



PRACTICE MONITORING PROGRAMME

THIRD PUBLIC REPORT

August 2009

The Accounting and Corporate Regulatory Authority (ACRA) is the national regulator of business entities and public accountants in Singapore. ACRA also plays the role of a facilitator for the development of business entities and the public accountancy profession. The mission of ACRA is to provide a responsive and trusted regulatory environment for businesses and public accountants.

Published August 2009

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EXECUTIVE SUMMARY

- 1.1 Through the provision of audit reports and other assurance services, Singapore's public accountancy profession plays a key fiduciary role in preserving and strengthening confidence in Singapore's business and financial markets. The profession must therefore aim for the highest professional standards to uphold Singapore's reputation as an international financial and business centre.
- 1.2 ACRA carries out rigorous regulatory oversight of the public accountancy profession to safeguard the public interest and to provide a strong basis for confidence in the quality of Singapore's audit reports and corporate financial information. To reinforce this basis, ACRA benchmarks its regulatory work with international regulatory practices and standards.
- 1.3 A visible commitment to audit quality from the profession, and from ACRA as the independent regulator, is critical to local and international confidence in Singapore's audited financial reports. To this end, ACRA publishes this annual Practice Monitoring Programme (PMP) Public Report.
- 1.4 This year's report is published during a challenging time for the corporate governance community, including auditors. In response, Auditors have lifted their professional scepticism, extended audit procedures and identified key concerns in financial statement audits.

- 1.5 Singapore's financial statement audit market has two broad segments: audits of listed and other public interest entities¹ (PIEs) and audits of non-PIEs. As the two segments have different challenges and stakeholders, this Report deals with each segment separately.
- 1.6 Overall, ACRA has found that most of the audit procedures and work it has reviewed has met regulatory expectations. However, in both segments, but to different degrees, ACRA has identified key performance gaps and systemic threats to audit quality. The profession needs to work on these issues as individual practitioners, as firms and as a profession. Improvement is needed before ACRA can regard the situation as satisfactory.
- 1.7 In common with its international peer regulators, ACRA's oversight is becoming more rigorous but also more targeted and risk based. Therefore the observations in this report, while of concern, also reflect a rigorous approach and a high benchmark tied to the need to maintain a high degree of confidence in the financial information that underpins Singapore's markets.
- 1.8 In public accountancy firms that audit PIEs (PIE firms), the internal quality control system at the firm level is a key determinant of audit quality. Thus for PIE firms, ACRA's review places its strongest emphasis on the quality and effective implementation of the firm's policies and quality controls which influence the overall effectiveness of the audit process. ACRA further

¹ PIEs include companies listed on the Singapore Stock Exchange (SGX), or intending to list on the SGX, companies in regulated industries such as banks and insurance companies, and other entities that raise funds from the public such as charities.

extends its reviews to individual audit engagements to ensure compliance with standards.

1.9 ACRA has found that the quality of policies, controls, and auditing in the reviewed PIE firms and audit engagements was for the most part acceptable. However, for nearly all reviewed firms, ACRA has identified a need for important improvements. Whilst over the past two years the PIEs segment has made progress in addressing key gaps identified, ACRA has advised the PIE firms to make further improvements particularly in the following four areas:

- (a) A need to strengthen involvement by experienced auditors in key audit areas;
- (b) A need for greater rigor in the exercise of professional scepticism in the conduct of audits;
- (c) A need for a more diligent and rigorous approach to tests for existence of assets and liabilities such as accounts receivable and accounts payable; and
- (d) A need to improve the effectiveness of internal monitoring programmes.

1.10 In the non-PIE segment, which comprises mostly sole-proprietorships or firms with two to four partners, a detailed review of a public accountant's individual audit engagement files is viewed as the best way to monitor audit quality.

- 1.11 As the PMP in the non-PIE segment has progressed, the reviews have continued to find a broad range of weaknesses. While there has been some progress in addressing previously reported findings, there were still recurring findings in certain basic audit areas. This trend highlights the systemic impediments the segment faces in the conduct of high quality audits. ACRA considers quality in some areas to be unsatisfactory and is concerned that the professionals in the smaller practices segment are struggling to keep up with increasing demands imposed by the changing audit environment.
- 1.12 The key systemic impediments would include the challenges the segment faces in attracting qualified audit staff, providing for adequate supervision and involvement by the public accountants responsible for the audit, as well as getting access to technical resources. These challenges may be related to the prevalent operating model of small audit firms in the segment, where the majority of the practices are one-partner setups, staffed with very junior officers, and which operate on a high volume/low fee practice model. Such a practice model would pose tremendous challenges to a public accountant in terms of devoting adequate time and resources to ensuring high quality audit.
- 1.13 ACRA will continue to work closely with the profession, including the Institute of Certified Public Accountants of Singapore (ICPAS), to address the key findings identified from the PMP to raise the overall quality of the Singapore profession in its work as statutory auditors. In carrying out its regulatory function, ACRA will continue to take firm regulatory actions to ensure that the Singapore public accountancy profession continues to uphold

the highest professional standards and quality in its work as statutory auditors.

OVERVIEW

2.1 Strong corporate governance and a trusted business environment are key hallmarks of Singapore's reputation as an international financial and business centre. Through the provision of audit and other assurance services, Singapore's public accountancy profession plays a key fiduciary role in preserving and strengthening public confidence and trust in Singapore's business and financial markets. Singapore's public accountancy profession must therefore strive to achieve the highest professional standards so that Singapore can maintain and enhance its reputation as an international financial and business centre.

Rigorous Audit Regulatory Regime Benchmarked to International Standards

2.2 To safeguard the interests of the public and investors in the work of Singapore's statutory auditors, ACRA carries out rigorous regulatory oversight of the public accountancy profession that is benchmarked to international regulatory practices and standards. ACRA is a founding member of the International Forum of Independent Audit Regulators (IFIAR) established in 2006 and has participated in various IFIAR audit inspection workshops on international best practices in audit inspection methodology and processes. ACRA has conducted joint audit inspections with its US counterpart, the US Public Company Accounting Oversight Board (PCAOB), on Singapore audit firms that are registered in both Singapore and the US. ACRA has also been elected to the six-member Advisory Council of IFIAR in October 2008 to assist and advise IFIAR's office bearers.

Objectives of the Annual PMP Public Report

- 2.3 The objective of ACRA's audit regulatory work is to ensure that the public and the investor community have a strong basis for confidence in the quality of Singapore's audit reports and corporate financial information. A visible commitment to audit quality from the profession, and from ACRA as the independent audit regulator, is critical to strong local and international confidence in Singapore's audited financial information. To this end, ACRA publishes this Annual PMP Public Report. The Report is intended to promote an understanding of ACRA's work and the results ACRA is seeking to achieve. This Report, ACRA's third, communicates key regulatory assessments of the Singapore public accountancy profession, with the ultimate objective of helping to ensure that the work of the Singapore profession meets the highest international professional standards.
- 2.4 This year's report is published during a challenging time for the corporate governance community, including auditors. The financial year of 2008/2009 has been marked by the difficult economic climate that has contributed to heightened risks in the corporate financial reporting and auditing environment. In response, the Singapore public accountancy profession raised its level of professional scepticism, extended audit procedures and identified key issues of concern in the audits of financial statements.

ACRA's Audit Regulatory Regime

- 2.5 ACRA takes a proactive approach to the regulatory oversight of Singapore's auditors. One of ACRA's key regulatory activities is to carry out regular

and cyclical reviews of public accountancy firms and public accountants registered with ACRA. ACRA also closely monitors events and carries out other regulatory oversight activities on the work and independence of statutory auditors when required. The Public Accountants Oversight Committee (PAOC), established by ACRA under the Accountant's Act, is empowered to take action in response to the outcomes of PMP reviews carried out by ACRA inspectors. For example, the PAOC requires public accountants who have failed to meet the expected professional standards to take necessary remedial actions. When warranted, the PAOC issues orders to protect the public interest by restricting a public accountant's practice. The Appendix to this Report describes the main orders that may result from a PMP review.

- 2.6 At the conclusion of its inspections ACRA advises public accountants and accounting entities of areas that ACRA expects to be improved. ACRA also monitors common findings and the overall standard across the profession. This Report includes the most important and common of these issues.
- 2.7 For a more detailed description of ACRA's PMP, please refer to ACRA's PMP Public Report 2007, which is available together with the 2008 Report, at www.acra.gov.sg.

Context of Findings

- 2.8 ACRA's inspection methodologies have been evolving, in common with those of its IFIAR peers. ACRA's oversight of the profession is becoming more rigorous but also more targeted and risk based. Therefore the

observations in this report, while of concern, reflect a rigorous approach and a high benchmark tied to the need to maintain a high degree of confidence in the financial information that underpins Singapore's markets.

- 2.9 In presenting the specific findings in this report, efforts have been made to provide as much of the context as possible under which these findings arose in the PMP. The findings should not be read in isolation or regarded as creating mandatory rules in addition to the auditing standards. Public accountants should read and review the applicability and severity of each of the findings in the broader context of upholding the profession's standards and in careful consideration of the uniqueness of actual situations for individual engagements.

Overall Findings

- 2.10 Singapore's financial statement audit market can be divided broadly into two segments: audits of PIEs and audits of non-PIE entities. This Report deals with each segment separately as the two segments have different challenges and stakeholders.
- 2.11 Overall, ACRA has found that most of the audit procedures and work that it has reviewed has met regulatory expectations. However, in both segments, but to different degrees, ACRA has identified key performance gaps and systemic threats to audit quality that the profession will need to work on as individual practitioners, as firms and as a profession. Improvement is needed in these areas before ACRA can regard the situation as satisfactory.

2.12 ACRA will continue to work closely with the profession, including the Institute of Certified Public Accountants of Singapore (ICPAS), to raise the overall quality of the Singapore profession in its work as statutory auditors. In carrying out its regulatory function, ACRA will not hesitate to take firm regulatory actions against public accountants who fail to uphold professional standards and quality in their work.

AUDITS OF PUBLIC INTEREST ENTITIES

- 3.1 Singapore's PIEs are audited by twenty public accountancy firms (referred to hereinafter as PIE firms). As at 31 December 2008, six PIE firms had more than thirty PIE clients each and fourteen PIE firms audited the remainder. This report covers PIE firms reviewed in the period from 1 April 2008 to 31 March 2009.
- 3.2 The internal quality control system at the firm level is a key determinant of audit quality for the PIE firms. ACRA's review of PIE firms therefore places its strongest emphasis on the quality and effective implementation of the firm's policies and quality controls which influence the overall effectiveness of the audit process. ACRA further extends its inspections to individual audit engagements to ensure compliance with professional and auditing standards.
- 3.3 At the conclusion of each inspection, ACRA advises the public accountants and PIE firms of areas that ACRA expects to be improved. This Report covers the most important and common findings faced by the PIE firms. The following two sections highlight the key regulatory findings identified at the audit firm level and at the individual audit engagements level respectively.

Key Observations: Firm Level Reviews in the Public Interest Entities Segment

- 3.4 The quality of policies, controls and auditing in the reviewed PIE firms and audit engagements for the most part met ACRA's expectations, but for nearly all firms, important improvements have been identified and need to be

implemented. Whilst the PIE segment has made progress in addressing issues identified by ACRA over the past two years, ACRA still has concerns in four broad areas where further improvements are needed by the PIE firms:

- (a) Dedicating sufficiently experienced and adequately staffed audit teams to audit engagements;**
- (b) Exercising professional scepticism;**
- (c) Taking a more diligent and rigorous approach to tests for the existence of assets and liabilities such as accounts receivable and accounts payable; and**
- (d) Improving the effectiveness of internal monitoring programmes.**

(a) *Involvement of Experienced Auditors*

3.5 Audit quality is closely linked to the experience and maturity of the audit team. The audit team's experience level needs to be suitable for each engagement. Experienced personnel, especially partners, must be intimately involved at all stages of the audit process from planning through to completion to ensure that the necessary business and industry knowledge is brought to bear on each engagement and the work of the less experienced staff members is carefully supervised and reviewed.

3.6 The level and nature of experience required in an audit engagement may depend on a number of factors, such as the PIE client's risk profile and complexity, and the audit team's overall competence, industry knowledge and experience.

- 3.7 ACRA observed that for many of the reviewed audit engagements, the general level of experience of the responsible audit team was not fully satisfactory. Some significant audit procedures, including those important in the detection of management override and fraud, were on many occasion found to be carried out by relatively junior staff members accompanied by less than adequate supervision from the audit partners and managers.
- 3.8 The involvement of engagement and concurring partners needs immediate attention and improvement across the profession. On average, only one to two percent of the total audit time was charged by the engagement partner and there was frequently a near zero level of concurring partner time charged to the engagement. A common explanation by the public accountants who had recorded low levels of time on an audit was that they did not record and charge all of the time they spent on the engagement. However, in most cases, the public accountants had little observable evidence to substantiate their claims, for example through evidence of involvement in the reviewed areas. The low level of partner involvement was reflected in various reviewed areas. Audit procedures that required experience and judgement were carried out either without partner involvement or by less experienced staff with little or no supervision. For example, in many audit engagements, ACRA found no sufficient evidence to substantiate adequate involvement by experienced staff in team planning meetings, team discussions on fraud risk assessment and the review and testing of journal entries.

(b) *Application of Professional Scepticism*

3.9 Professional scepticism requires a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud and a critical assessment of audit evidence without being obsessively suspicious or negative. It must be based on a thoughtful and knowledgeable assessment of what could go wrong in the financial reporting of corporations. The auditor should ask probing questions, critically analyse answers and diligently compare the results of this analysis with other evidence. Through its inspections, ACRA has observed three important areas where professional scepticism could be improved:

(i) *Audit of Management Estimates and Assumptions*

3.10 Applying professional scepticism to management estimates and assumptions is one of an auditor's most important tasks. Auditors should critically identify and assess the estimates and assumptions provided by management to ensure that they can stand up to scrutiny and are not inconsistent with the auditor's general understanding of the PIE and other corroborative evidence. Audit teams should be prepared to challenge management and require independent assessments when there are differing views.

3.11 ACRA found instances in which the auditors did not sufficiently test or challenge management's forecasts, views or representations and estimates in relation to:

- Impairment losses to reduce the trade receivables and inventory to their estimated realisable values;
- Goodwill impairment assessment;
- Going concern considerations;
- Identification of related parties; and
- Client acceptance and continuance considerations such as integrity of client, including client's principal owners, key management, related parties and those charged with corporate governance.

3.12 Public accountants should refer to the relevant auditing standard, SSA 540 *Audit of Accounting Estimates* for the principles and essential procedures in relation to audit of accounting estimates.

(ii) Audit of Related Parties Balances and Transactions

3.13 ACRA found cases of insufficient professional scepticism applied in the audit of related parties balances and transactions. Auditors should ensure the completeness of information on related parties including extending their enquiries to the PIE's shareholders (who may have joint and separate business interests that are related parties). Auditors should not take at face value, lists of related parties identified by management, without ascertaining the completeness of the lists or performing additional procedures to support their audit assertions. For example, for listed PIEs, auditors may consider verifying the list of identified related parties list against the interested persons transaction list available from the national exchange as a source of audit evidence to check for completeness of management representations.

3.14 ACRA's findings suggest a tendency for auditors to take the list of related parties provided by management at face value without questioning or challenging the completeness of the list and not performing additional procedures when circumstances called for further work. Further, there were cases where the auditors relied too much on management to provide information about the identity of related parties.

3.15 There were several instances where the reviewers noted that the work on identification of related parties was limited to inquiries with management, review of board minutes and resolutions, and enquiries/discussions at audit committee meetings. In many of these instances, other than identification of the holding company, subsidiaries and associated and joint venture companies, there was inadequate work to ensure that there were no undetected related parties, that is, completeness of related parties transactions. For example, the company's directors and/or substantial shareholders might have interests in other entities outside of the client group. SSA 550 *Related Parties* sets out the standards required in relation to related parties transactions.

(iii) Representations by Management

3.16 Management representations can support but cannot substitute for the audit evidence on which the auditor bases his opinion. Management representations do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal with. The fact that management has provided reliable representations does not affect the nature

or extent of other audit evidence that the auditor is required to obtain about such matters.

3.17 SSA 580 *Management Representations* provides that when (management) representations relate to matters which are material to the financial statements, the auditor will need to:

- Seek corroborative audit evidence from sources inside or outside the entity;
- Evaluate whether the representations made by management appear reasonable and consistent with other audit evidence obtained, including other representations; and
- Consider whether the individuals making the representations can be expected to be well informed on the particular matters.

3.18 Where management representations are required for important matters, executed written representations should be obtained to support and corroborate other audit evidence obtained. A request for written, rather than oral representations in many cases may prompt management to consider such matters more rigorously, thereby enhancing the quality of representations. ACRA found that reliance on representations by management was common in audit areas relating to management estimates and assumptions and related parties balances and transactions.

(c) *Taking a More Diligent and Rigorous Approach to Tests for Existence of Assets and Liabilities, such as Accounts Receivable and Accounts Payable*

3.19 Auditing standards generally require that external evidence be obtained to test for the existence of assets and liabilities, such as accounts receivable and accounts payable, to reduce audit risk to an acceptably low level. In the case of accounts receivable and accounts payable, the highest quality evidence of existence is provided by external confirmations of balances by debtors and creditors.

3.20 The procedures required to obtain this external evidence are often detailed and time-consuming. In the case of external confirmations, they require constant follow up and the use of robust alternative procedures when confirmations are not received. The need for such actions can pose special challenges to auditors, especially when there are internal and external pressures to keep audit costs under control and meet tight audit deadlines. ACRA has observed instances where PIE auditors have not been fully diligent when carrying out such procedures.

3.21 Examples of sub-standard audit work observed in the areas of accounts receivable and payable confirmations include:

- Use of a sample selected for one audit procedure to support a second audit procedure, for which the sample design may not have been appropriate;

- Failing to reconcile differences and/or to verify reconciling items between the balances in the clients' records and balances confirmed by customers;
- Insufficient professional scepticism regarding faxed replies to confirmation requests, resulting in no efforts to authenticate the replies;
- Using sub-standard alternative procedures when confirmations were not received (testing to internal evidence such as sales invoices rather than to external evidence such as signed delivery slips); and
- Failure to carry out alternative procedures for all balances not confirmed or for the full amount of such balances, resulting in "samples of samples".

3.22 In assessing the results and evidence obtained from the confirmation process, the auditor should consider the:

- Reliability of the confirmations, and also the effectiveness of the alternative audit procedures; and
- Nature of any exceptions, including the implications (both quantitative and qualitative) of those exceptions. These considerations shall include the causes and frequency of exceptions.

3.23 Further, the overall results of the confirmation process, including whether there has been a satisfactory response rate, whether inaccuracies have been revealed by the confirmation process and whether the alternative procedures carried out produced satisfactory results, should be evaluated to consider whether the necessary degree of assurance regarding the existence of the

entire account balance has been obtained. Where not obtained, the auditor is then expected to consider what further tests he should execute in order to satisfy himself that the account balance, taken as a whole, is fairly stated.

(d) *Effectiveness of Internal Monitoring Programmes*

3.24 Most firms have various monitoring programmes, ranging from triennial international network firm reviews to internal pre-issue and/or post-issue reviews. ACRA has observed a wide range of practices across the PIE firms, with some firms almost entirely dependent on the triennial review and others supplementing the review with additional monitoring initiatives. Generally, ACRA would regard a firm's internal monitoring programme, in which the only quality control check on a partner's work is a file review every three years, to be unsatisfactory, particularly in cases where the effectiveness of the concurring partner review is suspect. In some instances, firms were also unable to demonstrate to ACRA that there was a commitment to ensure timely, concrete and comprehensive follow up on the observations and results from these programmes. In a few instances, ACRA observed that firms could not demonstrate sufficient knowledge and understanding of the lapses identified in the firm's internal reviews to effectively remedy the weaknesses.

Key Observations: Engagement Reviews in the Public Interest Entities Segment

(a) Using the Work of Other Auditors

- 3.25 Singapore's public accountants often use the work of auditors in foreign jurisdictions when they act as principal auditors for clients with substantial foreign subsidiaries/operations. In many cases, the subsidiary auditors are from the same international network of firms as the principal auditor.
- 3.26 Principal auditors should determine the professional competency of the subsidiary auditor before reliance is placed on its work. This must be done regardless of whether the subsidiary auditor is part of the same international network of firms. The competence and audit quality of a network counterpart firm cannot be a presumption based on the other auditor's membership in the same international network as the principal auditor.
- 3.27 Principal auditors should ensure that major audit risk areas are discussed with the subsidiary auditor, including special country risk factors arising from business practices in the country in which the subsidiary operates. Principal auditors should also ensure that, in most cases, a review of the subsidiary auditor's working papers is conducted, with attention paid to higher risk areas and the appropriateness of the audit procedures carried out to address the higher level of risk.
- 3.28 ACRA's general observation is that the PIE firms need to pay further attention to and make improvements in this area. It is noted that the planned

revisions to SSA 600 *Using the Work of Another Auditor* will make the requirements for the principal auditors clearer.

(b) *Risk assessment including fraud risk considerations*

3.29 Auditors have a duty to identify and assess the risk of material misstatement, whether due to fraud or error, at the financial statements and assertion levels.

3.30 In its review of engagement files, ACRA observed that auditors generally identified few fraud risk factors, other than the presumed risk of fraud relating to revenue recognition in an audit engagement. From ACRA's reviews of audit working papers, it has been noted that the fraud risk factors identified have tended to be generic (for example, "revenue recognition") and on many occasions, may not demonstrate a deep, intuitive knowledge of the business or any efforts to develop scenarios as to how fraud or material misstatement could occur. The number and nature of fraud risk factors necessarily depends on the circumstances of each audit engagement. ACRA is concerned that fraud risk discussions and assessments could be regarded as a mere formality, with a lack of thoughtful deliberation by the engagement team. This was especially evident in reviewed engagements where audit plans, which cover fraud risk assessments, were drawn up by less experienced staff without much partner involvement. It is important for auditors to identify and consider relevant risk factors because such risk assessments form the basis for audit strategies and the design of audit procedures. In light of the current economic climate, fraud cases are already surfacing, and it is inevitable that fraud risk will continue to increase. ACRA expects the profession to be vigilant in identifying potential fraud

risks and ensuring that audit procedures are appropriately enhanced to address those risks.

The Impact of Audit Fee Constraints

- 3.31 Common feedback ACRA receives from the profession is that the level of audit fees paid in Singapore is an important factor influencing audit quality. It has been put forth to ACRA that by comparison with other international financial centres, including Hong Kong, audit fees in Singapore appear to be low. It has been further represented that low audit fees can affect the quality of audit work, including the extent of involvement of more experienced and therefore more expensive staff.
- 3.32 In this area, ACRA considers that the profession and ICPAS can play a positive role in educating clients and their audit committees on the value and benefits of a quality audit in Singapore and other jurisdictions in which Singapore companies operate. ACRA believes this to be critical as Singapore companies continue to expand their footprints overseas.

AUDITS OF NON-PUBLIC INTEREST ENTITIES

Overview and Systemic Issues

- 4.1 Singapore has over 500 small public accounting entities (small practices). Most of these small practices are sole proprietorships and about one quarter have two to four partners. These small practices audit mostly small and medium private companies (SMEs) (PIE firms also audit SMEs). A detailed review of public accountants' individual files is viewed as the best way of monitoring audit quality in this segment.
- 4.2 While this segment is not referred to as a 'public interest' segment, this does not mean there is no public interest in the quality of auditing of SMEs. The accuracy of the financial information of Singapore's SMEs and the quality of their audit reports are also important to Singapore's commercial success and reputation. Furthermore, overall confidence in Singapore's auditing framework is best achieved when all public accountants contribute with consistent and high quality work.
- 4.3 As the PMP in this segment has progressed, the reviews have continued to reveal a broad range of weaknesses. While there has been some progress in addressing previously reported findings, ACRA continues to identify recurring findings in certain basic audit areas. This trend highlights the systemic impediments the segment faces in the conduct of high quality audits. ACRA considers quality in some areas to be unsatisfactory and is concerned that the smaller practices are struggling to keep up with increasing demands imposed by the changing audit environment.

- 4.4 ACRA urges the profession and ICPAS to address the systemic deficiencies challenging the small practices so that the segment can work towards decisive improvements in the overall quality of audit.
- 4.5 The key systemic challenges would include the challenges of operating as a small practice with one or two partners, which is the predominant structure in this segment. This is not to say that a small practice cannot be successful and of high quality, but rather that such practices need to address certain issues in order to achieve the expected level of quality.
- 4.6 The systemic issues include that, in this market segment, the balance between the desire for low costs, and the need to dedicate sufficient time and resources to perform audits to the required standards, appears to lean too far towards low fee levels than high quality. This may lead public accountants to adopt a high volume/low fees operating model. In turn a high volume/low fees model may lead to threats to audit quality such as a superficial level of professional supervision by partners. This can be exacerbated by a lack of depth in the quality and experience of staff in audit teams. ACRA considers that these challenges may contribute to the basic audit lapses repeated across the segment that have been identified in the inspection process.
- 4.7 Nevertheless, a public accountant must find ways of overcoming these difficulties to ensure that there are appropriate resources for each audit engagement, especially for identified audit risk areas. Staff members should be equipped with the relevant industry knowledge, right level of audit skills and where possible, there should be staff continuity for the engagement. A public accountant should provide adequate supervision to the less

experienced staff members and where required, be involved in areas that need seasoned judgment. It is the public accountant's prime responsibility to be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and the audit opinion issued.

- 4.8 Improving the overall standard of practice will not be achieved with 'quick fixes'. It will take some time and a concerted effort from the profession. Alongside this effort, it will be important for the business community to develop an appreciation of the value of quality audit work and not view an audit report as a mere statutory requirement. For this to occur, the profession and ICPAS will need to educate the business community on the risks posed by audits performed at unrealistically low costs and the benefits of high quality audit work.

Key Observations: Engagement Reviews in the Non-Public Interest Entities Segment

- 4.9 The findings described in this section are common and significant findings from the review of engagement files in the non-public interest entities segment.
- 4.10 This section gives particular emphasis to findings that are relevant to the current economic environment, which has presented financial reporting challenges to public interest and non-public interest entities alike. The public accounting profession should pay close attention to these areas. ACRA will pay particular attention to these areas in forthcoming reviews.

4.11 This section presents findings related to the following areas:

- (a) ***Planning and risk assessment:*** arising from reviewed engagements in which no planning and risk assessment was performed;
- (b) ***Existence and accuracy of revenue and trade receivables:*** arising from reviewed engagements in which no work was performed on establishing existence and accuracy of revenue and trade receivables;
- (c) ***Recoverability of receivables and assessment of inventories obsolescence and write-down:*** arising from reviewed engagements in which no work was performed on recoverability of trade and other receivables, including receivables from related parties such as directors and related companies as well as to ascertain the realisable value of inventories;
- (d) ***Other fundamental lapses:*** various other fundamental lapses found in audit engagement files; and
- (e) ***Findings relating to audits of industry-specific companies.***

4.12 The following paragraphs elaborate on these findings and set out ACRA's expectations. ACRA advises public accountants to take note of these findings and expects to see improvements as it progresses with the PMP.

(a) ***Planning and Risk Assessment***

4.13 Planning is an integral and important part of an audit. SSA 300 Planning an Audit of Financial Statements states that the auditor should establish the overall audit strategy for the audit. SSA 315 *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement* requires

the auditor to obtain an understanding of the entity and its environment that is sufficient to identify and assess the risks of material misstatement in the financial statements and sufficient to design and perform further audit procedures.

4.14 Adequate planning helps to ensure that appropriate attention is devoted to important areas of the audit and also that potential problems are identified and resolved on a timely basis. It also facilitates proper resource allocation based on the necessary capabilities and competence of staff and time required for the engagement. This enables public accountants to devote due audit focus and effort to areas with higher audit risk and to consider the appropriateness and sufficiency of audit procedures that need to be carried out to reduce audit risk to an acceptably low level.

4.15 ACRA noted engagement files that did not have audit plans that set out the audit strategy to assess the risks of material misstatement in the financial statements.

(b) *Existence and Accuracy of Revenue and Trade Receivables*

4.16 Inadequate audit work in the areas of revenue and receivables continue to be prevalent in the PMP findings in the non-PIE segment. ACRA noted cases where the audit work performed on revenue primarily consisted of vouching recorded sales to internally generated documents such as sales invoices. Use of internally generated documents is not sufficient. Vouching procedures should include verification to external documents such as customer acknowledged delivery orders and contracts.

- 4.17 In the area of trade receivables, ACRA found cases of public accountants who, in response to non-replies to circularisations of receivable balances, had undertaken inadequate or no alternative procedures. Carrying out alternative procedures is essential to provide audit evidence about the assertions that the confirmation request was intended to provide.
- 4.18 Public accountants should also refer to paragraphs 3.19 - 3.23 on *taking a more diligent and rigorous approach to tests for the existence of assets and liabilities such as accounts receivable and accounts payable*, in the section on audits of public interest entities.
- 4.19 It is particularly important for public accountants to take note of the findings on existence and accuracy of revenue and trade receivables because in the current financial reporting environment, there may be an increased risk of misstatement of revenue and receivables. Companies may be subject to undue pressures to meet expectations or bank covenant requirements. This may give rise to an increased risk of fraudulent reporting. This is especially so in the area of revenue recognition, which carries a presumed risk of fraud. Public accountants should also perform appropriate audit procedures on revenue cut-off to ascertain that revenue has been recorded in the correct accounting period.
- 4.20 As always, public accountants should approach this area with sufficient professional scepticism. SSA 240 The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements requires the auditor to maintain an attitude of professional scepticism throughout the audit, recognising the possibility that a material misstatement due to fraud could exist,

notwithstanding the auditor's past experience with the entity and its management.

(c) ***Recoverability of Receivables and Assessment of Inventories Obsolescence and Write-down***

4.21 Deficiencies noted from the reviews of some public accountants suggest that there continues to be cases of insufficient work to address the valuation assertion of receivables and inventories. Current market conditions may bring about greater uncertainties and audit risks in the area of assets impairment. For example, collectability issues may surface from default on payment by customers; or inventories obsolescence may result from excess inventories carried as consumers tighten spending. Declining selling prices under current tough trading conditions may also lead to the need for inventories write-down to their net realisable values, which may now be at below costs.

4.22 Given that the risks relating to the area of assets impairment have become more significant in the current economic environment, there is a need for greater audit emphasis when auditing this area.

4.23 The extent of the audit work performed should be properly evidenced in the engagement file to support the appropriateness of the audit judgements relating to valuations and impairment.

- 4.24 In some cases, ACRA noted that public accountants had placed reliance on management representations without obtaining further corroborative audit evidence to ascertain the reasonableness of the management's accounting estimates relating to valuations and impairment.
- 4.25 Public accountants should note that management representations obtained when carrying out audit procedures in these areas cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available.
- 4.26 Reference should also be made to the comments in paragraph 3.16 - 3.18 on *Representations by Management* in the section on audits of public interest entities.

(d) *Other Fundamental Lapses*

- 4.27 Other fundamental lapses in audit work that ACRA observed in the PMP reviews are set out below.
- 4.28 Some observations listed below are similar to those reported in the past two years' PMP Public Reports. ACRA urges public accountants to take note of the observations and where considered applicable and appropriate in their specific audit client situation, perform audit procedures as required to address the gaps identified.
- 4.29 ACRA takes a more serious view of deficiencies that have been noted in previous public reports.

Planning

- ACRA found audit engagements in which no planning materiality was set although required by SSA320 Audit Materiality. As materiality affects the determination of the nature, timing and extent of audit procedures and evaluation of the effect of misstatements, this should be established as part of audit planning.

Functional currency

- ACRA found audit engagements in which no work was done to assess whether the functional currency determined by management was in compliance with FRS 21 *The Effects of Changes in Foreign Exchange Rates*.

Foreign currency translation

- ACRA found audit engagements in which no work was done to test the year-end translation of foreign currency denominated monetary assets and liabilities. Such translation is required by FRS 21.23.

Inventories

- ACRA found audit engagements where there was no attendance at the entity's inventory count to ascertain the existence of inventory.
- ACRA found audit engagements in which no work was performed to investigate differences between quantities per test count and final inventory list.

- ACRA found audit engagements in which no work was performed to test costing of inventories in accordance with the entity's accounting policies.

Trade and other payables

- ACRA found audit engagements in which no or inadequate alternative procedures were performed to address non-responses to creditors' circularisation.
- ACRA found audit engagements in which no work was done to search for unrecorded liabilities.

Profit and loss

- ACRA found audit engagements in which no work was done on significant operating expenses, where a substantive audit approach had been adopted.
- ACRA found audit engagements in which no work was done to verify staff salaries and bonuses despite staff costs being a significant profit and loss item.

General

- ACRA found audit engagements in which subsequent events review was either not performed or not updated up to the date of audit sign-off.

(e) *Findings relating to audits of industry-specific companies*

4.30 ACRA has noted common findings in respect of the audit of project accounting in construction companies and sets these findings out here for the particular attention of public accountants who undertake audits in the construction industry.

4.31 Companies in the business of construction of assets, rendering of services directly related to the construction of assets (e.g. those of project managers and architects) or are involved in contracts for the destruction or restoration of assets should apply FRS 11 *Construction Contracts* in accounting for the construction contracts. The significant items in the financial statements of such companies would include accounts such as “contract revenue”, “contract costs”, “progress billings” and “work-in-progress”.

4.32 In some of the files reviewed, ACRA noted engagement files which had the following deficiencies in the audit of “work-in-progress”, “progress billings”, “contract revenue” and “contract costs”:

- No work performed on work-in-progress and progress billings;
- No work performed to recognise the contract revenue and contract costs by reference to the stage of completion as required under FRS 11 *Construction Contracts*;
- Stage of completion of projects (i.e. percentage of completion) was not verified, such as to independent quantity surveyors’ certificates; and
- No work performed to assess if any provision for foreseeable losses is required at year end.

4.33 A public accountant should perform procedures to obtain sufficient appropriate audit evidence on these accounts, where significant, instead of placing reliance on management's estimates of percentage of completion and representation that no foreseeable losses are expected, without carrying out independent audit procedures.

ACRA'S FOCUS IN THE COMING YEAR

5.1 ACRA will be scrutinising particular audit areas that are susceptible to heightened risks in light of the challenging economic environment. These areas include:

- Audit risk assessments and fraud considerations during the planning stage of the audit and the auditor's assessment with respect to going concern (including the consideration of the entity's ability to generate future cash flows, comply with loan covenants, re-finance current borrowings);
- Existence of bank and cash balances;
- Valuation of financial instruments;
- Asset impairment;
- Provisions for onerous contracts and restructuring; and
- Financial statements disclosures.

5.2 ACRA will continue to be pro-active in its regulatory oversight and where necessary, will issue practice directions to communicate expectations in areas of concern.

5.3 Where there are issues that are prevalent and affect a wide segment, ACRA will work closely with ICPAS to raise awareness and provide avenues for learning. Initiatives that public accountants may wish to take advantage of include:

- Attending ACRA's Essentials for Business, an event which aims to educate auditors and directors of small companies about the financial reporting requirements of small companies, especially Exempt Private Companies.
 - Attending continuing education seminars, forums, technical updates and summaries, making use of technical query services, and making reference to the ICPAS Audit Manual for Small Companies.
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APPENDIX: About the Orders that May Result from a Practice Monitoring Programme Review

1. This section describes the range of orders that the PAOC may issue as a result of an inspection conducted under the PMP. This is to help public accountants and stakeholders understand the reasons for and significance of the various orders.
2. PAOC orders have a range of severity. The fact that a public accountant is required to undergo remedial or regulatory actions as a result of the PMP does not mean that the public accountant is unfit to practice or that the public accountant's audit opinions were unsound. The PAOC imposes orders when the PAOC considers that the public accountant needs to improve to meet the required high standard, and when there is a need to protect the public interest. Some orders include both a remedial and a sanction element.

PAOC Orders

Revisit

3. The PAOC issues revisit orders to public accountants who have not met the expected standard in certain areas but whom the PAOC considers can still adequately practice. Such public accountants may be reviewed again after a period so that ACRA can assess whether the public accountant has remedied the identified weaknesses. If the public accountant does not meet

expectations after a revisit, the severity of the order will increase.

4. Additionally, from May 2009, public accountants subject to a revisit are required to attend a regulatory course and must have three audit engagements reviewed by a suitably qualified person after the audit opinions are signed, so that the ‘peer reviewer’ can mentor and advise the public accountant.

Hot review for a pre-determined time period or number of audit engagements

5. A hot review is both a remedial order and a sanction that places restrictions on a public accountant’s practice. Hot reviews are imposed on public accountants who have not met the expected standard and need to improve under supervision. The public accountant must have his or her work reviewed by a suitably qualified person before the audit opinion is signed, during a certain period or for a certain number of audit engagements.

Suspension and Cancellation

6. If the PMP finds serious deficiencies in a public accountant’s work such that the public accountant poses a risk to the public interest, the PAOC will suspend or cancel his/her registration.

Others

7. The PAOC issues letters of warning or censure to public accountants and accounting entities. Such letters may or may not accompany one of the above orders.

8. The PAOC may also restrict a public accountant from performing audits of listed and other public interest entities.



Accounting and Corporate Regulatory Authority

10 Anson Road

#05-01/15, International Plaza

Singapore 079903

Website: www.acra.gov.sg