Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Assurance (AS)

EXAMINATION DATE: 7 December 2021

Section 1
General comments

The overall performance of the candidates was weaker than the previous examination in June 2021. The quality of answers for Question 2 and Question 4 was not satisfactory. Question 2 involved the audit of revenue from contracts with customers and Question 4 involved the audit of impairment of goodwill. A possible issue could be weak accounting knowledge on these accounting matters, thus affecting the quality of the audit procedures identified and poor evaluation of the company's accounting for them.

The main objective of an audit is to evaluate, with reasonable assurance, the truth and fairness of the financial statements prepared by audit clients. Financial statements should comply with the applicable financial framework to be true and fair. Performing audit procedures without knowing what would be the correct accounting treatment and conversely what would constitute a misstatement [from failure to comply with accounting standards] is the same as auditing without a direction.

Candidates are advised to retain their knowledge in financial reporting and integrate the accounting principles with auditing procedures.

Section 2
Analysis of individual questions

Question 1

As with previous exams, **Part (a)** required Candidates to use data analytics to identify unusual transactions for further analysis. Generally, Candidates were able to identify the unusual transactions correctly but the explanations on why the transactions were considered unusual and should be investigated were weak. For example, cash paid to CEO is one of the unusual transactions identified by the Candidates.

Most Candidates stated that further investigation was required to check whether the transaction was approved by the Board of Directors. Candidates should instead investigate the nature of payment:

- Reimbursement of expenses paid by the CEO on behalf of the company would not be a cause for concern;
- Repayment of loan due to the CEO would not be a cause for concern;

- Loan to CEO would be a cause for concern as loan to Directors is prohibited by the Companies Act unless certain conditions are met;

- Misappropriation of cash by the CEO would be a serious concern.

Part (b) tested Candidates' knowledge on the key contents of the auditor's report, namely the auditor's opinion on the truth and fairness of the financial statements they have audited. Significant control deficiencies are usually not included in the audit report on the financial statements. However, if significant control deficiencies are the contributing factors to the material misstatements that caused the qualified audit opinion [or adverse opinion] to be expressed, an auditor may describe the significant control deficiencies while explaining the material misstatements in the Basis for Qualified Opinion section [or the Basis for Adverse Opinion section]. In this case, the description of the significant control deficiencies is to help users of the audit report understand how the material misstatements in the financial statements occurred.

Several Candidates mistook that significant control deficiencies must be reported in the auditor's report on the financial statements.

Question 2

Part (a) required Candidates to describe the audit procedures to be performed to confirm that the documentation by the audit assistants on the sales system was accurate.

In general, auditors are required to ascertain the audit client's accounting system and then document the system. The task of ascertaining and documenting the client's system is usually delegated to the audit assistants. Before auditors review the system documentation to identify internal controls [or the lack of internal controls] for the purpose of evaluating control risk and designing test of controls to be performed, there is a need to ensure that the documentation produced by the audit assistants accurately reflects the client's system. This is usually achieved by the auditor performing a walkthrough test.

Most Candidates were able to identify that the procedure to be performed was a walkthrough test. However, many Candidates lost marks due to the lack of description of how a walkthrough test is performed. Weaker Candidates described the test of controls to be performed. This suggested that they either misunderstood the question requirements or did not have knowledge of the concept of a walkthrough test.

Both **Part (b) and (c)** required Candidates to:

(i) Identify and explain the risk of material misstatements (RMM) based on the facts provided in the case; and
(ii) Design audit procedures in response to the RMM identified.

It was observed that some Candidates seemed to be confused with the question requirements for **parts (b) and (c)**. **Part (b)** focused on the RMM relating to the TIMING of revenue recognition; while **part (c)**, focused on the RMM relating to the MEASUREMENT of revenue recognition.

Although most Candidates were able to identify early recognition of revenue from product sales as the RMM in **part (b)**, some wrote about the lack of provision for sales returns as RMM in **part (b)**.

Some Candidates did not use the information from the case and wrote about overlooking of invoicing to customers, etc. Therefore, no marks were awarded.

Common mistakes identified:

a) Potential sales return is accounted for, in SFRS(I) – 15 – Revenue from Contracts with Customers, as variable consideration. Thus, it affects the amount of revenue to be recognised, i.e. measurement of revenue.
    - Sales return should be discussed as RMM in **part (c)**.

b) In SFRS(I) – 15, the expected sales return should be recognised as refund liability instead of sales revenue. SFRS(I) – 15 further requires the cost of sales relating to the refund liability not to be recognised as cost of sales, but as a contract asset instead.
    - The cases clearly stated that sales returns are only recorded upon goods returned as a debit to revenue. The RMM in revenue measurement is not reversing expected sales return from revenue at year-end. Some Candidates wrote about the percentage of completion to recognise revenue from service as the RMM relating to measurement whilst **parts (b) and (c)** are referring to revenue from product sales.

Some Candidates still referred to the transfer of “risk and reward” of ownership of goods as the point of recognising revenue. In SFRS(I) – 15, revenue should be recognised when the control of the goods or services [collectively known as “assets”] is transferred to customers. In SFRS(I) – 15, “risk and reward of ownership” is just an indicator of the control of goods being transferred to customers. This shows that some Candidates have not kept up with the changes in standards.

For **part (d)**, most Candidates did well in explaining that the revenue was recognised before the service was performed and thus before the control of the assets was transferred.

However, the Candidates’ performance for **part (e)** was less than satisfactory. Candidates were required to recommend a method to recognise revenue from the service contracts. Most Candidates correctly recommended the percentage of completion method but lost marks due to the following:

- Candidates did not explain why a percentage of completion method will comply with the requirements of SFRS (I) – 15, specifically paragraph 35; and

- Candidates did not provide details of the percentage of completion method, e.g. survey of buildings for which painting was completed.

For the audit procedures, many of the Candidates did not make use of information from the case facts and provided generic answers such as 'Select delivery notes before and after year-end and trace to sales invoices and ledgers'. Such answers do not attract high marks. Candidates should write the audit procedures based on the company's workflow and documents, such as sales return log, etc.

Question 3

Part (a) required Candidates to design audit procedures to detect the abuse of the government's Job Support Scheme (JSS) subsidy. Five possible cases of abuses identified by the Inland Revenue Authority of Singapore (IRAS) were included in the requirements. Such audit procedures should contain two elements:

- Identifying possible abuses;
- Confirming whether abuses occurred.

Therefore, the first audit procedure must be to select transactions or items that might be abused for further investigation. For example, identifying non-genuine employees meant "employees" for which CPF contribution was paid but they were not bona fide employees of the company. A simple and effective procedure to detect this would be to compare names in the CPF contribution paid to the names in the company's staff list. Some answers focused on easy procedures such as asking Management if any employees were put on no-pay leave (which is less reliable as evidence).

Candidates who did not follow the logical sequence of audit procedures suggested the same audit procedures for all abuses, such as recalculating the CPF contribution to ensure accuracy.

Part (b) required Candidates to apply the Non-Compliance with Laws and Regulations (NOCLAR) response framework when an abuse of the JSS has been detected.

The following observations were noted:

- Some Candidates repeated the entire framework without application and thus did not score well. For example, they stated that the first step is to obtain an understanding of the incident. No marks were awarded for this answer because the auditor detected the NOCLAR and thus should already have a good understanding of the incident.

- Some Candidates wrote about the implications of the NOCLAR on the auditor's report. Whilst this is a correct consideration for an audit of financial statements, it is not required for this exam question which specifically asked about response according to EP 100. Thus, the implication on the auditor's report is irrelevant to what the question was asking.

Part (c) required Candidates to respond to professional clearance requests from a prospective auditor as your firm resigned as auditor due to the client's NOCLAR. Some Candidates did not have the knowledge that EP 100 requires the predecessor audit firm to provide information on the NOCLAR even if the audit client refused to permit the predecessor auditor to communicate with the prospective auditor.

Question 4

Parts (a) to (d) required the Candidates to evaluate the goodwill impairment analysis performed by an audit client:

Part (a) required Candidates to evaluate the client's use of Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) instead of net profit after tax (NPAT) as a starting point of a proxy, to determine the projected cash flows as the value in use. Generally, Candidates were able to explain why EBITDA is a better proxy than NPAT because EBITDA already excluded non-cash items such as depreciation and amortisation whilst NPAT included these non-cash items.

However, some Candidates went on to explain that EBITDA needed adjustments to include cash inflow and outflow relating to interest payment/receipts and tax payments. This shows that these Candidates lack technical knowledge of determining value-in-use for impairment testing.

SFRS(I) – 1-36 – Impairment of Assets, paragraph 50 states that:

"Estimates of future cash flows shall not include:

a) cash inflows or outflows from financing activities; or
b) income tax receipts or payments."

EBITDA is a better proxy for cash flow than NPAT because EBITDA excludes tax and interest. Candidates should be aware that there is a difference between the cash flow forecasts prepared for impairment testing and the cash flow forecasts prepared for going concern review. Cash flow forecasts prepared for going concern review should include all potential cash inflows and cash outflows, i.e. forecast cash flows relating to operating, financing and investing activities.

Part (b) required Candidates to evaluate the appropriateness of using the Weighted Average Cost of Capital (WACC) as the discount rate to determine the net present value for the projected cash flow. Most Candidates correctly identified that WACC is a post-tax rate whilst SFRS(I) – 1-36 requires a pre-tax discount rate to be used. However, not many Candidates identified that the WACC needs to be adjusted to take into account specific risks relating to the subsidiary.

Part (c) required Candidates to identify and describe TWO items that should be included in the cash flow projection but are currently omitted. Three items were omitted in the cash flow forecast provided in the case:

- Cash flows beyond five years – this is typically estimated by using a terminal value;
- Cash flows relating to changes in working capital;
- Cash flows relating to capital expenditure

The overall performance for this question part was poor with only a handful of Candidates managing to identify the first omission while most of the Candidates identified the third omission. Many Candidates stated the omission of cash flows relating to interest and tax. This shows a lack of technical knowledge as explained earlier.

Part (d) required Candidates to evaluate the appropriateness of comparing the value-in-use (as calculated by Management) to the goodwill to measure the impairment loss.

Paragraph 90 of SFRS (I) – 1-36 requires goodwill to be tested for impairment by comparing the carrying amount of the unit, including the goodwill, with the recoverable amount of the unit. Thus, it is not appropriate to compare the value-in-use to the goodwill only. Candidates who did not know this accounting principle wrote generally about the risk of material misstatement in management's estimated cash flows being subjective.

Part (e)(i) tested the Candidates' knowledge of the auditor's report and the different types of audit opinion. Given a material but not pervasive understatement of impairment loss of $10m, Q4(e)(i) required Candidates to evaluate the appropriateness of an auditor issuing an unmodified opinion and adding an Emphasis of Matter to draw attention to the disclosure note on the goodwill. Most Candidates correctly explained why this was not appropriate. However, some Candidates went on to recommend a qualified opinion, which was not required by the question and not awarded marks.

Part (e)(ii) required Candidates to consider whether a disclaimer of opinion would be appropriate. Whilst many Candidates correctly stated that disclaimer of opinion was inappropriate, the rationale provided was wrong. They stated that the misstatement was material but not pervasive, as such the disclaimer of opinion was not appropriate. Also, if the misstatement was material and pervasive, the disclaimer of opinion would be appropriate.

This shows that there is a lack of understanding of the 2 issues affecting the auditor's opinion on the financial statements:

- Misstatements;
- Lack of evidence [commonly known as a limitation on scope]

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In the case of lack of evidence, the auditor would not be able to conclude whether there are material misstatements. In this case, the auditor was able to conclude that there was an understatement of impairment loss of $10m, implying that the auditor had sufficient evidence to support their conclusion, i.e. there was no limitation on scope. Thus, a disclaimer of opinion was not appropriate.