



PRACTICE MONITORING PROGRAMME

SECOND PUBLIC REPORT

July 2008

The Accounting and Corporate Regulatory Authority (ACRA) is Singapore's corporate regulator as well as the independent regulator for public accountants. It was formed from the merger of the Registry of Companies and Businesses (RCB) and the Public Accountants Board (PAB) on 1st April 2004.

ACRA's primary role is that of the regulator of businesses and public accountants. Its secondary role is that of a facilitator of businesses.

ACRA plays an important role in facilitating doing business in Singapore but our main role remains that of a regulator. In line with the need to create a responsive and trusted regulatory environment, ACRA seeks to facilitate a pro-enterprise environment. ACRA is committed to continually reviewing the legislation and reducing the regulatory burden to be in tune with business needs and international developments and to help promote entrepreneurship and enterprise. To this end, ACRA sees confidence in corporate reporting and governance as vital to the healthy functioning of businesses and the market, and making a significant contribution to the overall economy and Singapore's competitiveness in international markets.

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“Published July 2008

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ONE – EXECUTIVE SUMMARY AND OVERALL CONCLUSIONS

Background

1.1 The Practice Monitoring Programme (PMP) provides quality assurance to market participants through ascertaining whether public accountants have complied with prescribed auditing standards, methods, procedures and other requirements in discharging their responsibilities for the provision of public accountancy services in Singapore.

1.2 In the inaugural public report published last year in July 2007, ACRA reported on the broad areas of improvement as well as an interim statistical distribution of the PMP review outcomes from PMP reviews conducted. This second PMP annual public report builds on the foundation laid down from the inaugural report to focus on the key areas of improvement that have been identified in the PMP reviews conducted during the period from April 2007 to March 2008.

Overall Conclusions

1.3 While there continue to be areas for improvement identified in the PMP reviews, the overall quality of auditing in Singapore remains fundamentally sound. ACRA has noted positive efforts on the part of the reviewed accounting entities, especially by the bigger accounting entities, to raise audit quality in many important areas. The accounting entities and public accountants reviewed have generally shown a commitment to audit quality and have policies and procedures in place to address the elements in

Singapore Standard on Quality Control (SSQC) 1 on quality control for accounting entities.

1.4 The improvements observed in the small accounting entities segment, which comprise sole proprietors and 2-3 partners' entities, are however more patchy and less pervasive. These entities continued to face significant resource challenges and constraints in putting in place effective quality control systems and processes to address audit quality issues that have been identified in the PMP process.

Key Areas for Improvement

1.5 For the firm-level reviews, ACRA continued to note opportunities for improvement for the profession in general in key areas that include the following:

- the extent and scope of engagement partners' involvement in audit engagements and resulting quality of supervision of the engagements;
- the extent and scope of concurring partners' involvement in audit engagements;
- the implementation of procedures in relation to independence and ethical requirements;
- the execution of client acceptance and continuance procedures; and
- the extent and scope of the accounting entities' internal quality control reviews conducted.

Although these observations apply to both large and small accounting entities, in the larger accounting entities, greater focus needs be placed on the effectiveness of the implementation of the system of quality control, whereas in the smaller accounting entities, it is often the comprehensiveness of the system of quality control that could be improved.

1.6 For the PMP reviews of the individual audit engagements, ACRA noted the following in a number of instances:

- Gaps in the overall quality of documentation of key audit evidence and processes, especially the support for important judgments on which the audit opinion was based;
- Inadequate follow-up audit procedures when exceptions were identified; and
- Inappropriate procedures carried out to address certain audit assertions.

1.7 ACRA will monitor the trend of the key PMP findings as well as the PMP outcomes over a period of time to make a better assessment of the improvements and progress made by the profession in the quality of auditing in Singapore.

PMP Process

1.8 ACRA is appreciative of cooperation received from the accounting entities in the course of the PMP reviews. There were however instances, albeit isolated ones, where the efficiency and effectiveness of the firm-level

reviews was impacted by issues of timely access to information and key personnel. While ACRA was generally able to gain access to the information it required in such cases, ACRA does not consider it acceptable for any accounting entity to seek to limit the scope of the reviewers' work. Such attempts are likely to influence conclusions drawn by ACRA about the accounting entity. Accordingly, we expect full cooperation, and full and timely access to both people and information, to be provided by all accounting entities in the future.

Conclusion

1.9 ACRA has issued this report to highlight areas that require the attention and focus of the profession in order to enhance audit quality in Singapore. Accounting entities, however, should not assume that the areas and issues noted in this report are the only areas requiring attention. Each accounting entity should, in the course of monitoring its own performance, identify and address any specific impediments to compliance with the professional standards. Accounting entities should also continually stress the critical need to conduct all aspects of their audits with due care and professional scepticism.

1.10 Going forward, the PMP will continue to cover all public accountants, using a risk-based approach and with a continuing emphasis on standards for engagement quality control reviews and quality monitoring.

TWO - INTRODUCTION

2.1 Audit quality is the cornerstone of market confidence in the reliability of financial information. A strong audit profession helps maintain and promote confidence and integrity in Singapore's capital and business markets.

2.2 Promoting high quality audits remains a key focus of ACRA's auditor oversight activities, in particular through the Practice Monitoring Programme (PMP). The PMP provides quality assurance to market participants by ascertaining whether public accountants have complied with the prescribed auditing standards, methods, procedures and other requirements in discharging their responsibilities in the provision of public accountancy services in Singapore.

2.3 The PMP, conducted for all public accountants that provide public accountancy services in Singapore, is calibrated in scope and intensity according to the nature and complexity of the public accountancy services provided.

2.4 Public accountants in accounting entities that audit public interest entities are subjected to a review process that considers the accounting entities' systems of quality control and the effectiveness of the implementation of and/or compliance with the firms' policies (known as firm-level reviews), in addition to detailed reviews of public accountants' individual engagement files. In addition to the detailed engagement file reviews, an average of 15 – 25 engagement files are tested for particular

characteristics over a 6 – 8 weeks onsite inspection process as part of the review of the system of quality control. For public accountants in accounting entities that do not audit public interest entities, the focus is primarily on engagement file reviews, with an average of three engagement files reviewed for each public accountant.

2.5 This public report, the second since the inaugural edition published by ACRA in July 2007, reports on the main findings gathered by ACRA from the PMP reviews conducted during the period from April 2007 to March 2008.

2.6 The PMP for public accountants in accounting entities that audit public interest entities entered its second cycle of reviews of the Big 4 firms, by completing the first of the four firm-level reviews in this cycle. The PMP continued with the first cycle for the other accounting entities that audit public interest entities, completing up to 57 per cent of firm-level reviews at the end of this review period. A total of 36 sample engagements were tested in the course of the firm-level reviews in order to assess certain aspects of “engagement performance”¹, while 16 engagements were selected for more detailed review.

2.7 For ACRA’s own internal assessment purposes, the accounting entities’ best practices in their respective systems of quality control will be benchmarked against those in their peer groups and also compared to those

¹ These are targeted reviews to assess if engagements are performed in accordance with specific professional standards, regulatory and legal requirements.

of other accounting entities within the profession.

2.8 The PMP for public accountants of accounting entities that audit non-public interest entities continues with the assistance of ICPAS under the direct oversight of ACRA during the year. A total of 44 such public accountants have been reviewed during the year.

2.9 Details of the PMP process are provided in the inaugural edition of the PMP report which can be located in ACRA's website at <http://www.acra.gov.sg>.

2.10 This report does not constitute a comprehensive list of all the observations noted during the PMP. Public accountants and accounting entities are provided with individual detailed reports on the full findings and assessments from the PMP reviews.

2.11 Instead, this report attempts to summarise the most important and common findings that ACRA views as requiring particular attention from the profession.

2.12 It should be emphasised that, because ACRA's focus in this report is on opportunities for improvement, conclusions about the overall quality of auditing in Singapore should not be drawn from reading this report.

THREE – FIRM-LEVEL REVIEWS OF ACCOUNTING ENTITIES THAT UNDERTAKE PUBLIC INTEREST ENTITY AUDITS

3.1 The firm-level review is carried out in accordance to SSQC 1. It involves an assessment of the accounting entities' systems of quality control in the following areas identified in SSQC 1:

- Leadership responsibilities for quality within the firm;
- Independence and ethical requirements (which include the Code of Profession Conduct and Ethics set out in the 4th schedule to the Accountants (Public Accountants) Rules);
- Acceptance and continuance of client relationships and specific engagements;
- Human resources;
- Engagement performance; and
- Monitoring.

3.2 The paragraphs that follow highlight the main observations gathered in each area.

Leadership responsibilities for quality within the firm

3.3 ACRA was pleased to note that the senior management of the accounting entities appeared to appreciate the need to focus on audit quality. The accounting entities' leaders generally demonstrated a commitment to high quality work. For example, in the reviewed accounting entities' communications to staff, ACRA noted frequent references from the

leadership to the importance of audit quality. In addition, some accounting entities have increased resources expended on quality control functions and training.

3.4 An important aspect of leadership in an audit practice comes from active partner involvement in the audit process. The engagement partner takes responsibility for the direction, supervision and performance of the audit engagement in compliance with professional standards and regulatory and legal requirements.

3.5 Most accounting entities reviewed have in place formal procedures for assigning partners and staff to audit engagements. Generally, the accounting entities reviewed consider the following factors in making such assignments:

- Capabilities
- Competence
- Authority and
- Time to perform the role

3.6 ACRA does not consider the practice of allocating junior partners to higher-risk engagements to be acceptable. While this practice is not a pervasive one, ACRA would nevertheless like to remind the profession that accounting entities are required under the Singapore Standards on Auditing and SSQC 1 to give due consideration to the experience and capability of the partners and requirements of the engagements when assigning resources.

3.7 Incorporating audit quality benchmarks in partners' appraisal

procedures supports and reinforces the accounting entity's view on the importance of quality. It is essential that performance appraisals be formally documented, with sufficient weight given to quality indicators in the goals and objectives against which performance is assessed.

Independence and ethical requirements

3.8 Auditor independence remains a critical foundation of audit quality and public confidence in audit reports. It is crucial that the partners and staff understand and adhere to the ethical standards.

3.9 ACRA noted that most of the accounting entities reviewed had put in place systems and processes designed to ensure compliance with auditor independence requirements and the conduct of quality audits, including:

- policies on financial interests in the accounting entities' clients;
- regular training and updates to emphasize adherence to independence policies; and
- policies and procedures in relation to the acceptance and approval of non-audit services for existing audit clients.

3.10 While ACRA has not come across any serious breaches of the Code of Professional Conduct and Ethics during its reviews, a number of common deficiencies in the implementation of the accounting entities' policies and procedures were noted. These include:

- individual independence declarations not completed on a timely basis;

- monitoring of independence compliance not extended to staff members;
- listing of prohibited/restricted investments not updated on a timely basis; and
- lack of established criteria and safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an audit engagement over a long period of time

Acceptance and continuance of client relationships and specific engagements

3.11 Client acceptance and continuance procedures are an important first step in carrying out an effective audit. An accounting entity should obtain and assess the information it considers necessary before accepting an engagement with a new client or when deciding whether to continue an existing engagement, and must document the assessment made. In its decisions in relation to client acceptance or continuance, the accounting entity must consider whether it has the capabilities, competence, time and resources to undertake the engagements, taking into account the specific requirements of the engagements and the existing partner and staff profiles at all relevant levels.

3.12 ACRA is pleased to note that many accounting entities reviewed are increasing their emphasis on managing the risks associated with accepting and retaining clients. Acceptance and continuance decisions were generally supported with in-depth risk analysis and documentation.

3.13 Although all the accounting entities reviewed had acceptance and continuance policies in place, ACRA continued to find some cases of ineffective implementation. For example, during the completion of acceptance and continuance forms, engagement team members made many procedural breaches. This suggests that the engagement team members may not have taken the process seriously and may have regarded the process as more of a “form-filing” exercise.

3.14 Some examples of the above-mentioned procedural breaches include:

- documents supporting the decision to accept or continue with a particular client were found to contain incomplete/inaccurate information. For example, information relating to the identity and business reputation of the client’s principal owners, key management, related parties and those parties charged with governance;
- lack of robustness in the risk analysis;
- issuance of consent letters and/or engagement letters before completing the required client acceptance/continuance procedures; and
- terms of the engagement letters for recurring audits not revisited in light of changed circumstances.

The above procedural breaches might have had a bearing on the quality of accounting entities’ client acceptance/continuance decision-making process.

Human Resources

3.15 People in sufficient numbers and with sufficient knowledge and experience is an important element to ensure high audit quality. While the accounting entities reviewed are focusing on attracting, developing and retaining qualified people, ACRA noted continuing challenges for the accounting entities in this area, likely exacerbated by recent high demand for talent in Singapore's financial sector.

3.16 Specifically, ACRA has observed the following:

- high partner to staff ratios in most accounting entities, where partner to staff ratios in excess of 1:25 are not uncommon.
- deterioration in the average levels of audit experience;
- low recorded engagement partners' time spent on audit engagements, in some cases less than 3% of total engagement time; and
- low recorded concurring partners' time spent on reviewing the audit engagements.
- pressure on staff to achieve higher engagement recovery rates, including suppression of overtime charges.

3.17 In ACRA's view, low levels of experience among audit staff and overstretch at the partner and senior manager/manager levels remain important audit quality issues.

Engagement Performance

3.18 The accounting entities reviewed have put in place in-house audit methodologies designed to provide reasonable assurance that audit engagements are performed in accordance with professional standards and regulatory and legal requirements. Through these audit methodologies, the accounting entities seek to establish consistency in the quality of engagement performance. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials.

3.19 The tests of audit files carried out by ACRA to assess the quality of engagement performance within an accounting entity were not designed to permit ACRA to draw conclusions as to the overall adequacy of the audit of any specific individual engagement. Generally, ACRA formed the impression that most of the engagements tested were performed to an acceptable standard. However, ACRA continued to observe common weaknesses in the following areas:

- instances in which work performed by the auditor and relied on in forming his/her conclusions for relevant audit assertions was not or was inadequately documented;
- instances where no response was received to confirmation requests from external parties and no or inadequate alternative procedures were performed as a consequence;
- failure to evaluate the financial impact of the cumulative list of unadjusted audit differences;

- failure to include the summary of uncorrected financial statement misstatements in the written representations from management;
- failure to carry out a subsequent events review or to update it up to the date of auditor's report;
- undocumented or inadequately documented fraud risk discussions including consideration of the risk of management override;
- analytical procedures performed that lacked robustness and for which no expectations were formed;
- setting materiality at inappropriate levels;
- lack of or inadequate audit evidence about the design and implementation of relevant controls; and
- in relying on the work of another auditor (including an affiliated firm), failure by the principal auditor to:
 - consider the professional competence of the other auditor;
 - ensure sufficient planning, supervision, review and attention to significant audit areas identified by the other auditor; and
 - ensure adequate follow up procedures when other auditors did not report in accordance with the group audit instructions. For example, another auditor's clearance opinion was signed off in accordance with local generally accepted accounting principles (GAAP), rather than that applicable for group reporting.

3.20 In one engagement tested, an outdated audit manual was employed by an accounting entity. This could indicate a lack of emphasis on audit quality or possible gaps in the implementation of an appropriate audit methodology.

Monitoring

3.21 Monitoring of quality control refers to the compliance work done by the accounting entities internally to ensure that their systems of quality control are relevant, adequate, operating effectively and are complied with in practice.

3.22 ACRA observed that the scope of internal monitoring programmes varies across accounting entities. The large accounting entities reviewed, in addition to being subjected to periodic international quality control reviews mandated by their global firms, are putting in place local or regional post-issuance reviews of audit engagements to supplement the international reviews.

3.23 For some of the accounting entities reviewed, ACRA is not in a position to evaluate the robustness or effectiveness of their internal quality monitoring processes. This is because the accounting entities reviewed were not able to make available to ACRA copies of their internal review reports due to the destruction of the reports in accordance with the accounting entities' global document retention policies. Accounting entities should understand that ACRA's capacity to rely on their systems of quality control will be adversely affected unless ACRA is in a position to consider the results of their own quality monitoring processes.

3.24 ACRA also identified a number of improvements needed in the internal monitoring programmes of the accounting entities reviewed, including:

- higher degree of transparency in the reporting of results to senior management and partners in relevant decision-making roles;
- more timely follow up, and communication of the results of internal reviews to partners and staff;
- clearer accountability for the monitoring programmes; and
- stronger linkage of the results of the internal reviews with the performance evaluations of partners and staff.

FOUR - INSPECTIONS OF PUBLIC ACCOUNTANTS CARRYING OUT PUBLIC INTEREST ENTITY AUDITS - ENGAGEMENT REVIEWS

4.1 In the audit engagement reviews conducted on the files of individual public accountants, ACRA assesses the work of the public accountants in planning, supervising, conducting and completing the audit engagements in accordance with the auditing standards required of the profession.

4.2 Among the many issues identified by ACRA in the course of the public accountant engagement reviews, ACRA has selected for consideration by the profession the more prevalent and significant areas of concern. These areas can be classified under the following broad headings:

- consideration of fraud risk;
- assessment of the work of another auditor;
- follow-up work from the issuance of group audit instructions; and
- business combination and impairment of assets

Consideration of fraud risk

4.3 Singapore Standard on Auditing (SSA) 240 requires the auditor to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, including misstatements caused by fraud. The risk of non-detection by the auditor is likely to be higher for misstatements caused by fraud than for misstatements caused by error, since fraud usually involves deliberate concealment and may involve collusion with third parties. The auditor should, therefore,

assess risks and apply procedures directed specifically at the detection of material, fraudulent misstatements of the financial statements

4.4 To determine a client's fraud risk, an auditor should make enquiries of management, parties charged with governance and others as appropriate, and document the engagement team's discussion about the susceptibility of the entity's financial statements to material misstatements due to error or fraud. Such discussions and assessments should be documented in the engagement files. These steps are required by SSA 240 and SSA 315.

4.5 In some of the audit engagement files reviewed by ACRA, the following weaknesses were noted in the approaches taken by public accountants:

- Complete reliance was placed on management representations without independent audit procedures;
- There was no discussion or no documented discussion among members of the engagement team regarding the financial statements' susceptibility to material misstatement due to fraud or error; and
- Audit procedures designed to respond to the risk of management override of controls were inadequate and/or inappropriate.

Assessment of the work of another auditor

4.6 When planning to use the work of another auditor, including an affiliated firm, a principal auditor should consider the other auditor's

professional competence in the context of the specific assignment. Likewise, before relying on the other auditor's work, a principal auditor should perform procedures to obtain sufficient appropriate audit evidence that the other auditor's work is adequate for the principal auditor's purposes in the context of the specific assignment. These requirements are set out in SSA 600.

4.7 Some observations made by ACRA in this area include the following:

- Failure to obtain independence confirmations from the auditor of an overseas subsidiary; and
- Insufficient consideration of the professional competence of an auditor of an overseas subsidiary.

4.8 The fact that the other auditor is a member of the principal auditor's international network does not in itself negate the need for the principal auditor to give appropriate consideration to the other auditor's competency and adequacy of the work done. While the use of common methodologies and cumulative knowledge built up over the years are helpful indicators of competence, these alone are not sufficient.

4.9 When considering the other auditor's professional competence, and especially before concluding it is unnecessary to apply procedures to obtain sufficient appropriate audit evidence that the work of the other auditor is adequate, the principal auditor should have sufficient evidence to satisfy himself or herself that the other auditor's work is adequate, especially in key risk areas of the audit engagement.

Follow-up work from the issuance of group audit instructions

4.10 In a group audit, the principal auditor should perform procedures to obtain sufficient appropriate audit evidence that the work of the other auditor is adequate for the principal auditor's purposes in the context of the specific assignment. This includes following up on issues that arise in relation to the work of another auditor.

4.11 In some cases noted in the PMP reviews, public accountants did not undertake proper follow-up procedures. Examples include:

- incomplete receipt of audit reporting deliverables such as certificate of independence, key issues memorandum, reporting packages and signed financial statements for entities within the group structure;
- outstanding items reported by the other auditors in the group audit questionnaire and in the key issues memorandum not followed through by the principal auditor; and
- reconciliations of differences between foreign GAAP (used by the other entities within the group) and Singapore's Financial Reporting Standards either not performed or not fully carried out.

Business combinations and impairment of assets

4.12 When auditing any business combination, the auditor should determine whether the transaction was accounted for in accordance with the Singapore Financial Reporting Standards, including whether:

- (a) measurement of the cost of business combination was appropriate; and
- (b) the purchase price was allocated appropriately (based on fair values as the date of acquisition) to the individual acquired assets (tangible and identifiable intangible) and liabilities assumed, with any excess purchase price designated as goodwill

4.13 ACRA noted a few instances in which adequate audit procedures were not performed, including the following:

- Inadequate assessment/failure to assess the competency and objectivity of the person(s) performing the purchase price allocation exercise;
- Inadequate assessment/failure to test the allocation of the purchase price and the reasonableness of the fair values assigned to the assets acquired and assumed liabilities; and
- Inadequate assessment/failure to review management's impairment assessment for goodwill and other intangibles with indefinite useful lives.

FIVE - INSPECTIONS OF PUBLIC ACCOUNTANTS CARRYING OUT NON-PUBLIC ENTITIES – ENGAGEMENT REVIEWS

5.1 ACRA’s PMP observations arising from engagement reviews of public accountants in accounting entities that do not audit public interest entities tend to be more diverse than those arising from reviews of public accountants in firms that do audit public interest entities. Many of the former observations are similar to those reported in last year’s PMP Annual Report.

5.2 In selecting issues for inclusion in this section, ACRA has focused on the more significant issues. The areas highlighted in this year’s report are as follows:

- no/inadequate documentation of audit procedures;
- audit procedures carried out that do not meet the audit objectives;
- no/inadequate assessment of functional currency;
- inadequate consideration of related party transactions;
- inadequate use of analytical procedures;
- failure to adequately address going concern considerations; and
- other fundamental lapses.

5.3 SSAs require the documentation of all work that is important in providing evidence to support the audit opinion. ACRA noted many instances in which documentation improvements were required.

5.4 Many of the deficiencies found relate to a failure to document in the

audit files key audit work performed or considerations taken into account by the auditor and relied on in forming his/her conclusions concerning relevant audit assertions. In such instances, it can be difficult for another auditor (termed as “experienced auditor” in SSA 230) to determine how the audit opinion was formed. Ordinarily, oral explanations on their own do not represent adequate support for the work performed or conclusions reached, although they may be used to explain or clarify other information contained in the audit documentation. Timely audit documentation helps to facilitate the effective review and evaluation of audit evidence obtained and conclusions reached before the audit report is issued. Failing to comply with documentation requirements may increase the risk that the audit work was not adequately performed and that the conclusions reached were not appropriate.

5.5 Audit objectives guide the audit engagement members in understanding and scoping the audit procedures to be carried out. Where audit objectives are not clearly stated, inadequate or incorrect audit procedures can be a consequence.

5.6 Deficiencies noted from the reviews of some public accountants suggest that the audit work did not meet the intended audit objectives. For example:

- Confirmations of trade receivable balances carried out to address the existence assertion were used also to assess recoverability (i.e. valuation assertion); and

- Internally generated documents (e.g. sales invoices) were vouched to test for details of revenue and cost of sales instead of using external documents (e.g. acknowledged delivery orders).

5.7 When exceptions are found in the course of carrying out audit procedures, follow-up procedures should be carried out to resolve each of the exceptions noted. ACRA identified many instances in which proper follow-up procedures were not carried out to explain the exceptions noted. Unresolved exceptions included:

- differences in quantities between physical counts and inventory listings;
- samples where the costs of inventories were higher than the related net realisable values; and
- accounts receivable and payable confirmations received with discrepancies noted.

5.8 Additionally, when exceptions are noted in the sample tests, the public accountant should make an assessment and perform additional procedures to obtain the necessary level of assurance. In the files reviewed, this was frequently not done.

5.9 SSA 500.2 requires the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion.

5.10 Whilst it is the responsibility of the management of the client to assess and determine the appropriate functional currency of the entity, the public accountant should critically review and assess the appropriateness of the functional currency selected by the client, taking into account the requirements of FRS 21.9 and FRS 21.14.

5.11 In some of the files reviewed, the public accountant did not assess whether the functional currency determined by management was in compliance with FRS 21. Complete reliance was placed on management representations and no independent audit procedures were carried out.

5.12 In planning the audit, public accountants should perform procedures designed to obtain sufficient appropriate audit evidence regarding the identification and disclosure by management of related parties and the effect of related party transactions that are material to the financial statements. This is important because the existence of related parties or related party transactions may affect the financial statements, and a related party transaction may be motivated by other than legitimate business considerations, for example, inappropriate profit sharing or even fraud.

5.13 ACRA has observed deficiencies relating to:

- Failure to understand and test the nature, economic substance and business rationales of transactions with related parties;
- No or inadequate audit procedures performed to verify both the validity and accuracy of related party transactions and balances outstanding; and

- Failure to identify and address the lack of financial statement disclosure of related party transactions.

5.14 SSA 520 states that “the auditor should apply analytical procedures as risk assessment procedures to obtain an understanding of the entity and its environment and in the overall review at the end of the audit. Analytical procedures may also be applied as substantive procedures”. ACRA noted many instances of either inadequate or inappropriate use of analytical procedures by the public accountants in their audit work.

5.15 In performing such procedures, the auditor should consider what relationships might reasonably be expected to exist. In many of the cases reviewed, ACRA noted that such expectations were not considered in advance, disaggregated data and information were not used, and explanations from the client were not corroborated with other audit evidence.

5.16 Public accountants have a responsibility to evaluate whether there is substantial doubt about the entity’s ability to continue as a going concern. ACRA noted that in a number of files reviewed, no evaluation was performed or the evaluation was superficial and inadequate. This evaluation is crucial as the going concern assumption is a fundamental principle in the preparation of financial statements.

5.17 ACRA noted that some public accountants failed to perform, or did not adequately perform the following procedures:

- Identify or evaluate the significance of conditions indicating that an entity may not be able to continue as a going concern, such as cumulative losses since incorporation, negative operating cash flows, and net liability/net current liability positions;
- Evaluate management's plan to mitigate the effects of such adverse indicators, and/or obtain information about the likelihood that such plans could be implemented effectively; and
- Evaluate the adequacy of the financial statements' disclosure of the going concern conditions and management's plan to mitigate them.

5.18 As highlighted in last year's PMP report, ACRA continued to observe certain fundamental lapses in the audit work. Some of the examples are:

Planning

- No planning and risk assessment performed;
- No documentation of discussion regarding susceptibility of financial statements to material misstatements due to fraud and error;
- Audit engagement letters not updated in light of changed circumstances;

Circularisation

- No or inadequate alternative procedures performed to address non-responses or responses with exceptions;
- No validation of the source of replies received in electronic form (for example, faxed or email confirmation responses);

Inventories

- Non attendance at the entity's inventory count exercise;
- Test counts performed only one way instead of both ways (i.e. from list to floor and from floor to list) so as to address both the existence and completeness assertions;
- Where a physical count was performed on a date other than the year-end date, no work done to test the roll forward or roll back of the physical count quantities to year end quantities in order to ensure that changes between the two dates were correctly recorded;
- No work performed to investigate differences between quantities on actual test counts and final inventory lists;
- Inadequate work done to test costing of inventories in accordance with the entity's accounting policy;
- Inadequate work done to ensure that inventories were stated at the lower of cost and net realisable value;
- No assessment of allowance for inventory obsolescence;

Trade and other receivables

- No or inadequate work performed on recoverability of trade and other receivables, including intercompany balances;
- Credit notes review not performed;

Trade and other payables, provisions

- No work done to search for unrecorded liabilities;
- Non-existence of present obligations (legal or constructive) for provisions made;

Profit and loss

- No work done on sales and purchase cut-off;
- Sales cut-off/purchase cut-off performed using sales invoices/suppliers' invoices as a reference point;

General

- Subsequent events review not performed, or not updated up to the date of the auditor's report;
- Failure to ensure that management representation letters includes management's acknowledgement of its responsibility for the design and implementation of internal control to prevent and detect error;
- Failure to detect or address inadequate financial statement disclosures in such areas as breakdowns of other operating expenses and income; key management personnel compensation; reconciliation of the carrying amounts of fixed assets at the beginning of a period and the end of a prior period; break-downs of foreign-denominated financial assets and liabilities; reason for and nature of restated comparative figures.

5.19 Other significant observations made by ACRA in its reviews of public accountants included:

- The challenge of handling a large number of audit engagements with limited resources; and
- Lack of clarity as to the responsibility of public accountants in relation to the audit opinion issued.

5.20 In the course of the PMP reviews carried out over the last year, ACRA observed that a “resource crunch” affected all accounting practices to at least some extent, but often posed the most severe challenge for small practices, in particular sole-proprietorships. In a typical sole-proprietorship, the public accountant has responsibility for the audits of a significant number of entities and is supported by a couple of audit assistants. There is often a disparity between workloads and resources that can threaten the quality of audit work undertaken by the public accountants.

5.21 In performing an audit, a public accountant provides users of financial statements with an independent professional opinion on the representations of management reflected in the financial statements. SSA 200 stipulates that “the objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework”. The glossary of terms for SSA’s defines “auditor” as the person with final responsibility for the audit.

5.22 SSA 220 stipulates that “the engagement partner should take responsibility for the direction, supervision and performance of the audit engagement in compliance with professional standards and regulatory and legal requirements, and for the auditor’s report that is issued to be appropriate in the circumstances.” Before the auditor’s report is issued, the public accountant, through review of the audit documentation and discussion with his/her engagement team, should be satisfied that sufficient appropriate

audit evidence has been obtained to support the conclusions reached and the auditor's report that is to be issued.

5.23 ACRA was concerned to find cases, albeit isolated ones, where the public accountant tended to view his/her prime responsibility as the high level supervision of the audit staff and was overly reliant on the staff for the performance of audit work including the conclusions supporting the professional opinion expressed in the auditor's report.

SIX - CONCLUSION

6.1 ACRA has issued this report to highlight areas that require the attention and focus of the profession in order to enhance audit quality in Singapore. Accounting entities, however, should not assume that the areas and issues noted in this report are the only areas requiring attention. Each accounting entity should, in the course of monitoring its own performance, identify and address any specific impediments to compliance with the professional standards. Accounting entities should also continually stress the critical need to conduct all aspects of their audits with due care and professional scepticism.

6.2 Going forward, the PMP will continue to cover all public accountants, using a risk-based approach and with a continuing emphasis on standards for engagement quality control reviews and quality monitoring.



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