Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Assurance (AS)

EXAMINATION DATE: 10 June 2021

Section 1
General comments

The overall performance of the Candidates is poorer than the previous exam in December 2020.

The following weaknesses are observed from the answers provided by Candidates:

i. Over-reliance on work experience in the preparation of exams. Questions relating to lease modification and discontinued operations were poorly answered. These may not be the usual areas Candidates would encounter in their work. However, it has become more common in the current environment affected by the COVID-19 pandemic. Candidates should spend sufficient time and effort to prepare for the exam and ensure wide coverage of the syllabus.

ii. Lack of understanding on how government grants work. Some grants required the businesses to apply to the regulator and others are given to the businesses without the need for an application. The Job Support Scheme (JSS) is an example of the latter. Thus, audit procedures such as reviewing the grant application and grant approval letters are irrelevant. JSS was widely publicised and affects all businesses in Singapore. Candidates should keep up with the business changes that affect accounting and audit.

iii. Poor knowledge in the accounting and audit of sales return, lease modification and loan restructuring. Some Candidates are still using the knowledge from outdated FRS 18 *Revenue* and FRS 17 *Leases*. This reflects the need to keep up with the latest technical developments. An audit is to verify whether financial statements are prepared in accordance with accounting standards. Outdated accounting knowledge will lead to the use of inappropriate audit procedures.

Two suggestions that could be useful to Candidates based on the above observations are:

- Revise the entire syllabus and not based on what were examined in previous exams; and

- Be updated on changes in Singapore Financial Reporting Standards (International) (SFRS(I)), Singapore Standards on Auditing (SSA) and the Ethics Pronouncement (EP) 100 (the ISCA Code of Professional Conduct and Ethics).

Section 2
Analysis of individual questions

Question 1

As with previous exams, Question 1 focused on using data analytics for audit purposes. For this exam, this case focused on the context of providing internal audit service in examining the entity's expense claims by employees. It required Candidates to go beyond looking for authorisation and accuracy of recording. Candidates are expected to pick up expense claims that did not appear to be economical as well. Most Candidates met this expectation and performed well for **part (a)**. However, the performance **for part (b)** was less than satisfactory.

Part (b) required Candidates to identify the potential internal control deficiencies that could have allowed the unusual transactions in **part (a)** to have occurred, such as expense claims by employees who have left.

The following observations were noted:

- Many Candidates suggested that the expense approval process did not tally with the employees who made the claim against the updated HR list. No mark was awarded for this answer. This is because the case clearly states that the expense claims are approved through the payroll system. Thus, it is expected that the payroll system has an updated list of employees. The internal control deficiency was that the employee list in the payroll system was not updated. These answers suggested that some Candidates did not read the case fact properly and simply used the information or they did not realise that the employee list must be in the payroll system for it to work.

- Some of the Candidates' answers suggested that there was a lack of limit to the expense claim. This was not one of the unusual transactions in this case. These Candidates made up the control deficiency without linking it back to the case.

- Some of the Candidates' answers suggested that the review/approval process was lacking because the source documents and supporting documents were not attached and reviewed. However, it was clearly stated in the case facts that supporting documents such as hotel bills, restaurant invoices are attached. This is another example of Candidates not reading the case carefully and not using the information provided in the case.

- Many Candidates repeated the unusual transactions in **part (a)** as the internal control deficiency. For example, ex-employees were able to claim expense reimbursement was a control deficiency. This is not a control deficiency but a consequence of the control deficiency that employee details in the payroll system are not updated.

Question 2

This question was framed in the context of a new audit client in the business of supplying medical supplies to hospitals, clinics, and pharmacies. It was stated in the case where the audit firm accepted the audit appointment even though the professional clearance process with the predecessor audit firm was not satisfactorily completed. The issue was that the predecessor audit firm responded to the professional clearance request by stating that they were denied permission by the audit client to communicate with the new auditor. The quality of the answers to this question was mixed. While there were certain parts that were relatively well answered, there were also certain areas of weaknesses.

Part (a) required Candidates to describe the further actions to address the uncompleted professional clearance. Several Candidates copy and paste the professional clearance procedures in EP 100 without applying them to the case. For example, some wrote that firm should send a letter to the predecessor audit firm indicating that the firm will accept the audit appointment as there was no reply from the predecessor audit firm. This is clearly wrong. The predecessor audit firm did reply. The issue was that they did not receive permission from the audit client to disclose details. Thus, the minimum steps the new audit firm should take include clarifying with the client management to check whether what the predecessor audit firm said was true and request the management to permit the predecessor audit firm to freely communicate with the new auditor.

Part (b) required Candidates to provide a justification for mentioning that the audit client is new and how it should be communicated in the audit report. Many did well and correctly describe the use of the “Other Matter” section to do so. A handful of the Candidates wrongly suggested the use of the “Emphasis of Matter” section. Some Candidates suggested that the audit opinion will be qualified due to the problem with the opening inventory balance and thus the fact that this is a new audit client will be explained in the Basis for Qualified Opinion section. This assumes the prior year’s modification in the audit report will continue to affect the current year’s audit opinion which may not be the case.

Part (c) focused on the problem of the company sending inventories to customers and in some cases, quantity in excess of customers’ orders was delivered. Most Candidates correctly pointed out that a control deficiency that could have allowed the problem to happen was the lack of integration of the online sales system and the delivery system. Customer order details had to be manually keyed into the delivery system. Data entry errors could lead to the wrong quantity being keyed into the delivery system. However, a handful of Candidates suggested that customers were allowed to change the order quantity after sales orders were placed. This was the Candidates’ personal assumption and not based on the information provided in the case facts.

For **part (d)**, it was indicated in the case facts that the company’s contract with customers did not allow sales return. However, some returns were detected during the audit. The question required Candidates to explain why it was important to verify whether the customers have the right to return goods or not. Some Candidates provided very good answers based on SFRS(I) 15 *Revenue from Contracts with Customers*. Specifically, if sales returns are allowed, then management should estimate the expected sales return and reverse them from revenue. The associated cost of sales and inventory issued should also be reversed. A refund liability should be recognised. It was also noted that some Candidates were still using the old accounting principles in FRS 18 *Revenue* and discuss provision for sales return.

Candidates were also required to describe the test of details procedure that could be performed to confirm whether the right to return goods exists or not. Very few Candidates suggested obtaining direct confirmation with the entity's customers on the sales terms, i.e. whether sales returns are allowed or not. This was not surprising because the norm is confirming receivables balances as part of circularisation. It was not a standard routine practice to ask customers to confirm sales terms. However, the case states that the sales returns are mostly from a single customer. Candidates should be alerted that this is unusual, given the audit procedures performed have confirmed that sales returns are not allowed. This suggests a possible special arrangement with this customer or the existence of a side agreement.

Singapore Standards on Auditing, specifically SSA 330, requires the auditor to design and implement responses to the risks of material misstatement identified. In addition, SSA 330 requires that, irrespective of the assessed risks of material misstatement, the auditor designs and performs substantive procedures for each material class of transactions, account balance, and disclosure. The auditor is also required to consider whether external confirmation procedures are to be performed as substantive audit procedures. SSA 505 – External Confirmations recommends in certain situations, the auditor may, for example, design external confirmations procedures not only to confirm outstanding amounts but also to confirm the details of the sales agreements, including date, any rights of return, and delivery terms. Many Candidates are not alerted to the risk of material misstatements in "unofficial" sales returns and did not know the requirements of external confirmations well.

For **part (e)**, many Candidates were able to identify the possible use of sales refunds to hide the bribery of the customer's purchasing manager. Only a handful of the Candidates were able to suggest the fake sales return, i.e. goods were never returned, could be due to the warehouse manager diverting the excess quantity to somewhere else.

Question 3

Question 3 is topical and is framed in the current context of the COVID-19 pandemic. Some businesses have proactively sought to extend loan repayment with their lenders. In this case, the loan details are provided and changes to the loan repayment are also provided. In **part (a)**, there were two requirements for Candidates to address in relation to the loan restructuring:

- Describe the audit procedures to be performed; and

- Evaluate whether the company's accounting treatment is correct

Candidates' performance for the first requirement was better than the second requirement. Most Candidates were able to suggest reviewing the revised loan agreement, seeking direct confirmation on the loan details from the lenders, and reviewing the revised amortisation cost calculation. However, the audit procedures described by the Candidates were too general as they did not adequately describe the purpose of the audit procedures to be performed. The purpose was to see whether the accounting for loan modification was correct. This was possibly due to inadequate accounting knowledge on loan modification, as elaborated in the next paragraph.

Only a handful of Candidates knew the accounting requirements in relation to loan modification. SFRS(I) 9 *Financial Instruments* requires quantitative tests and qualitative tests to be performed to assess whether the modification is substantial or non-substantial. If it is substantial, the modification should be accounted for as an extinguishment of the existing loan and a recognition of a new loan. If non-substantial, the modification should be accounted for as an adjustment to the existing loan. Thus, the audit procedures to be performed is to evaluate management's quantitative test and qualitative test.

The Candidates know what audit procedures to perform but do not really know what the audit procedures are attempting to address. The objective of an audit is to verify whether the financial statements are true and fair in accordance with the accounting standards. Thus, audit procedures are meant to obtain evidence of whether the accounting complies with accounting standards or not.

Part (b) deals with the government measure to help businesses by granting property tax rebates to the landlord and tenants of qualifying properties. Most Candidates focused on discussing that the property rebate should not be recognised, as there was no reasonable assurance that the grant condition would be met. These Candidates did not read the case carefully and failed to recognise that the issue was a dispute between the landlord and the tenants in relation to the amount that should be passed on from the landlord to the tenant. The tenant felt that the landlord should pass on more of the rebate that the landlord indicated. Thus, the amount not disputed is grant income, and the amount disputed is a contingent asset. Candidates who failed to see this issue did not do well for this question part.

Part (c) focused on another aspect of the impact of COVID-19 on businesses, i.e. the Job Support Scheme (JSS). Similarly, Candidates were required to:

- Describe the audit procedures to be performed; and
- Evaluate whether the company's accounting treatment is correct

Candidates performed better in the evaluation of accounting treatment than in describing the audit procedures. Given the prominence of JSS in the media coverage and its significant impact on businesses, it is surprising that some Candidates demonstrated a lack of basic knowledge on it. For example, a common audit procedure written by Candidates was to review the JSS grant application letter. Businesses do not need to apply for JSS. Thus, there is no application letter to sight.

Part (c) tested the Candidates knowledge of evaluating implications on misstatements when forming audit opinion. SSA 450 required the auditor to evaluate whether misstatements may be considered material either individually, or when taken in combination with other misstatements.

There were 3 misstatements given in **part (c)**. Candidates should evaluate each misstatement on its own and consider whether the misstatement was material on its own. Any uncorrected misstatement that was individually material would lead to a modified audit opinion. For those misstatements that were evaluated to be immaterial on their own, the auditor should consider them on an aggregated basis to determine whether they were material. Many Candidates did not follow this process and were not able to identify the one material misstatement that should be corrected to avoid a modification to the audit opinion.

Question 4

Similar to question 3, this question is topical in relation to the business impacts of COVD-19, i.e. downsizing and the related termination of leases, staff redundancy and sales of property, plant and equipment. This question was the worst performing question.

Part (a) required Candidates to design audit procedures for each issue identified and explain the risk of material misstatements the audit procedures were intended to address. For the lease termination, Candidates' answers were generally not satisfactory. This could be due to the lack of understanding of accounting for leases by the lessee in accordance with SFRS(I) 16 *Leases*. Many Candidates described the audit procedure to confirm provision for an onerous contract due to lease termination was correctly recognised. This was incorrect as the lease liability had already been recognised. The issue was how the lease liability should be remeasured as lease modification. Candidates also failed to consider the impairment of the right-of-use assets.

In contrast, Candidates' answers on staff redundancy and sales of equipment in terms of audit procedures and risk of material misstatements were generally well answered.

Part (b) tested the Candidates' ability to identify and recognise that the discontinuation of the restaurant business met the criteria as discontinued operations in SFRS(I) 5 *Non-current Assets Held for Sale and Discontinued Operations*. The following points were observed:

- Some Candidates correctly pointed out that the restaurant business was a cash generating unit and a major separate line of business that was ceased and thus it was discontinued operations.

- Many Candidates focused on the assets of the restaurant business to be classified as held for sale and completely missed the requirement.
- Some Candidates discussed the disclosure of the operating segment and explained why the restaurant business was a separate reportable segment. However, operating segment disclosure was not the issue here as the company was not listed and, SFRS(I) 8 *Operating Segments* do not apply.

Part (c) focused on the ethical issue of buying assets from audit clients at a significant discount. The majority of the Candidates were able to discuss an ethical issue such as self-interest threat. However, only a handful of Candidates were able to use the information from the case to evaluate whether the self-interest threat was significant. Candidates were expected to discuss the value of the discount and evaluate whether it was insignificant or not.