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MEDIA RELEASE

AUDIT FIRMS URGED TO FURTHER IMPROVE QUALITY OF THEIR AUDITS

- ACRA's audit inspection findings show mixed results

Singapore, 22 September 2015 – Calls for enhanced transparency and disclosure in financial reporting continue to gain momentum. In tandem, expectations for high quality audits as a key instrument in ensuring sufficient transparency and disclosure in the markets, have grown. Audit firms have been urged to take heed of the latest findings from ACRA's audit inspections which show improvements in some areas while in others, recurring deficiencies.

The annual report by ACRA's Practice Monitoring Programme¹ which conducts inspections on audit firms in Singapore was released today. It notes an overall general improvement in the audits of listed companies. Larger audit firms were found to have placed a greater emphasis on audit quality. There was also greater involvement of audit partners in the audit process. However, some smaller audit firms auditing non-listed companies were found to have recurring audit deficiencies in areas such as revenue recognition, fair value measurements and construction contracts. One of the root causes is the incorrect identification of audit risks at the onset. This was due to the low involvement of the audit partners in the audit review process, and/or insufficient technical knowledge. (*For details on the report, please refer to Annex 1*).

¹ ACRA's Practice Monitoring Programme (PMP) aims at increasing the quality of audits in Singapore through the inspections on the adequacy and appropriateness of the audit procedures performed by public accountants.

Commenting on the findings, Chief Executive of ACRA, Kenneth Yap noted that “the audit profession as a whole continues to maintain a consistently high quality of audit. Internal controls within larger firms dealing with listed companies have improved, however smaller audit firms auditing non-listed companies need to do better and adopt best practices. Some are overstretching themselves by taking on too many clients, thereby spending less time and effort on the audit process. They should set realistic workload benchmarks and ensure that they have sufficient staff-to-client ratios to maintain the quality of their audits”.

On the finding that recurrent audit deficiencies were found in smaller audit firms auditing non-listed companies, Prof Tan Cheng Han, Chairman of the Public Accountants Oversight Committee said “It is untenable that the same audit deficiencies are recurring in the same segment of the industry time and again. It is apparent that some public accountants do not take audit quality sufficiently seriously. The PAOC will be paying particular attention to such deficiencies during its practice review outcomes with public accountants. ACRA will also step up its enforcement actions. New measures being explored include public reporting of PMP outcomes.”

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About ACRA

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. As at 31 August 2015, 476,610, business entities and 1,060 public accountants practising in public accounting firms, accounting limited liability partnerships and accounting corporations are registered with ACRA.

About the Public Accountants Oversight Committee (PAOC)

The PAOC was established under the Accountants Act and promotes audit quality and protects the public interest through functions such as the registering of public accountants, the determining of standards and other professional requirements, as well as the administering of the Practice Monitoring Programme (PMP), complaints and disciplinary procedures.

For more information, please visit www.acra.gov.sg

Key inspection findings from ACRA's PMP Report 2015

1. The key findings arising from the PMP are reported under two broad segments of ACRA's inspection activities: firm-level inspections and engagement file inspections.

Firm level inspections

2. Following the enhanced inspection programme that commenced in 2014, the focus of the firm-level inspections was to obtain an understanding or update on the design of the firm's quality controls and test the effectiveness of those controls. In the inspections of the Big-Four firms, ACRA is heartened to note that:

- i) the leadership of these firms have placed a greater emphasis on audit quality in the determination of the partner's overall performance, and
- ii) partners and EQCR partners have spent more time on their audits over the last three years.

3. However, the indicators tracking partner's time showed that the improvement was not sustainable. After trending up to a high in 2014, there was a considerable drop in 2015. ACRA urges public accountants to continue spending more time on their engagements, as we believe that the lack of involvement of partners not only give rise to a higher number of inspection findings but also contributed to factors that drove up staff turnover.

4. To understand the effects of the lack of involvement by partners and managers on staff, ACRA conducted a survey of 300 staff in the Big-Four firms to assess their perception on the extent and timeliness of their partners' and managers' supervision and review. One of the survey results showed that the actual coaching received by the junior auditors lagged behind the expected level of coaching junior auditors would like to receive during the audit fieldwork. There is an expectation gap

which partners and managers need to close by ensuring that they are onsite at the audit fieldwork to provide sufficient and timely coaching to staff.

Engagement file inspections

5. In this year's report, other than the common deficiencies on fair value measurements and revenue recognition, ACRA focused on deficiencies arising from three other most prevalent areas of inspections over the last twelve months, namely:

- Identification and assessment of significant risks;
- Substantive Analytical Procedures ("SAP"); and
- Audits of companies that apply FRS 11 *Construction Contracts*.

6. ACRA noted that whilst public accountants, particularly in firms that audit non-listed companies, have attempted to identify significant risks at the planning stage, the risks identified did not demonstrate an understanding of the client's business or key changes during the year of audit. In a dynamic environment in which we operate in, public accountants should avoid a "checklist" approach to auditing. Incorrect identification of risks would lead to either incorrect or insufficient audit procedures performed to address the significant risks in the engagement.

7. The use of SAP can be an effective tool to perform an audit. However, public accountants often misconstrue fluctuation analysis as SAP. Instead, SAP is a type of predictive analysis which public accountants can perform to an extent of sufficient detail and relevance on a financial statement item. Comparison is then made between the independent expectation formed by the public accountant and the actual financial data generated by management to assess if further analysis and investigation are required. Public accountants should ensure they are able to satisfy the requirements of SSA 520.5 prior to using SAP as a means of audit testing.

8. ACRA continues to note findings in the application for FRS 11 on long term contracts where revenue is being recognised as the contract progresses. The recurrence of this finding is a clear indication of the extent of the lack of technical competence of the profession in project accounting. In addition to the deficiencies in

the cut-off in contract revenue and testing of management's budgets, public accountants tend to confine their audit inquiry of contracts to the staff in the finance department (instead of project managers) who may not provide relevant updates to the progress of the contracts.

Root Cause Analysis – addressing underlying problems instead of symptoms

9. Firms and public accountants are required to perform a root cause analysis and thereafter implement a remediation plan targeted at addressing the audit deficiencies noted during the PMP inspections. Remediation plans not based on the actual root causes may resolve only the symptoms in the short term. Meanwhile, the unidentified root causes, will still persist into the long term.

10. One of the possible root causes of recurring deficiencies in the audits of long term contracts is the lack of understanding of how project accounting works (e.g. the correlation between management's budgets, the stage of completion of contracts and contract costs recognised in the profit or loss). As a result, teams would not be able to tailor their audit procedures to address the inherent risks peculiar to clients applying FRS 11.

11. ACRA will continue to monitor and evaluate the firms' root cause analysis and public accountants for effectiveness and sustainability. Through regular engagements with the profession, ACRA will also continue to identify the drivers that lead to consistent quality audits and make the appropriate recommendations to help firms and public accountants stay on the right track for improvement.