as staff.

9. Having the appropriate manpower requirements is critical for firms in carrying out quality audits. ACRA noted that some firms monitor head counts on a monthly basis, but there are no formal budgeted or targeted head counts set for the estimation of personnel needs for resource planning requirements.
10. ACRA has also seen some firms reacting to staff shortages by leveraging on university interns and secondees from overseas network firms to bridge the gap in staff resources during the peak period as well as offshoring part of their audit work to another network firm operating in a lower cost country. Smaller-sized firms may have similar arrangements when they outsource audit work to part-timers and external consultants.
11. Firms need to be mindful of maintaining audit quality for such arrangements by ensuring that the personnel performing the work is (a) equipped with the necessary audit skills and knowledge; (b) conversant with the firms' audit methodology; and (c) have sufficient levels of appropriate training.

**(b) *Staff retention/turnover***

12. Whilst staff attrition is expected, however, staff turnover rates recorded by some firms are way beyond normal levels and are likely to have negative effects on audit quality. The inability of the firm to find suitable replacements on a timely basis also adds undue pressure on existing limited staff resources to perform quality audits.

**(c) *Performance evaluation, compensation and promotion***

13. SSQC 1 provides principles for performance evaluation, compensation and promotion procedures, including principles that require firms to give due recognition and reward to the development and maintenance of competence and commitment to ethical principles. Some firms have less formal methods of evaluating the performance of their personnel. The challenge is for firms to provide sufficient and appropriate incentives to reward individual performance in a way that promotes quality audit work.
14. As discussed in APB No. 1 of 2012, promoting an internal culture based on quality includes the establishment of policies and procedures that address performance evaluation, compensation and promotion with regard to its personnel. A strong and

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<sup>5</sup> These are employers of SQP candidates, accredited by the Singapore Accountancy Commission to offer the practical experience component of the SQP.

well-understood linkage between audit quality and staff performance evaluations and compensation can be an effective tool in driving up audit quality within the firm.

15. SSQC 1.A28 suggests some steps that a firm may take in developing and maintaining competence and commitment to ethical principles. These include (a) making personnel aware of the firm's expectations regarding performance and ethical principles; (b) providing personnel with evaluation of, and counselling on, performance, progress and career development; and (c) helping personnel understand that advancement to positions of greater responsibility depends, among other things, upon performance quality and adherence to ethical principles, and that failure to comply with the firm's policies and procedures may result in disciplinary action.
16. Staff performance evaluations play a crucial role in the development of staff and assist the firm in monitoring the performance and quality of employees. Appraisals, done on a timely basis, are essential for shaping and improving the behaviours and performances of staff, including the quality of their professional work.
17. There are various selection criteria for completing engagement appraisals such as based on a certain audit fee threshold, the minimum number of hours charged to the engagement or a combination of both. Regardless of the criterion of selection of engagement for appraisals, firms should establish policies that are clear to staff. ACRA noted that most firms do not have a formal process in place to monitor the completion and submission of the engagement appraisals.
18. Firms should specify the timeframe when engagement appraisals should be completed and monitor the submission of the relevant appraisal forms that meet the selection criteria. Such a process would help to ensure that (a) important engagement appraisals are not omitted during the staff engagement appraisal process; and (b) staff receive the documented feedback in time to be applied to their next engagement and this will improve overall audit quality for the firm.
19. ACRA noted that in some firms, the criteria used for the assessment of staff performance include quantitative factors such as job recovery and portfolio fees. Whilst ACRA understands that such factors may be necessary to be included in the assessment of staff performance, firms need to emphasize that audit quality is an important component of the staff appraisals. For example, the outcome of the quality review results (e.g. ACRA's Practice Monitoring Programme, review letters from ICPAS' Financial Statements Review Committee, firms' internal reviews or network reviews) conducted on the various engagements can also be used as an assessment criteria of audit quality.

20. ACRA noted an instance where technical competence was not a key criterion considered in evaluating the performance for professional staff of a supervisory grade. The firm's rationale was that the professional staff, having achieved the appropriate technical competencies and promoted to supervisory grade, is expected to focus more on soft skills, supervisory and client management skills. ACRA encourages firms to re-assess whether the reduction in the emphasis on technical competencies in the annual performance evaluations as the professional staff progresses within the firm, is appropriately aligned towards motivating positive individual's professional behaviour in firms' efforts to perform high quality audits.
  21. In respect of compensation, ACRA noted in one firm that the better performers and average performers received equal monthly variable bonuses. The firm had taken the stand to differentiate and reward better performers through career advancement and salary increments but not on bonus payments. However, firms need to assess what are the components that staff regard as remuneration and ensure a clear linkage to the level of audit quality achieved.
  22. A recent survey<sup>3</sup> has shown that career proposition is fundamental to attract Generation Y professionals. Therefore, firms need to be very clear on the career path opportunities available and how these individuals can develop within the firms, and the associated time frames. This would call for increased transparency and clarity on the development path that gives sight to partnership admission particularly for staff aspiring to be partners.
- (d) *Capabilities, including time to perform assignments***
23. Firms need to ensure the sufficiency and competency of audit professionals so that all necessary audit procedures, which are required to address specific risks of each engagement, can be fully performed to support the public accountant's opinion in the audit reports issued by the firm. Apart from this, firms also need to ensure the competency of the audit professionals carrying out the reviews. For supervision and reviews to be effective, they need to be carried out by senior personnel (i.e. the engagement partner and the engagement quality control review partner) who are more experienced in such audits. The benefit of experience puts them in a better position to identify potential audit issues and apply professional scepticism, especially in risky and judgemental areas in assessing the adequacy and persuasiveness of the audit evidence obtained.
  24. The average number of years of experience for the firms' professional staff represents an important indicator and has direct correlation to the level of audit quality of the staff and the audit engagement. Based on the most recent data collected, the average years of

experience of professional staff for some firms was low and indicative of a fairly junior staff mix. With high staff turnover rates and low average years of experience, firms may be operating at a sub-optimal level with regard to competency levels and this could impact the effectiveness of audits carried out by relatively inexperienced professional staff.

25. Through interviews conducted with audit professionals as part of ACRA's inspections, managerial staff often provide feedback that they are spending a significant amount of their time performing administrative duties that could have been spent on supervision of team members. Whilst ACRA recognises the necessity and practicality of such practices, especially for smaller-sized firms, striking a balance between the two is vital to ensure that senior engagement personnel do not spend disproportionate amount of time on these administrative responsibilities and that such responsibilities do not affect the level of supervision provided to their subordinates.
26. ACRA looks at the time recorded as an indicator of partner involvement and supervision and this is noted to be low at less than 5% of total engagement time spent. In many instances, there was no evidence of timely review of key audit documents such as planning and completion memorandums by the engagement partner. Given the high staff turnover and low average years of experience in some firms, engagement partner time involvement is especially important to ensure effective supervision and review, particularly for audits of PIEs which are of higher risks.

***(d) Competence, Learning and Development***

27. SSQC 1.A25 suggests that competence can be developed through a variety of methods, including (a) professional education; (b) continuing professional development, including training; (c) work experience; (d) coaching by more experienced staff, for example, other members of the engagement team; and (e) independence education for personnel who are required to be independent.
28. The continuing competence of the firm's personnel depends to a significant extent on an appropriate level of continuing professional development so that personnel maintain their knowledge and capabilities. Effective policies and procedures emphasize the need for continuing training for all levels of firm personnel, and provide the necessary training resources and assistance to enable personnel to develop and maintain the required competence and capabilities.
29. ACRA recognises the commitment and continued investments that firms have made in the area of staff training and development over the years. Bigger-sized firms in the PIE segment typically have dedicated training resources and departments. Such firms

generally tap on their internal resources by using a combination of in-house trainers or leverage on staff from the audit or technical department who are sufficiently knowledgeable or specialised in certain areas to conduct training. Firms which are part of a wider network may also, in certain instances, collaborate with other member firms or obtain from their network's global training arm, training materials for updates on audit methodologies and auditing/accounting standards. Smaller-sized firms may consider the use of a suitably qualified external person or professional bodies, when internal technical and training resources are unavailable, as provided under SSQC 1.A27. Firms can also use the guides on the six elements of SSQC 1 recently issued by ICPAS to support the small and medium-sized practices<sup>6</sup>.

30. An important contributor to audit quality is the quality, breadth and relevance of the firm's training programs as well as the extent of participation of partners and staff in those programs. A robust training framework should ensure that each level of staff attend the appropriate training relevant to their work on a timely basis. Firms operating in the PIE segment often have a process for monitoring compliance with its training requirements although the process could be tightened. Whilst firms maintain attendance records for all training courses, ACRA has noted instances of inadequate follow-up with absentees to ensure that they have either attended make-up training or have read and understood the training materials provided. ACRA has also seen instances where new joiners were immediately deployed to audit assignments prior to receiving adequate training on the firm's audit manual and methodology.
31. Some firms obtain formal course feedback immediately from course participants after the training courses. Such course feedback provides information about the quality of the trainer and/or training materials. Course feedback plays a crucial role in developing more effective and better course content for future training. In one firm, the contributions of good and effective trainers are recognised and trainers are classified into categories such as "Solitaire", "Gold" and "Silver".

**(e) *Employee surveys***

32. Reasonably high levels of staff satisfaction are important elements of retaining the staff that firms want. Satisfied staff go hand in hand with lower levels of turnover and higher levels of average experience. Employee surveys are tools to help identify issues which when addressed by the firm, can lead to better staff engagement and retention as well as workplace productivity. Such surveys can be conducted in various ways including

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<sup>6</sup> ICPAS' SSQC 1 Practice Guides can be ordered via this link - <http://download.icpas.org.sg/QA/Order%20Form%20-SSQC%201%20Practice%20Guides.pdf>

informal chit chats during planning meetings, formal one-to-one interviews, focus group sessions and online surveys.

33. ACRA noted that most firms conduct employee survey which consists of various kinds of questions and topics which include the organisation, management and workplace climate. However, firms need to improve on the communication with staff on the actions they have taken to address the key concerns of staff. It is important for firms to evaluate the results of such surveys, acknowledge the issues and establish a platform for open communication with staff in a transparent and proactive manner.
34. ACRA also noted that most firms conduct exit interviews with all professional staff members leaving the firm. This is a good practice as exit interviews enable the firm to understand the underlying reasons for the resignation and to take follow up actions where there are trends of complaints regarding certain people or situations.
35. Two commonly reported reasons for staff leaving the audit profession are deadlines that are perceived to be unreasonable and heavy workloads aggravated by inadequate resource allocation which results in the lack of work-life balance. It is encouraging to note that there are continuous efforts made by some firms to address the lack of resources during the peak periods. Such efforts include: (a) conducting pre-final audits outside the peak period; (b) performing assessment of going concern prior to the year end; and (c) better execution of team planning and post interim events.
36. Based on staff interviews conducted by ACRA during its inspections, it appeared that the issue of not being able to charge all overtime hours worked is prevalent in a number of firms. Staff often explained that their inability to charge overtime worked is driven by a culture to meet budgets and expected recovery rates. This has an important implication as staff who have to suppress overtime are not likely to be motivated to thoroughly pursue possible problem areas in the course of their audit work.
37. The “tone at the top” is important to send the message that all time spent on engagement must be fully charged to the engagements. ACRA noted in a firm that overtime policy was amended such that charging of overtime by staff no longer needs a manager’s approval. As a best practice, an analysis of the time cost incurred and the engagement issues encountered may help the engagement team and/or the firm to better estimate the level of resources required and plan ahead to staff recurring engagements appropriately. Poor resource planning may result in the firm’s inability to adequately staff engagements to support audit quality and the timely delivery of such services.
38. Firms are reminded that the six elements of SSQC 1 quality controls are overlapping and the entire system of quality controls becomes effective when all six elements are

working. For example, as firms focus on quality controls pertaining to Human Resources, they should keep in mind the linkage to:

- a. Tone at the top as discussed in APB No. 1 of 2012 whereby the firm's leadership's commitment to audit quality will drive the strategies to tackle talent attraction and retention issues.
- b. Acceptance and Continuance of Client Relationships and Specific Engagements as discussed in APB No. 2 of 2012 whereby firms when undertaking or continuing relationships and engagements, have to assess if they have the adequate resources to perform the engagement.

## **Conclusion**

39. Attraction and retention of top quality talents are critical to firm's ability to uphold audit quality and manage risk within the firm. Professional scepticism, which forms the bedrock of audit quality, is developed and heightened through the accumulation of audit experience. Firms should undergo a holistic review of their programmes and initiatives to attract and retain the professional staff they want.

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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 ACRA 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.