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MEDIA RELEASE

NEW REGULATORY MEASURES TO FURTHER RAISE THE AUDIT QUALITY BAR

Singapore, 25 August 2016 - New regulatory measures will soon be introduced to ensure auditors in Singapore continue to uphold high audit quality standards. This was announced by Senior Minister of State (SMS) for Law and Finance, Ms Indranee Rajah at the Singapore Accountancy Convention (SAC) this morning.

2. Audits are the foundation of market integrity and crucial in upholding stakeholders' confidence in our markets. A key finding from a survey on retail and institutional investors which was presented at the SAC shows that investors continue to place a premium on audited financial statements¹. The new regulatory measures were developed following a review by ACRA of audit inspection insights gleaned from a decade of audit inspections conducted under its Practice Monitoring Programme (PMP). The PMP serves to help audit firms identify key performance gaps and systemic audit quality issues. The programme pre-emptively inspects on a risk-based approach the statutory audits conducted by public accountants and the systemic controls in place within accounting entities that audit listed and non-listed companies in Singapore.

3. In her keynote address at the SAC, SMS Indranee noted that audit firms performing listed companies audits have consistently shown improvements over the years and are on course to meet a key audit quality target set by the International Forum of Independent Audit Regulators (IFIAR). Early this year, IFIAR set a reduction target for GPPC² networks to achieve a 25% reduction in the percentage of inspected audit engagements with at least one finding in 4 years' time. Among firms that perform listed companies audits (i.e. 16 firms as at 31 March 2016),

¹ Refer to Media Release "Investors Want Greater Transparency And Disclosure In Financial Reporting".

² The six networks are BDO International Limited, Deloitte Touche Tohmatsu Limited, Ernst & Young Global Limited, Grant Thornton International Limited, KPMG International Cooperative and PricewaterhouseCoopers International Limited. Collectively, these network firms are referred to "GPPC networks" reflecting their common membership in the Global Public Policy Committee (GPPC).

Singapore's 2016 inspection results when compared to 2015, shows an encouraging 27% reduction. However, firms auditing non-listed companies have not shown any improvement. ACRA's PMP report on audit inspection findings which was released at the SAC today, shows these audit firms continue to garner persistent findings in the non-compliance of basic and fundamental audit procedures.

4. An inspection finding is raised when ACRA finds that audit work performed by a public accountant in significant risk areas did not comply with what is required in the auditing standards. An inspection finding alone does not necessarily mean an audit failure i.e. the audit opinion was wrong or not supported by sufficient appropriate audit evidence. Similarly, it also does not necessarily mean that the financial statements prepared by the company were misstated.

5. To ensure public accountants in Singapore continue to hold themselves to high audit quality standards, ACRA will soon be implementing the following measures:

- (i) Setting a target for the six audit firms that are part of the GPPC³ networks that perform listed company audits, to achieve a 25% reduction in the percentage of inspected audit engagements with at least one finding over a four year period (from 2015 to 2019);
- (ii) Introduction of six Audit Quality Indicators⁴ targets that will provide firms as well as audit committees with a common yardstick to compare audit quality; and
- (iii) Publication of inspection outcomes for public accountants who have failed at least two successive inspections (the latter being a revisit) and received a hot review, or restriction⁵ followed by a hot review outcome imposed in their later inspection.

[See Annex 1 for more details on the new regulatory measures]

6. ACRA currently publishes the names of public accountants whose licenses have been suspended or cancelled for serious audit deficiencies found during ACRA's inspections. The new measures above will apply to inspections carried out from 1 April 2017. Said Kenneth Yap, Chief Executive of ACRA, "This move introduces transparency and further safeguards the public interest and ensures

³ The Singapore audit firms that are part of the GPPC networks are BDO, Deloitte, EY, Grant Thornton, KPMG and PwC. However, as at 31 March 2016, Grant Thornton does not perform any audits of listed companies and will therefore be part of this initiative from Singapore's perspective when it starts to audit listed companies.

⁴ AQIs are quantitative measures used by ACRA to benchmark audit quality across firms.

⁵ These public accountants are prohibited from performing statutory audits for a fixed period.

continued market confidence in the audit profession. It will help to level the playing field for the vast majority of public accountants who are steadfast in their commitment to audit quality”.

7. To help these public accountants raise their audit quality levels, ACRA has in place a closely supervised hot review process where suitably qualified public accountants will review the work of the inspected public accountant with the aim of guiding and helping them make key quality improvements to their audit work. The decision to suspend, cancel registration or prohibit public accountants in Singapore from performing statutory audits lies with the Public Accountants Oversight Committee (PAOC). The PAOC comprises selected members of the ACRA Board with professional legal or audit related qualifications. Commenting on the new regulatory measures, PAOC Chairman Professor Tan Cheng Han, S.C said: “The audit profession plays a key role in upholding continued public trust in Singapore's financial reporting system. I urge auditors to view these new measures as an opportunity to bring the quality of audits to a new level.”

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About ACRA

The Accounting and Corporate Regulatory Authority (ACRA) is the national regulator of business entities, public accountants and corporate service providers in Singapore. ACRA also facilitates the development of business entities and the public accountancy profession. As a regulator and facilitator, ACRA constantly strives to provide a responsive and trusted regulatory environment for businesses, public accountants and corporate service providers and make Singapore the best and trusted place for doing business. ACRA’s role is to achieve synergies between the monitoring of corporate compliance with disclosure requirements and regulation of public accountants performing statutory audit. ACRA’s goal is to make good corporate governance, quality corporate financial reporting and high quality audit the hallmarks of our financial and corporate sectors.

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

ACRA's New Initiatives to Improve Audit Quality

1. Established in 2004, the objective of the Practice Monitoring Programme (PMP) is to increase the quality of audits through the inspection of audit engagements performed by public accountants. In administering the programme, ACRA strives to balance its regulatory approach with non-regulatory initiatives⁶ to enhance the quality assurance of the profession.

2. This year, ACRA takes further steps to raise the bar on audit quality with the introduction of several regulatory and non-regulatory measures. These initiatives are multi-prong and targeted at both the engagement-level and firm-level to ensure that public accountants and firms in the listed and non-listed segments alike are encouraged to continue in their efforts to continually improve audit quality. The new regulatory and non-regulatory initiatives implemented by ACRA are as follows:

At the engagement-level:

- (i) A targeted 25% reduction in the percentage of inspected audit engagements with at least one finding over a four-year period ("25% reduction initiative") among the six firms that are part of the GPPC network; and
- (ii) An extension of ACRA's Publication Regime on Inspection Outcomes.

At the firm-level, through the introduction of ACRA's Targets on six Audit Quality Indicators ("AQIs").

New Initiatives Impacting Engagement-level inspections

3. The results from a decade of inspection experience revealed **varied progress** made between public accountants in the listed and non-listed segments (*For details, please refer to Annex 2*). It is ACRA's intention to level the playing field between these two segments through the introduction of two new regulatory initiatives explained below.

4. ACRA, being an active member of the IFIAR Advisory Council and Working Groups, has adopted IFIAR's global initiative in Singapore. This initiative targets a **minimum reduction of 25% in the percentage of inspected audit engagements with at least one finding** from 2015 (baseline year) to 2019. With the adoption of this initiative, firms and countries will have a common measurable target to ascertain the extent of improvement in audit quality.

⁶ ACRA's commitment to help the profession through non-regulatory initiatives such as issuance of Audit Practice Bulletins, Practice Directions, specific training courses for areas of development and commissioning research pieces since 2013 targeted at each stakeholder in the financial reporting value chain.

5. For a start, the 25% reduction initiative rolled out in Singapore will only apply to listed company audits for the **six firms⁷ that are part of the GPPC networks.** This stringent measurable target will directly impact the Big-Four firms who perform audits of a significant share of market capitalisation of listed companies in Singapore. Firms are provided with a target to internally track their progress over the above-said period. ACRA is committed to help these six firms achieve this target through critical analysis of the inspection findings and the firms' root causes noted through external inspections.

6. Whilst presently imposed only on the six firms in the GPPC networks, ACRA also encourages the remaining firms in the listed companies segment to adopt the same target.

7. To supplement the adoption of the 25% reduction initiative, ACRA will be expanding⁸ the existing Publication Regime of Inspection Outcomes to include public accountants who fail a **revisit inspection** with a hot review, or restriction followed by a hot review outcome. This new initiative affects public accountants who have not shown any improvement despite given an opportunity to remediate their audit deficiencies from a preceding inspection. With this initiative, ACRA believes:

- (i) Public accountants will be motivated to develop sound remediation plans before the revisit inspection takes place;
- (ii) It will level the playing field in the long run so as to benefit public accountants who have made the efforts to uphold audit quality; and
- (iii) It will protect public interest so that stakeholders, such as audit committees, make informed decisions before engaging the services of public accountants.

8. The publication of such inspection outcomes will take effect for revisit inspections **commencing on or after 1 April 2017.** With seven months before the effective date, public accountants have an opportunity to ensure that audits performed comply with the Singapore Standards on Auditing ("SSAs").

New Initiatives Impacting the Firm-level inspections

9. In October 2015, ACRA launched the AQI Disclosure Framework where eight AQIs were introduced to Audit Committees as common measurements by which audit quality can be assessed. To further enhance the use of the AQI information disclosed, ACRA is introducing **six targets on certain AQIs** that firms and Audit Committees may find useful. These targets provide firms and Audit Committees with

⁷ The six Singapore audit firms that are part of the GPPC networks are BDO, Deloitte, EY, Grant Thornton, KPMG and PwC. However, as at 31 March 2016, Grant Thornton does not perform listed companies audits.

⁸ Presently, names of public accountants who fail the practice reviews with suspension and cancellation orders are published on ACRA's website.

a common yardstick to enable comparison and thereafter, facilitate meaningful audit quality conversations.

10. The six AQIs and ACRA's Targets are set forth below:

| | AQIs at the Firm-level | ACRA's Targets |
|---|---|-----------------------------|
| 1 | Staff retention rate | Between 75% and 80% |
| 2 | Staff oversight ratio - Staff per partner ratio - Staff per manager ratio | Less than 15 Less than 5 |
| 3 | Number of listed company audits with the same financial year-ends allocated to each public accountant | Not more than 5 |

| | AQIs at the Engagement-level (per engagement basis) | ACRA's Targets |
|---|---|---|
| 4 | Engagement partner hours over total engagement hours | At least 5% (normal risk engagements) At least 10% (higher risk engagements) |
| 5 | Engagement partner <u>and</u> manager hours over total engagement hours | At least 20% |
| 6 | EQCR partner hours | At least 13 hours ⁹ |

11. The engagement-level targets above are introduced based on actual past achievements by partners, managers and EQCR partners in meeting the minimum required time on their audit engagements. ACRA is heartened to note the larger firms generally heed ACRA's findings, and believes that these six targets will be a stepping stone for other ACRA targets to be set in the future.

⁹ The 13 hours target is the minimum based on an activity-based estimate of a EQCR partner's time spent for an audit engagement in ACRA's Audit Practice Bulletin No. 1 of 2011 *Engagement Quality Control Review*.

ACRA'S 10th ANNUAL PMP PUBLIC REPORT 2016 – 10-YEAR TRENDS AND INSPECTION FINDINGS

1. The 10th year report is a significant milestone for ACRA's annual publication of inspection findings. The accumulation of the past decade's inspection findings has enabled ACRA to perform a trend analysis of findings noted from firm-level and engagement-level inspections which are discussed below.

Firm-level Inspections

2. Firms in the listed companies segment that were subjected to firm-level inspections have generally made **commendable efforts** in enhancing the systems of quality controls. However, certain firms in this segment progressed at a slower pace due to the lack of urgency and/or efforts to remediate and improve; thus creating a **disparity in the extent of progression** within this segment.

3. The positive trends were notably at the firm's leadership where there is now greater importance placed on audit quality. The firm's long-term commitment to this end is evidently seen in their willingness to invest in resources and headcount to support the delivery of quality audits.

4. Over time, firms have been better at retaining audit staff and have successfully maintained a healthy and stable range of staff oversight ratios between audit staff, partners and managers. Partners, EQCR partners and managers, being senior audit team members, are now spending more time supervising and directing the audit engagements. This is a commendable improvement noted from ACRA's inspections.

5. With the introduction of the AQI targets mentioned in Annex 1, ACRA believes this will spur firms on to tighten and monitor these indicators that have a direct impact on audit quality.

6. Despite these improvements, ACRA continue to note findings in the firms' internal monitoring mechanisms and these fall into two main categories:

- (i) Monitoring controls were in place and operating effectively, but inappropriate follow-up actions were taken to address the lapses identified
- (ii) Monitoring controls were in place but not operating effectively in that lapses were not identified.

7. Such findings are of concern to ACRA as ineffective monitoring results in the firm's failure to detect non-compliances in its quality controls. ACRA would like to highlight the danger of routinely carrying out processes and controls that have become perfunctory and/or failed to meet its intended quality objectives.

Engagement Inspections

8. The trends in inspection findings showed a general improvement in the audits of public accountants within the listed companies segment. As an indicator, the percentage of inspected audit engagements that had at least one finding decreased by 27% in 2016 when compared to 2015. In this segment, the nature of inspection findings shifted from basic procedural-type of findings to more complex ones that required management's judgement and estimates.

9. However, public accountants in the non-listed companies segment did not show any improvement. There continues to be findings noted in basic and fundamental audit procedures not performed.

10. In this year's report, ACRA disclosed the four main themes¹⁰ and common audit deficiencies that contributed to more than 80% of inspection findings in the last decade of inspections. These common audit deficiencies are published to remind public accountants of the frequent areas where work was not appropriately carried out. Steps should be taken to understand the root causes of the findings and develop action plans to avoid them from recurring.

11. Public accountants are also reminded of new and upcoming accounting and auditing standards that will impact how audits are performed. With the new revenue standard on IFRS 15 *Revenue from Contracts with Customers*¹¹ and Enhanced Auditor Reporting Standards¹², public accountants are urged to step up and stay abreast of these changes to ensure they are equipped to continue to uphold the quality of audits in Singapore. To ensure proper application of the enhanced standards by public accountants, this will be a focus for ACRA's inspections in 2017.

¹⁰ The four main themes were (i) Accounting estimates, including fair value measurements; (ii) Audit evidence; (iii) Revenue; and (iv) Group audits.

¹¹ IFRS 15 replaces FRS 18 *Revenue* and FRS 11 *Construction Contracts* and are effective for period beginning on or after 1 January 2018.

¹² Effective for audits beginning on or after 15 December 2016.